Final Report and
Draft Legislative Proposals

EL SALVADOR: Revision of Laws Governing International Trade and Investment

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1.0 INTRODUCTION

1.1 Background and Scope of Work

This study was conducted by Nathan Associates, Inc., as part of the Latin American/Caribbean Trade and Investment Development Project (the "LAC/TI Project" or "Project"), under contract to the United States Agency for International Development (A.I.D.) [Contract No. LAG-0797-C-00-2046-00 and Technical Service Order No. 013], in response to a request from the USAID Mission in San Salvador, El Salvador.

The overall goal of the LAC/TI Project is to foster economic integration in the Western Hemisphere and promote an open trade and investment environment through stimulating and supporting market opening initiatives and to move trade and investment regimes toward international standards through A.I.D.-assisted programs. The Project staff and affiliated technical consultants provide technical expertise and assistance to identify and propose remedies to tariff and nontariff barriers and other impediments to expanded trade and investment, with particular focus on legal and regulatory constraints inhibiting such trade and investment. The LAC/TI Project makes available technical expertise and services to A.I.D./Washington and USAID missions abroad and, through them, to governments and their agencies throughout the region.

USAID/El Salvador's request for assistance from the LAC/TI Project was based upon concerns of the Government of El Salvador (GOES) with regard to changes that might be needed or useful in its trade and investment laws. These laws include, specifically, the: (1) Law for the Promotion and Guaranty of Foreign Investment; (2) Law Governing Free Zones and Bonded Warehouses; and (3) Law for the Reactivation of Exports. All three were enacted in the late 1980s or early 1990s at a time when El Salvador retained a generally protectionist, import substitution-based economy and macroeconomic policies that effectively discouraged foreign direct investment (FDI). The Economic Structural Reform Program, instituted by the Cristiani Administration in 1989, resulted in outward-oriented macroeconomic reform policies and noticeable internal economic growth. Consequently, the laws cited appear obsolete, serving to impede rather than facilitate the GOES' market-opening initiatives and its ability to attract FDI. Meanwhile, exogenous factors such as the conclusion of the North American Free Trade Agreement (NAFTA) and the completion of the Uruguay Round of multilateral trade negotiations sponsored by the General Agreement on Tariffs and Trade (GATT), among others. have suggested the desirability of close legal analysis and possible revision or outright repeal of the above laws and, particularly, the appropriateness of basing market-opening and export promotion policies primarily on the establishment and operation of Free Trade Zones and subsequent reliance on incentives related to the Zones as the principal vehicle to generate new exports through labor-intensive assembly and processing operations.

Accordingly, USAID/El Salvador requested the assistance of the LAC/TI Project to review the GOES' existing trade and investment legal and regulatory regime; analyzing the provisions and impacts of similar laws and regulations in the neighboring countries of Costa Rica, the Dominican Republic, Guatemala, and Honduras, all primary competitors of El Salvador for expanded trade and new FDI; and drafting proposed legislative initiatives for presentation to the GOES for the amendment or repeal and superseding of the three laws enumerated above with the overall goal of enhancing El Salvador's global competitiveness for trade and investment by upgrading its trade and investment legal and regulatory regimes to accord with current internationally-accepted standards.

The study specifically involved: (A) legal review, analysis, and evaluation of existing Salvadoran trade and investment laws, including specifically, the: (1) Law for the Promotion and Guarantee of Foreign Investment, (2) Law Governing Free Zones and Bonded Warehouses, and (3) Law for the Reactivation of Exports; (B) collection, review, and evaluation of similar such laws in Costa Rica, the Dominican Republic, Guatemala, and Honduras and the eliciting of private sector views in those countries regarding the content and implementation of such laws, the problems they present for private entrepreneurs, and suggestions for improvements therein that could be compared with and applied to El Salvador in the effort to redraft - as indicated - its trade and investment laws; (C) consultation with the Salvadoran private sector for similar input; and (D) drafting of one or more proposed legislative initiatives for amendment or repeal and replacement of the laws enumerated above for presentation to the GOES. The study team visited El Salvador, Dominican Republic, Guatemala, and Honduras for purposes of the study and relied on information already available from existing resources in the case of Costa Rica. Among the Salvadoran Public and Private Sector organizations consulted were the Ministers and staff of the Ministries of Economy and of Treasury and officials of the Salvadoran Foundation for Economic and Social Development (FUSADES), the Exporters' Corporation of El Salvador (COEXPORT), the Salvadoran Association of Industries (ASI), the Commission for the Development of Exports (FOMEX), and the Chamber of Commerce and Industry of El Salvador.

1.2 Summary and Recommendations

The study's review and analysis of El Salvador's trade and investment laws suggest there are a number of problem areas in terms of the scope and content of its foreign direct investment legal/regulatory framework as well as a number of problems arising out of its export promotion laws. Some of the problems identified arise out of the convergence of impacts flowing from all three laws.

1.2.1 El Salvador's Foreign Investment Regime

The basic legal framework for foreign direct investment in El Salvador is comprised of certain provisions of its Constitution and of the Law for the Promotion and Guaranty of Foreign Investment. There are few provisions in the Constitution dealing directly with FDI but there are both geographical and sectoral exclusions, principal among which are: (a) the prohibition on foreign investment in the conduct of "small" commerce, industry and services; (b) the reservation of postal and telecommunication services to the State; (c) certain provisions regarding the forced reversion of dock, railroad, canal and similar services to the State without indemnization; (d) the prohibition on acquisition by foreigners of rural real property; and (e) restrictions on investment in certain fishing activities. These prohibitions on investment by foreigners as such are extended by constitutional prohibitions against such investments by Salvadoran companies majority-owned by foreigners.

The Investment Promotion and Guaranty Law was enacted to regulate the rights and obligations of foreign investors in order to facilitate the contributions thereof to the economic and social development of the nation, particularly in terms of enhancing productivity, generating employment, increasing exports of goods and services, and increasing and diversifying production. The law does not provide special positive incentives applicable solely to FDI or foreign investors as such. It does, provide certain important "guarantees" that operate only with regard to foreign direct investors. These include: (a) free remission of net profits (although only up to 50 percent of registered investment in commercial and service industries); (b) free remission of proceeds from the liquidation of investments;

(c) free transferability of such investments within the country; and (d) free remission of net capital earnings on the investment.

The law makes available these guarantees only to foreign investors "registered" with the Ministry of Economy. It allows for a significant administrative discretion in the consideration of aspects of the investment - nature, value, origin, and destination - and clear discretion in the valuation of intangible property, without providing clear, explicit, criteria for approval. It establishes specific time limits for administrative processing of registration applications and accords prospective investors appeal rights in the event of the Ministry's refusal to register a proffered investment. So, given: (a) the effective requirement for prior approval of an investment via the registration process; (b) the lack of explicit criteria therefor; and (c) the geographical and sectoral restrictions on FDI, El Salvador's current FDI legal regime would have to be characterized as a "Closed/High Discretion" regime under guidelines developed by a joint committee of the World Bank, International Monetary Fund, and Multilateral Investment Guaranty Agency.

Moreover, the Promotion and Guaranty Law, in particular, and the Salvadoran FDI legal regime in general, present a number of specific concerns. Principal among these are their failure to provide guarantees relating to National Treatment and protections against expropriation. "National Treatment" means that a host country will treat investments and investors from another country at least as favorably as the most favorable treatment it accords investments by its own nationals and companies in the same circumstances, e.g., non-discriminatory treatment. Although El Salvador appears generally to treat foreign investors fairly, explicit provision for such treatment in an FDI legal regime is considered standard in international practice. International standards for FDI regimes also require that a host country's FDI regime should include and apply certain protections in the event of expropriation. These include: (a) that there be a lawful public purpose therefor; (b) that the expropriation be effected under concepts of due process of law, including recourse to administrative and judicial review; (c) that it be undertaken on a non-discriminatory basis; and (d) that it be accompanied by prompt, adequate, and effective compensation. Other problems identified in El Salvador's FDI regime include: (a) concerns about the extent of investor recourses in investment dispute resolution; (b) the apparent lack of provisions on taxation of remitted profits; and (c) lack of guarantees for free immigration of expatriate personnel. As a result of all these concerns and problems, El Salvador's FDI legal regime appears something of a nontariff barrier in itself.

This study recommends that the Law for the Promotion and Guaranty of Foreign Investment be amended to address most of these concerns and has drafted a proposed law to that effect (Annex D).

1.2.2 El Salvador's Export Promotion Regime

The recent history of Salvadoran export laws reflects a growing adherence to a strategy of "export-led" economic growth, under which the GOES has emphasized fiscal incentives and other benefits to attract investment in export-oriented production operations that emphasize El Salvador's main sectoral area of comparative advantage - the quantity and quality, but mostly the comparatively low cost, of its labor force. From 1970 to the present, the thrust of this strategy has been to develop non-traditional exports by building a labor-intensive, export-oriented, manufacturing base, in support of which the GOES enacted a series of export promotion and export-related laws - in 1970, 1974, and 1986 - that laid the basis for its current legal regime.

In 1990, El Salvador enacted two statutes directly premised on encouraging increased Salvadoran exports through incentives designed to reward investors operating export-oriented enterprises. These two laws, the (a) Law Governing Free Zones and Bonded Warehouses ("Free Zones Law") and (b) the Export Reactivation Law, clearly were intended to work in tandem by encouraging export-focused production both within Free Zones and Bonded Warehouses (where production solely for export was rewarded with significant tax incentives) and within the rest of the country (where domestic production for export regardless of the percentage actually exported was rewarded with scaled-down, proportional incentives).

The Free Zones Law was enacted to regulate the operation of Free Zones, first authorized in 1974, and to encourage the development, administration, and use of such zones by the granting of benefits "equivalent to those granted in international practice." The law authorizes and regulates both Free Zones (Zonas Francas) and Bonded Warehouses (Recintos Fiscales). Article 2 of the Free Zones Law defines "Free Zones" as "those areas of the national territory beyond the [national] customs [territory] previously qualified [and] subject to a special [customs] regime, where enterprises, national or foreign, may be established and operate, which undertake the production or commercialization of goods for exportation, as well as the rendition of services linked to international commerce and the activities related or complementary thereto." The law does not provide an equivalent conceptual definition for Recintos Fiscales, which are actually general depositary warehouses that operate under the same customs regime as the Free Zones.

El Salvador's Free Zones Law provides fiscal incentives to developers and/or administrators of Free Zones and users of both Free Zones and Bonded Warehouses. These incentives include: (a) total exemption from Income Tax for ten to 15 years; (b) total exemption from asset/property taxes for similar periods; (c) exemption from stamp taxes (now Value-Added taxes); and, in the case of users, (d) total exemption from import taxes on machinery, equipment, etc., and (e) "free importation" [presumably from both customs duties and import taxes] into the Free Zones of raw materials, parts, components, etc. The Free Zones Law establishes a customs regime ("Temporary Admission") to regulate and facilitate operations in both Free Zones and Bonded Warehouses while ensuring that they remain separate from the national "customs territory" so as not to undermine the security and integrity of the nation's normal tariff structure and customs regime.

The Temporary Admission regime governs temporary entry into the Free Zones and Bonded Warehouses, temporary entry into the national customs territory, temporary exports from the same into the Free Zones and Bonded Warehouses, inter-Zone transfers, final (definitive) imports into the national customs territory, and final exports from the Free Zones and Bonded Warehouses. Basically, these provide that entry of inputs into the Free Zones and Bonded Warehouses from either the national customs territory or from abroad for incorporation into finished products thereafter exported will not be subject to customs duties or import or export taxes while temporary entry of Free Zone/Bonded Warehouse goods into the national customs territory for contract assembly or processing activities will not have duties or taxes imposed upon them as long as the resulting final products are actually exported outside of the Central America area (respecting El Salvador's obligations to its fellow Central American Common Market - CACM - neighbors). However, the law requires bonds to cover the value of any import duties or import or export taxes that would be payable should such merchandise be misapplied to evade the regular customs laws. The procedures established by the law dealing with applications for its benefits, denial and appeals, infractions and penalties, contain administrative provisions mandating actions within prescribed time periods and establishing presumptions of eligibility for failure of government agencies to act within the prescribed time periods.

The Export Reactivation Law was intended to complement the Free Zones Law to provide export incentives for producers outside the Free Zones and Bonded Warehouses and to make at least some incentives available to those producers who export only part of their production. It establishes different classes of grantees for such benefits and is extremely complicated in matching up the classes of beneficiaries with its different "classes" of benefits. Most of the incentives involve: (a) refunds of a percentage of the value of exports "as compensation for import taxes paid"; (b) exemption from stamp taxes and "any other indirect taxes" in connection with generating exports; and (c) exemption from asset/property taxes "in a percentage equal to the exported value . . ." of total production.

The Free Zones Law and the Export Reactivation Law "intersect" in that both laws involve performance requirements - exports - with incentives related to the level of export generation while the former involves a geographical performance requirement - location in a Free Zone or Bonded Warehouse. Moreover, the Free Zones Law explicitly states that persons applying for benefits under the Free Zone Law may not enjoy benefits under the Export Reactivation Law "unless they renounce the incentives granted under the [Free Zones Law]." El Salvador also has separate Bonded Warehouse legislation governing the domestic operation of Bonded Warehouses apart from the Free Zones Law that also authorizes to Bonded Warehouses "the custody and conservation of foreign merchandise even if it is still pending Customs registration and clearance or upon which import taxes are still owing." But, under this law, unlike the Free Zones Law, such institutions may be established anywhere in the country and still avail themselves of a customs regime.

El Salvador's export generation policies and legal regime operate within the context of both its membership in the CACM and of the sharp competition among Central American and other Caribbean neighbors for increased foreign investment and enhanced exports. So, it was considered conducive to a better understanding of the dynamics of export promotion through incentives in El Salvador to undertake a survey of export promotion laws in these countries and much of the study is devoted to describing these laws, many of which are remarkably similar to, and, in some cases, served as models for, El Salvador's laws.

El Salvador's two export promotion laws with their fiscal incentives designed to attract foreign investment and generate exports raise the question whether its laws authorize subsidies of a type that contravene basic international rules governing global trade or are otherwise inconsistent with international trade agreements. Article XVI of the General Agreement on Tariffs and Trade (the GATT) requires its Contracting Parties to forswear the use of direct or indirect subsidies for promoting exports other than of primary products. The Tokyo Round GATT Subsidies Code, which supplements and applies the GATT provision, currently is the basic international regulatory regime for subsidies. While it does not specifically define "subsidies", its Illustrative List of [subsidy] Practices provides that "subsidies" encompass at least the following: (a) provision of incentives contingent upon export performance; (b) full or partial exemption or remission specifically related to exports of direct taxes; (c) remission or drawback of import charges in excess of those actually levied on imports; and (d) any other charges on the public account constituting an export subsidy (which the Tokyo Round code applies to both income and asset/property taxes). But the Tokyo Round Code provides an affirmative defense to developing countries and fails to provide any enforcement procedures, while El Salvador isn't even a signatory to that Code.

But the just-signed Subsidies Code of the recently-completed GATT Uruguay Round of multilateral trade negotiations, when it enters into effect, will supersede the Tokyo Round Code and will apply to all developing country members of the new World Trade Organization (the successor organization to the GATT) as well as provide an effective enforcement procedure through its mandatory dispute resolution procedures. The Uruguay Round Code defines a subsidy as existing whenever "there is a financial contribution by a government or any public body . . . where . . . government revenue that is otherwise due, is foregone or not collected (e.g., fiscal incentives such as tax credits) . . . and . . . a benefit is thereby conferred." That Code specifically prohibits "subsidies contingent, in law or in fact, whether solely or as one of several conditions, upon export performance. . ." Still another major international trade agreement, the North American Free Trade Agreement (NAFTA) also includes disciplines on export subsidies prohibiting new waivers of customs duties or performance requirements related to exports. These two subsidies-restricting international agreements raise the possibility that El Salvador eventually may be pressed to eliminate its export subsidies as a condition to accession to the NAFTA or even incident to the grant of NAFTA-parity for CBI countries. For this reason, the study recommends that the GOES should at least consider elimination of such subsidies, subject to so-called Acquired Rights for those in Free Zones who have been granted incentives under existing law applicable for unexpired periods. The study concludes that Free Zones as such are a standard device to facilitate international commerce and should be retained for that purpose, but that Free Zone incentives intended to spur exports are, at best, a transitory economic development device no longer appropriate to El Salvador (given its costs) and may, in fact, have the unintended result of postponing actual real economic development through misallocation of development priorities and resources.

The study recommends that: (a) the Free Zones Law should be retained but purged of incentives (other than the Temporary Admission regime) and of any involvement of Bonded Warehouses; (b) the Bonded Warehouse Law's utilization of a customs regime be terminated; (c) Salvadoran tariffs should be amended to eliminate all tariffs or Customs duties on products imported by domestic enterprises as inputs not available in El Salvador utilized in the manufacturing of final products whether or not exported; (d) repeal of the current Export Reactivation Law and its replacement with an export promotion law that encourages exports and production for export by providing benefits compatible with international rules and standards of conduct relating to subsidies; and (e) the GOES consider enactment of a general Industrial Incentives Law providing non-export-related general fiscal and other incentives open to all investors in El Salvador. The study includes two draft laws, one amending the Free Zone Law (Annex E) and one constituting an entirely new Law for the Encouragement of Exports which repeals the Export Reactivation Law (Annex F).

2.0 SALVADORAN TRADE AND INVESTMENT LAWS

2.1 Foreign Investment

2.1.1 General Legal Framework

The basic legal framework regime for FDI in El Salvador is comprised of certain provisions of its Constitution and the Law for the Promotion and Guaranty of Foreign Investment. There are few constitutional provisions dealing directly with FDI or foreign investors as such, but there are some geographical and sectoral exclusions or limitations on FDI. Principal among these is Article 115 of the Political Constitution of El Salvador which reserves in its entirety the conduct of "small" "commerce, industry, and rendering of services" to Salvadorans by birth or citizens of other Central American countries (in recognition of El Salvador's membership in the Central American Common Market, hereinafter referred to as the "CACM"). The Regulatory Law for the Exercise of Commerce and Industry establishes "size" standards relating to the liquid capital of such enterprises below which foreigners are forbidden by the Constitution to carry on commerce or industry, e.g., (1) for individually-owned commercial entities - Colones 100,000; (2) for individually-owned industrial entities - C 50,000; and (3) for incorporated entities, double the foregoing amounts for commercial and industrial activities, respectively, with service enterprises considered as industrial entities for purposes of these criteria.

Paragraph 4 of Article 110 of the Constitution reserves postal and telecommunications services to the State, while Article 120 provides that certain public service "concessions" such as docks, railroads, canals and certain other such services, while they may be owned and operated by private entrepreneurs for a period of up to 50 years under such concessions, must eventually revert into State ownership "without any indemnization". The article applies to both Salvadoran and foreign owners or holders of such concessions and does not, thereby, discriminate against foreigners as such. Article 109 of the Constitution provides that rural real property may not be acquired by foreigners except for the purpose of emplacing and operating industrial establishments. Finally, it should be noted that certain fishing activities are restricted to Salvadoran individuals or to companies not majority-owned by Salvadorans under Article 2 of the Fishing and Maritime Hunting Law. Article 95 extends such constitutional prohibitions as well to Salvadoran companies that are majority-owned by foreigners.

2.1.2 Foreign Investment Promotion and Guaranty Law

The earliest in time of the three Salvadoran laws that are the subjects of this study is the Foreign Investment Promotion and Guaranty law (Ley de Fomento y Guarantía de la Inversión Extranjera) [Diario Oficial No. 85, Book 299, of May 9, 1988] first enacted May 9, 1988 and effective May 17, 1988, as amended by Legislative Decrees No. 189 of March 1, 1989 [Diario Oficial No. 49, Book 302, of March 10, 1989] and No. 413 of December 8, 1989 [Diario Oficial No. 231, Book 305, of December 13, 1989], hereinafter referred to as the "Promotion/Guaranty Law". According to Article 1 thereof, the law has as its goal "the promotion and guaranty of foreign investment" and was enacted to regulate "the rights and obligations of foreign investors who . . . can contribute to the economic and social development of the nation, with the impacts of enhancing productivity, generating employment, exporting goods and services, and increasing and diversifying production."

Article 2 defines "foreign investment" as meaning ". . . every form of capital transfer to El Salvador originating from other countries, effected through natural or juridical foreigners for the production of goods and services and duly registered with the Ministry of Foreign Commerce."[1] Article 3 fills out this definition by enumerating the forms which such FDI may take, which include: (a) financial resources in freely convertible foreign exchange; (b) tangible property such as machinery,

[1]Although Article 2 refers to the "Ministry of Foreign Commerce" as the government agency responsible for registering foreign investment, the Law explicitly delegates this responsibility to the Ministry of the Economy in Article 8 and throughout the rest of the Law.

equipment, accessories, spare parts, and raw materials; (c) certain intangible property such as patents, trademarks, trade names, and copyrights; lease contracts; contracts for marketing and technical assistance services; managerial know-how, and, in general, "any right having an economic value conferred thereon by law or under agreement . . .";(d) certain loans in foreign exchange; and (e) shares and participations acquired by foreign investors for the capitalization of companies domiciled in El Salvador or for the increase of capital in branches of foreign companies. An amendment to Article 3 provides that "foreign capital transfers" shall also include "reinvestment of profits obtained in the country by foreign investors as long as they have originated out of foreign investment duly registered" (and, thus, be treated as FDI) under the Law.

Although Article 4 of the Promotion/Guaranty Law states explicitly that "for purposes of this Law, natural or juridical foreigners may transfer capital to El Salvador to effect investments in any economic sector", Article 5 thereof incorporates the constitutional restrictions on foreign involvement in small business, industry and services and in certain fishing operations noted above.

The Promotion/Guaranty Law does not provide special positive incentives applicable solely to FDI or foreign investors as such, nor does it provide fiscal incentives of any kind. It does, however, provide certain important "guarantees" that operate, in fact, only with regard to foreign investors. Article 15 provides, in pertinent part, that registered foreign investment shall be guaranteed the following:

> "a) Free remission of net profits generated by such investments." (But this provision is substantially undercut by the sentence following which provides that "Nevertheless, in the case of investments made in commercial and service activities, of net profits obtained in any year, they may remit only up to 50% of registered investment.")
>
> "b) Free remission of amounts arising from total or partial liquidation of enterprises in the proportion that reflects their [percentage] of foreign capital . . ." . . .
>
> "ch) Free transferability of its foreign investment in the country."
>
> "d) Free remission of net capital earnings that the foreign investor obtains from the transfer of its registered investment in the country."

Unlike some countries that restrict the availability of local financing for foreign investment, Article 19 of the Promotion/Guaranty Law provides that foreigners with registered investments "shall have access to financing in the country and to the opening of foreign exchange accounts in the financial system."

Although the Promotion/Guaranty Law does not explicitly require prior approval of FDI in El Salvador, the guarantees described above are only available to those foreign investors whose FDI is "registered" with the Ministry of the Economy. However, since a certain degree of administrative discretion is implicit from the matters that must be considered set forth in the law (see next paragraph), it appears that the exercise of such discretion, in considering applications, inherently involves a degree of "approval" of the investment so that, under the law, approval, in fact, becomes a precondition to its registration. Chapter II of the Promotion/Guaranty Law sets forth the procedure for obtaining registration of a foreign investment. Article 11 provides that a foreign investor, itself, or through a legal representative, must apply to the Ministry of Economy for registration of its investment through which it qualifies for the guarantees described above.

Article 8 of Law provides that the Ministry of Economy, for purposes of effecting such registration, "shall consider the nature, value, origin, destination, and date of entry of such investment." Clause two of Article 10 clearly provides a degree of discretion to the Ministry in terms of accepting or not the proposed value of intangible property. The clause provides that, while the value thereof shall be established in the "respective documentation", "nevertheless, the Ministry of Economy, prior to registration, if it considers it appropriate, may assess a new value in conformity with the criteria specified in the Customs valuation legislation and whatever other criteria it deems appropriate." The Regulation issued for the implementation of the Promotion/Guaranty Law, [Executive] Decree No. 1 of January 9, 1990 (discussed below) enlarges on the matter of establishing the "value" of the investment. Article 24 of the Regulation provides that: "In the event the Ministry deems it appropriate to assess the value referred to in the second paragraph of Art. 10 of the Law, this shall be accomplished by two specialized experts with experience in the area involved, and shall be concluded within ten working days following the date on which such valuation was ordered."

The Promotion/Guaranty Law specifies time limits for administrative processing of the registration application and accords prospective investors appeal rights in the event of the Ministry's refusal to register a proffered investment or, in the view of the applicant, undervalues intangible property contributed as part of the investment. Article 11, clause 3, provides that: "The Ministry should register such investment within the thirty working days following the date of filing of the application or of the conclusion of the period of the most recent [request for further information] if that has been complied with by the applicant." [2] The Law's injunction to the Ministry to proceed with registration within that period is buttressed by clause 4 which provides that: "Upon expiration of such period, if registration has not been effected, it shall be presumed that the Ministry of Economy has authorized and is therefore obliged to effect such registration." (Emphasis added.)

In the event of an unfavorable decision by the Ministry, the Law provides opportunity for appeal. Article 20 provides that the applicant may appeal to the Minister of the Economy for reconsideration of any action denying registration of a foreign investment or with respect to the valuation of intangible property, within eight working days following notification thereof. Again, it mandates a time specific for such administrative action, providing that the Minister shall determine the matter of the appeal within 15 working days thereafter if the applicant has complied with all pertinent requests. And again it mandates dispositive action, providing that: "If, upon passage of such period of time, a decision has not issued, the Ministry of Economy should effect the requested registration." Note that the Law's original Spanish text again uses the term "deberá efectuar" (see footnote 2).

Article 21 of the Law addresses the resolution of investment disputes. It provides that, in the event of any dispute arising between the State and foreign investors relating to the treatment of their

[2] The Spanish text uses the term "deberá registrar", which, in literal translation means "should register" in place of "registrará", translated as 'shall register". Latin Code Law practice equates the two in meaning and degree of obligation, although U.S. and other Common Law tradition lawyers would argue that "ought" implies the relevance of certain affirmative defenses to the obligation that is generally thought to be eliminated when the term "shall" is used.

investments, the parties may submit the matter to the Conciliation and Arbitration Tribunal established in the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States of March 18, 1965 (known as the "Washington Convention"), signed by El Salvador on June 9, 1982 and ratified by means of Legislative Decree No. 111 of 1982 published in Diario Oficial No. 230, Book 277, of December 14, 1982. The GOES and the United States concluded an Investment Guaranty agreement of January 29, 1960 providing for insurance by the Overseas Private Investment Corporation for losses suffered by U.S. investors in El Salvador by reason of expropriation or currency inconvertibility. But it should be noted that the Promotion/Guaranty Law itself contains no provisions relating to expropriation or compensation therefor.

2.2 Export Incentive Laws

2.2.1 Historical Background

The recent history of Salvadoran export laws reflects the growing adherence of the GOES to a strategy of "export-led" economic growth, pursuant to which successive governments have emphasized the use of fiscal incentives and other benefits designed to induce investment in export-oriented production operations emphasizing El Salvador's main sectoral area of comparative advantage, e.g., the quantity and quality of its labor force. Throughout the period beginning around 1970, the thrust of this strategy has been to develop "non-traditional" (or incremental) exports, e.g., exports other than El Salvador's traditional primary products, Coffee, Sugar, and Cotton, by building an export-oriented industry emphasizing labor-intensive manufacturing. In pursuance of this gradually developing strategy, El Salvador enacted a series of export-related and/or export promotion laws - in 1970, 1974, and 1986 that led up to and set the context for the current legal regime.

1970 Law: The first of these laws was the Export Promotion Law of 1970, Legislative Decree No. 148 of November 3, 1970 (Diario Oficial No. 221, Book 229 of December 3, 1970). That law had as its purpose to promote the development of non-traditional industrial products, handicrafts, and agricultural products for export beyond the CACM and it granted a number of incentives to enterprises engaged in such activity. The 1970 law established three classes of beneficiaries: (A) Net Export Enterprises, (B) Mixed Industries, and (C) Export Trading/ Enterprises, each category of which received a discrete range of incentives. A "Net Export Enterprise" was a firm that exported all of its production to other member countries of the CACM, and these firms received the following benefits: (1) 10 years exemption from payment of taxes imposed on imports of machinery and equipment, parts, and accessories required in the production of their products; (2) "Free introduction" for 10 years into bonded warehouses of raw materials, semi-finished products, and packaging necessary for production; (3) 10 years exemption from the Income Tax; (4) 10 years exemption from taxes on assets and property; and (4) free remission in foreign exchange of funds arising out of the sales of their products beyond the CACM. "Mixed Industries" referred to industrial enterprises that destined part of their production to CACM nations and part for export beyond the CACM. It included both enterprises that manufactured for their own account and those who subcontracted their manufacturing operations to others. These firms received a form of drawback, e.g., refund of taxes on imports of materials utilized in the production of goods exported beyond the CACM. And "Export Trading Companies" were defined as enterprises that were not, themselves, actual manufacturers of products, but who traded in or "commercialized" the export of covered products beyond the CACM. They received: (1) the drawback for 10 years of import taxes and (2) 10 year exemption from the Income Tax.

1974 Law: In 1974 a new Export Promotion Law was enacted, Legislative Decree No. 81 of September 5, 1974 (Diario Oficial No. 180, Bood 244 of September 27, 1974). That law added to the legislative policy goals, not only the generation of exports, but the creation of more job opportunities, to which end the law, for the first time, explicitly authorized the use of Free Zones, established by and owned by the Government specifically for manufacturing, assembly, and processing operations that could be conducted under incentives designed specifically to attract both domestic and foreign investment therein. Article 14 of the law defined the Free Zone as follows: "An Industrial and Commercial Free Zone means every extra-customs area of the national territory under fiscal vigilance and without a resident population, where industrial and commercial export enterprises can establish themselves to function in connection with or complementary to national or foreign industrial and commercial companies." In addition to authorizing use of Free Zones for such purposes, Chapter VIII of the law also established a Customs regime specific to Free Zones and Recintos Fiscales or "Bonded Warehouses" (see also discussion in **2.2.5**).

The 1974 law retained the conceptual framework of the 1970 law in making available its incentives to various categories of beneficiaries based on their involvement with exports. This time the Net Export Enterprises were defined as "those industrial enterprises established within a Free Zone, which export the entirety of their production beyond the CACM" (emphasis added). These received: (1) total exemption for an indefinite period from payment of taxes imposed upon imports of machinery, equipment, etc.; (2) 10 years exemption from payment of income tax, such exemption renewable for another five years if, in the last three years, their products contained a national Value-Added input of at least 40% of the total value thereof; (3) 10 years exemption from payment of taxes on assets and property, renewable for another three years under the same conditions as stated in (2); and (4) "Free entry" into a Free Zone or Bonded Warehouse ("Recinto Fiscal") of raw materials, semi-finished products, etc. "Mixed Industries" were defined as in the 1970 law except that the 1974 law required that at least 26% of their capital be held by nationals and they were described as being located outside of Free Zones. But in the 1974 law they received more incentives, e.g.: (1) 10 years total exemption from taxes imposed on imports of machinery and equipment, etc. but only if the enterprise were located in a Recinto Fiscal and exported more than 20% of its production; (2) 10 years exemption from payment of income tax provided that, in the last three years, their products contained at least 40 % Salvadoran added-value; (3) 10 years exemption from payment of taxes on assets and property on the same terms; and (4) ten years "free entry" into a Recinto Fiscal of raw materials, etc. required for production. And Export Trading Companies received: (1) five years total exemption from imposts on imports of equipment, parts, etc.; (2) 100% exemption from income tax for the first four years and 50% exemption from the income tax for the next four years but, in the latter case, only if located outside of a Free Zone and having a minimum 50% local capital. Finally, for the first time, the law established a system of Tax Compensation Certificates (Certificado de Compensación Tributaria). Under Article 75 of the law, "those enterprises not covered by this Law or other fiscal incentive regimen, who effect exports of the [covered] products beyond the Central American area, shall have the right to a Tax Compensation Certificate, which shall amount to ten percent of the value F.O.B. . . . of each exportation." The certificates were bearer documents, freely negotiable, exempt from any taxes, which could be used for the payment of all classes of direct or indirect taxes.

1986 Law: The immediate precursor to the two extant export promotion laws which form the principal focus of this study is the Export Development Law of 1986, Legislative Decree No. 315 of March 13, 1986 (Diario Oficial No. 55, book 290 of March 21, 1986). The purpose of the law was to modify the existing laws, institutions, and instruments through which the State promoted expansion of exports. Incentives for exports were extended to a broader range of products including semi-finished agricultural products (if these contained at least 30% national value-added) as well as to exports of services. This law required every exporter to be inscribed in a national exporter registry. The 1986 law authorized the establishment and ownership of Free Zones by private sector enterprises and provided fiscal incentives for the developers of the same. As with its predecessors, the law retained the beneficiary classification system, but this time utilized new categories thereof. These included enterprises exporting all of their production, those which directly exported only a part of their production, and those engaged in assembly and processing operations (in effect, maquilas) who were required to install such operation in either the Free Zones or the Recintos Fiscales. Producers who exported 100% of their production received the following incentives only if they conducted their operations in Free Zones or Recintos Fiscales: (1) Total exemption from taxes on the importation of machinery, equipment, etc., necessary to the production of exportable products; (2) total exemption from import taxes on imports of raw materials, semi-finished products, intermediates, packaging, containers, etc., utilized in such production; (3) similar exemption on imports of lubricants and combustibles necessary to the production process when not produced in the country; (4) ten years total exemption from the income tax for both the enterprise and for its shareholders with respect to their investments therein; and (5) ten years total exemption from taxes on assets and property. Except for those incentives with terms specified herein, all other of the incentives were of an indefinite period. Enterprises that directly exported a part of their production received roughly similar incentives, except that the period thereof was for ten years and renewable for an equal period, except for the last two incentives which were only for the ten year period.The law did not require such firms to locate in Free Zones or Recintos Fiscales as such, but, in Article 11 specified that their existing installations "should be declared as Recintos Fiscales." Assembly & processing (or maquila) firms, both domestic ones and "branches" of foreign firms, were required to operate in either Free Zones or Recintos Fiscales and received the following incentives: (1) total exemption from taxes on the imports of machinery, equipment, etc.; (1) total exemption from taxes on imports of raw materials, parts, components, etc. (3) ten years total exemption (renewable for another similiary period) from import taxes on lubricants and combustibles not produced in the country; (4) ten years total exemption from the income tax (both enterprise and its shareholders); and (5) total exemption from taxes on assets and property. Unless a period was specified, the incentives were indefinite in the period of their effectiveness. A fourth category, exporters of services (and their shareholders) were awarded exemption from income tax on earnings arising from such activities. The law continued the awarding of Tax Compensation Certificates, but narrowed the types of exports on which they could be earned as well as the amounts thereof to varying percentages of the products exported.

2.2.2 Current Legal Framework

On March 15, 1990, the Salvadoran Legislative Assembly passed two statutes directly oriented toward a new macroeconomic policy of stimulating export-led domestic economic growth and replacing the former import substitution-based policy of developing national industries via protectionist insulation from outside competition. The specific purpose of both laws was to encourage and promote the increase in Salvadoran exports through incentives designed to reward both national and foreign investors operating export-oriented enterprises. The two laws: (a) The Law Governing Free Zones and Bonded Warehouses and (b) the Export Reactivation Law, clearly were intended to work in tandem by encouraging exported-focused production both within Free Zones and Bonded Warehouses (where production solely for export was to be rewarded with significant tax incentives) and within the rest of the country (where "domestic" production for export regardless of the percentage of production actually exported was to be rewarded by scaled-down, proportional incentives). The two laws are intimately related and tend to intersect in some of their provisions, so that it is impossible to understand or evaluate El Salvador's export promotion legal framework without reading and evaluating them side-by-side. A major question arising in this study is whether the two, in practice and judged by their results, really do complement each other to the point of synergy in producing increased exports, or whether they effectively compete with and undercut each other and only complicate the realization of El Salvador's economic growth goals that underlie them.

2.2.3 The Free Zone and Bonded Warehouse Law

Legislative Decree 461 of March 15, 1990, effective March 23, 1990, the Law Governing Free Zones and Bonded Warehouses (Ley de Regimen de Zonas Francas y Recintos Fiscales) [Diario Oficial No. 88, Book 307, of April 18, 1990], as amended by Legislative Decrees 753 of April 19, 1991 [Diario Oficial No. ___, Book ___, of _________, 1991] and 211 of March 26, 1992 [Diario Oficial No. 65, Book 315, of _________, 1992] was enacted to regulate the operation of Free Zones and the activities therein believed to "generate employment, investment, and economic well-being" as well as to encourage the development, administration, and use of such zones by the concession of benefits "equivalent to those granted in international practice." The Law is bifurcated in that it authorizes both Free Zones (Zonas Francas) and Bonded Warehouses (Recintos Fiscales) while establishing a regulatory scheme common to both.

Article 2 defines "Free Zones" as "those areas of the national territory beyond the [national] Customs [territory] previously qualified [and] subject to a special regime, where enterprises, national or foreign, may be established and operate, which undertake the production or commercialization of goods for exportation, as well as the rendition of services linked to international commerce and the activities related or complementary thereto." (Underlining added for emphasis.) The Law does not provide an equivalent conceptual definition for "Bonded Warehouse" but merely states in Article 20 thereof that "Natural or juridical persons, nationals or foreigners, who are owners of enterprises which export their entire production or are devoted to international commercialization, and which are not located in a Free Zone, may request that their establishments be declared a Bonded Warehouse by the competent authorities." Use of the disjunctive "or" in the earlier qualifying phrase suggests a broader spectrum of possible internationally-oriented uses for Bonded Warehouses than for Free Zones, since the definition of the former suggests activities ("production or commercialization of goods for exportation" or "services linked to international commerce") related solely to export, while the latter implies the extended warehousing of imports for extra-aduanal inventorying or for certain international financing security arrangements. Moreover, while Articles 5 and 9 prohibit certain types of operations or activities in Free Zones, these restrictions are not apparently invoked as against Bonded Warehouses. For example, Article 5 provides that the benefits and fiscal incentives granted by the Free Zones Law "shall not be available to . . .persons who, within a Free Zone undertake the following activities". The activities enumerated under Article 4 are: "a) Travel Agencies and Airlines; b) Air, Sea, or Land transportation; c) Activities governed by the banking or financial laws of the country; [and] d) Services unrelated to international commerce . . " Article 9 also provides that certain activities may not be conducted in Free Zones, including: "a) Petroleum and natural gas exploitation; b) Hotels; c) Mining in its extraction phase; d) Production or storage of contaminating merchandise; [and] e) Activities involving the processing or management of explosives or radioactive materials.

The Free Zones/Bonded Warehouse Law provides positive investment incentives for four classes of enterprises or investors without distinguishing between nationals as opposed to foreigners, e.g., Developers of Free Zones, Administrators (Operators) thereof, Developer/Operators, and Users. Article 11 provides that persons authorized to establish Free Zones shall enjoy the following benefits and fiscal incentives:

> "a) Total exemption from import taxes on the importation of machinery, equipment, tools, parts, and implements necessary for its establishment and operation.
>
> "b) Total exemption from the Income Tax for a period of fifteen years . . . [and]
>
> "c) Total exemption from fiscal imposts upon the assets or property of the enterprise . . ."

The exemption from the Income Tax is stated as being for 15 years without any provision for its extension thereafter. The exemptions from import taxes on machinery, equipment, etc., and from taxes on assets or property appear to be unlimited to a given period and so, apparently, continue on indefinitely as long as the Free Zone developer continues to operate in good standing. The Law also makes certain incentives available to administrators of Free Zones. To the extent that the Free Zone administrator is separate from the Developer, under Article 14, it receives the following incentives:

> "a) Total exemption from the Income Tax for a period of fifteen years . . .
>
> "b) Total exemption from fiscal imposts upon the assets or property of the enterprise . . . [and]
>
> "c) Exemption from stamp taxes or any other indirect tax upon the rental contracts in the Free Zone."

As is the case with Developers, the total exemption from the Income Tax is for a single, non-extendible 15 year period. while the exemptions from asset/property taxes and stamp taxes appears to be indefinite. Since a number of Developers of Free Zones also administer the same, Article 15 of the Law provides that "any person who is both the developer and the administrator of Free Zones . . . shall enjoy the benefits granted in both capacities." Thus, the Developer/Administrator receives: total exemption from the income tax for 15 years (from the initiation of its operations in the Free Zone); total exemption from import taxes on machinery, equipment, etc., total exemption from asset/property taxes; and exemption from certain stamp taxes. The latter three exemptions appear to apply for an indefinite period as long as the Developer/Administrator continues to operate the zone in good standing. Moreover, the exemptions from the Income Tax and from the asset/property tax are conceded not only to the companies qualifying as Developers, Administrators, and Developer/Administrators but to their individual partners and shareholders to the extent of their respective shares in the earnings or dividends attributable to their investment in the company.

But the principal purpose of the Law is to encourage and reward users of the Free Zones as the generators of the increased exports the Law seeks to realize. Article 17 defines a "user" as "a natural or juridical person, national or foreign, authorized in accord with this Law to operate in the Free Zone and undertaking industrial or service activities <u>or</u> engaged in international commerce <u>as well as</u> maquila or assembly operations for export outside of the Central American area. (Underlining added for emphasis.) The Law, in using the connector "as well", apparently distinguishes between "industrial or service activities" and "international commerce" and Maquila or assembly operations. This distinction is emphasized by Article 18 which provides specifically as to the latter that:

> "Natural or juridical persons domiciled in the country may conclude service contracts for maquila or assembly [operations] with a client domiciled abroad, pursuant to the agreed terms and conditions of which [the latter] shall supply raw materials, parts, pieces, components, or other elements that the [former] shall transform for account of the client who, for its part shall utilize or trade [the products thereof] according to their contract."

The law then makes an array of incentives available to Free Zone users. Article 19 provides that "every . . .person . . . [who is] the owner of an enterprise [which is] an user of the Free Zone, who devotes itself exclusively to exportation shall have the right to enjoy the following benefits and fiscal incentives". The enumerated incentives are:

> "a) Total exemption from . . . taxes imposed on imports of machinery, equipment, tools, parts and accessories, utensils, and other appliances necessary for production for export;
>
> "b) Free importation into the Free Zones of raw materials, parts, pieces, components or other elements, semi-finished products, intermediate products, containers, labels, samples and models, necessary for the execution by the enterprise of the activities rewarded.
>
> "c) Total exemption for a period of ten years, extendible for an equal period, of taxes imposed on the importation of lubricants and combustibles necessary for the production activity, whenever these are not produced in the country;
>
> "d) Total exemption from the Income Tax for a period of ten years, extendible for an equal period . . ." [and]
>
> "e) Total exemption from fiscal imposts upon the assets and property related to the activities rewarded . . . and similarly extendible for an equal period."

Accordingly, users receive up to a possible 20 years total exemption from the Income Tax, from asset/property taxes, and from taxes on imports of lubricants and combustibles (not produced in the country) as well as indefinite (while the user remains in good standing) total exemption from taxes imposed on imports of machinery, equipment, etc. and free importation of raw materials, parts, etc. As with the Developers and Administrators of Free Zones, the exemptions from income tax and from asset/property taxes are also granted to partners and shareholders to the extent of their respective shares in the earnings or dividends attributable to their investment in the company.

An interesting question is raised here as to the real extent of the exemption regarding "taxes" imposed on imports of machinery, equipment, etc. The Spanish term used is "impuestos que graven la importación de" rather than "derechos aduanales" or "tarifas" which are generally used to describe customs duties.Thus, it appears the exemption is only from "taxes", presumably value-added taxes or surcharges rather than from actual customs duties. This impression is heightened by the use in the succeeding clause of the term "libre internación" or "free entry" for raw materials, parts, pieces, etc., a separate benefit that does not repeat the use of the terms "machinery, equipment, tools, parts and accessories, utensils . . ." to which the former benefit is related. (This distinction is observed as well in the incentives for Developers.) When this point was raised in discussions with Salvadoran counsel and government officials, the conclusion was that the term "taxes" probably was intended to cover both customs duties and import taxes since those concepts are often intermingled in legislative practice.

The law also provides incentives relating to the operation of Bonded Warehouses. Article 21 provides that. "Every natural or juridical person, national or foreigner, who is the owner of an enterprise that operates in a bonded warehouse shall have the right to enjoy the benefits and fiscal incentives established in article 19 [hereof]." The benefits made available, therefore, for users of Bonded Warehouses are the same as for users of Free Zones. At first glance, it appears that none of the benefits conceded to Free Zone Developers and Administrators in articles 11, 14, and 15 are granted to developers and administrators of Bonded Warehouses although the phrase "enterprise that operates in a bonded warehouse" rather than "user" thereof may have been intended to be inclusive enough to refer to Administrators if not Developers. Indications from practice, however, suggest that both Developers and Administrators of Bonded Warehouses are excluded from benefits.

But, otherwise, the law appears to treat the two types of entities alike in terms of both the customs regime established for their operations and the administrative procedures established for application, oversight, penalties, and appeals, with the same provisions applicable to both.

The law, in Article 22, establishes a Customs regime to facilitate and regulate operations in both Free Zones and Bonded Warehouses while ensuring that activities and products therein remain apart from the national Customs territory so as not to undermine its overall tariff structure and customs security.The regime is referred to as the "Temporary Admissions" regime and its provisions, found in Chapter V of the law, govern temporary entry into the Free Zones/Bonded Warehouses, temporary entry into the national Customs territory, temporary exports from the same, inter-Zone transfers, final (definitive) imports into the national Customs territory, and final exports from the Free Zones/Bonded Warehouses. Basically, these provide that entry of inputs into the Free Zones/Bonded Warehouses from either the customs territory or abroad for incorporation into finished products thereafter exported will not be subject to import or export taxes and that temporary entry of Free Zone/Bonded Warehouse goods into the national Customs territory to be used in contract assembly or processing activities will not have duties or taxes imposed upon them as long as the residual final products are, indeed, exported outside of the Central American area. Where the foregoing cases are involved, the law requires bonds to cover the value of any import or export duties or taxes that would be payable should such merchandise be misapplied to avoid the temporary admission regime or the Customs laws in general.

The approach to the procedures section of the law - dealing with application for benefits, denial and appeals, penalties, and appeals therefrom - essentially reflect the use of "sunset" administrative provisions noted in the discussion of the Promotion/Guaranty Law described in detail above, e.g., mandating action within a specified period of time and establishing presumptions of eligibility for incentives for failure of the government agencies to act within the prescribed time periods.

2.2.4 Export Reactivation Law

Legislative Decree 460 of March 15, 1990, effective March 23, 1990, the Law for the Reactivation of Exports (Ley de Reactivación de las Exportaciones) [Diario Oficial No. 88, Book 307, of April 18, 1990] has for its goal the promotion of exports of goods and services outside Central America by granting benefits to owners of enterprises that export goods and services. The law was intended to complement the Free Zone/Bonded Warehouse Law to provide export incentives for producers outside the Free Zones/Bonded Warehouses and to make at least portions of such incentives available to those producers who export only a part (as opposed to 100%) of their production.

Article 2 establishes the basic entitlement: "Natural or juridical persons, nationals or foreign, who are owners of enterprises that export goods and services - with the exception of the following traditional products - coffee, sugar, and cotton - shall enjoy the benefits established under this Law." But the law, in effect, establishes different classes of grantees of such benefits, differentiating among them both as to the nature and extent of their exports and certain other classifying criteria. The law is extremely complicated when it comes to matching up classes of beneficiaries with classes of benefits.

The primary class of beneficiaries (what we will call Class IA) are alluded to in Article 3, which provides that: "Natural or juridical persons, nationals or foreigners, who are owners of enterprises that are exporters of goods and services or trade therein, may enjoy the following" and grants unto them what we shall call Class I benefits, e.g.,

> "a) Refund of 6% of the F.O.B. value [of the export] as compensation for import taxes required to be paid on those goods necessary for the realization of exporting activities...
>
> "b) Total exemption from stamp taxes on exports and from any other indirect taxes required in connection with generating the export.

It should be noted that neither Article 2 nor Article 3 qualifies companies receiving these Class I benefits in terms of the required percentage, if any, of exports of total production. This issue is raised because of the language of Article 4 which establishes two more classes of beneficiaries and benefits. Article 4 first provides that: "Owners of enterprises that export, trade in, or partially [assemble] or temporarily process goods or services, shall also enjoy . . ." a benefit. That benefit (which we will call the Class II benefit) comprises an "exemption from the property tax in a percentage equal to the exported value thereof . . .". Article 4, clause two, then establishes yet another class of beneficiary (Class III), e.g., "owners of enterprises that export less than one hundred percent [of their production] and who have been qualified under . . . the prior Export Promotion Law [the Law for the Promotion of Exports, Legislative Decree 315 of March 13, 1986, Diario Oficial No. 55, Book 290, of March 21, 1986 which is repealed in Article 13 of the Reactivation Law] and grants them "proportional exemption from the property tax. . ." The issue raised by the "less than one hundred percent" language in Article 2, clause two, is whether or not the Class I benefits are available only to those producers who export one hundred percent of their production, or whether the Class I benefits are available on a proportional basis to those exporting a lesser percentage of their production as provided for in Article 4, clause two. The Regulation issued to implement the Reactivation Law [the General Regulation for the Law for the Reactivation of Exports, Executive Decree 68 of November 27, 1990, Diario Oficial ___, Book ___, of __________, 1990] appears to confirm the former impression, e.g., Article 3 thereof provides, in pertinent part, that:

> "Persons desiring to avail themselves of the benefits granted by the Law in Articles 3 and 4 thereof . . . should file . . . a written request . . . detailing therein the activities they pursue and indicating they will export 100% of their production out of the Central American area."

Article V dilutes the bias against the traditional exports enumerated in Article 2 by establishing still another class of beneficiaries (Class IV), e.g., ". . .natural or juridical persons who export traditional products that have undergone a transformation process that incorporates, at a minimum, 30% added value of national origin after such processing" and gives them both Class I benefits, e.g., refund of 6% of F.O.B. value of their exported transformed products and total exemption from stamp taxes and the Class II benefit, e.g., proportional exemption from property tax in a percentage equal to the exported value thereof, which, in the case of Class IV beneficiaries presumably would mean a percentage of the total export value reflecting the national origin value added incident to transformation.

The law adds even more classes of beneficiaries. Article 7 describes "natural or juridical persons . . . who devote themselves to partial assembly or temporary processing [of goods] (Class V) and, in addition to permitting them to apply for temporary admission for goods imported under contract for assembly/processing operations, also provides in its second clause that they shall enjoy one of the Class I benefits, e.g., "repayment of 6% of the amount of national origin value added thereto incident to such operations. Article 7 also concedes the Class I and Class II benefits described above to these Class V beneficiaries "for those exports of theirs that do not involve assembly or processing." Article 11 in its first clause provides for a transitional eligibility of certain enterprises qualified in conformity with the (since repealed) Export Promotion Law and provides that these "shall have full right to enjoy the benefits granted under this Law, so long as they meet the requirements established." Clause two of Article 11 then establishes a Class VI of beneficiary, in this case "natural or juridical persons . . . who, upon entry into effect of this Law, have [residual] raw materials awaiting liquidation that were imported under the coverage of the aforementioned Export Promotion Law" and provides that they too "shall enjoy the benefit of [refund] of 8% " presumably of import taxes they had to pay on such imports.

There remains a point about the way in which the Free Zone/Bonded Warehouse and the Export Reactivation Laws, in effect, intersect. Article 6 of the Free Zones/Bonded Warehouses Law provides that ". . . persons who apply for the benefits established [under the Free Zone/Bonded Warehouse Law] should be located in a Free Zone or . . . Bonded Warehouses and should not enjoy the provisions of the Law for the Reactivation of Exports." Moreover, it goes on to require that persons may not avail themselves of the provisions of the Reactivation Law unless they "renounce the incentives granted under [the Free Zones/Bonded Warehouses] Law". But, while the Free Zones/Bonded Warehouse law limits the availability of its incentives to those who engage exclusively in exportation (Article 19), it applies the provisions of its Temporary Admission regime to a number of other entities (described in Articles 24, 25, and 26) who do not qualify for its incentives. Article 26 specifically points domestic (non-Free Zone) exporters to Central American free zones in the direction of the Reactivation Law, providing that: "Natural or juridical persons who export goods and services in conformity with the provisions of this article may avail themselves of the law for the Reactivation of Exports upon compliance with the requirements established therein." Article 11 of the Reactivation Law then provides a further base for non-Free Zone domestic exporters, providing that "Owners of enterprises qualified in conformity with the Law for the Promotion of Exports repealed by this Law shall have full right to enjoy the benefits granted under this Law so long as they meet the requirements established." Thus it is clear that the two export incentives laws were considered as inextricably bound up with one another - the one to promote exports through companies that lodged in the Free Zones/Bonded Warehouses by giving them more extensive incentives, and the other to promote exports of those companies not located in Free Zones/Bonded Warehouses and who may not produce entirely for export or who perform contract assembly and processing operations for those who do, by giving these more limited incentives.

Finally, there is a valid concern as to so-called "Acquired Rights" (Derechos Adquiridos). The phrase refers to a theory in Latin law that persons who have received certain "rights" from the State for a time certain, such as benefits under incentives laws, have entered into risk-based entrepreneurial investment and economic activities in reliance on a government's representation that such benefits will, indeed, endure and remain available for the entire period of time stated. The theory is that it would be unjust and, in those countries wherein the Derechos Adquiridos theory is incorporated into the Constitution as a property guarantee, illegal to withdraw such benefits before the expiration of the time period specified. The Acquired Rights issue has been raised in terms of the transition from the prior Export Promotion Law (repealed by the Reactivation Law) to its twin successors, the Free Zones/Bonded Warehouse Law and the Reactivation Law. In the Report of the Working Party considering El Salvador's GATT accession adopted December 12, 1990, certain members of the Working Party, in reviewing El Salvador's Memorandum on the Foreign Trade Regime, noted the Export Promotion Law of 1986, the Free Zone/Bonded Warehouse Law, and the Reactivation Law and asked the Salvadoran negotiators to brief them regarding the export incentives and promotion aspects of the three laws. In paragraph 45 of the Working Party Report, it is recorded that "In response to questions concerning the tariff exemptions, the representative of El Salvador that . . . all other tariff exceptions and fiscal incentives had been repealed . . . [but] he added that even though the tariff exemptions established in the Export Promotion Law [of 1986] had also been repealed, under the Export Revival Law or the Law on Free Zones and Bonded Warehouse Regime, <u>enterprises continued to enjoy their acquired rights.</u> Thus, 100 percent exemption for enterprises selling their products outside the CACM [Central American Common Market] <u>were no longer being granted"</u> (emphasis added).

This statement raises two points of confusion. First, as pointed out above, Article 11 of the Reactivation Law specifically provides that: "Owners of enterprises qualified in conformity with the Law for the Promotion of Exports . . . shall have full right to enjoy the benefits granted under <u>this</u> Law . . ." Similarly, Article 52 of the Free Zones/Bonded Warehouses Law provides that: "Owners of enterprises qualified in accordance with the Law for the Promotion of Exports . . . shall be entitled to enjoy the benefits granted by <u>this</u> Law." In both cases, the transition provisions of the two laws appear to <u>cancel</u> rather than preserve concessionary incentives made available under the prior Export Promotion Law.

And a second area of confusion is that, although the response of El Salvador to the Working Party's inquiry indicated, as quoted above, that "100 percent exemption [from tariffs] were no longer being granted", Article 11 paragraph a) of the Free Zones/Bonded Warehouses Law appears to give Developers of Free Zones, and Article 19 paragraph a) of the same Law gives Users thereof an unlimited (in duration) "Total exemption from the taxes imposed on imports of machinery, equipment, tools, parts and accessories, utensils, and other appliances necessary for production for export" and Article 19 b) gives an unlimited "Free entry into the Free Zones of raw materials, parts, pieces, components or other elements, semi-finished products, intermediate products, containers, labels, samples and models, necessary for the execution by the enterprise of the activities rewarded." Thus, GOES assertions reported by the Working Party in its Report on El Salvador's GATT accession appear at odds with the text of the two export promotion laws when it comes to both Acquired Rights and the cessation of granting of exemptions [from prepayment] of import taxes and, possibly, duties.

2.2.5 Related Legislation

El Salvador has separate legislation that governs the domestic operation of Bonded Warehouses apart from the Free Zones/Bonded Warehouses Law. That legislation is comprised in Title Four of the Law for Credit Institutions and Auxiliary Organizations (Ley de Instituciones de Crédito y Organizaciones Auxiliares), Legislative Decree No. 94 of September 17, 1970 (Diario Oficial No. 199, Book No. 229 of October 30, 1970). While most of the rest of this law has been subsequently repealed incident to the recompilation of banking laws, Title Four remains in effect. Article 7 of the law defines "Auxiliary Credit Organizations" as "those which, without taking public moneys, develop activities linked to the financial markets and providing the services referred to in Article 206 of this Law." Title Four is entitled "Operations of Auxiliary Credit Organizations". Article 206 provides that "Auxiliary Credit Organizations . . . are those that offer the following services" and then enumerates four areas of services, number II of which states: "Guardianship and custody of merchandise in general depositary warehouses . . ." Article 215 states that auxiliary organizations authorized to engage in the operations referred to in number II of article 206 "shall have as their principal object to undertake the guardianship and conservation of merchandise deposited under their care, issuing certificates of deposit or pledge securities for such merchandise." It goes on to provide that they can also "undertake or oversee, as may be confided to their care by their depositors, operations [involving] cutting, connecting, drying, packaging, transforming, or other form of processing of merchandise." Article 216 divides general depositary warehouses into two classes:

> "1 - The guardianship and conservation of national products, as well as foreign merchandise legally entered into the country, for which import taxes have been paid, and
>
> "2 - The custody and conservation of foreign merchandise even if it is still pending Customs registration and clearance or upon which import taxes are still owing."

According to Salvadoran counsel, "class 1" describes what would normally be referred to as "bonded warehouses" in standard domestic commercial practice dealing with secured warehousing for financial and lien purposes, while "class 2" refers to what are known in Spanish as "recintos fiscales", the term normally employed to refer "bonded warehouses" in a Customs regime setting, as suggested in the Law Governing Free Zones and Bonded Warehouses. The final sentence of Article 216 provides that "The operations referred to in number 2 above require authorization regulated by special law." But the "law" referred to is obviously not the Free Zones/Bonded Warehouse Law since Decree Law No. 94 was enacted in 1970 and the latter was not enacted until 1990. The "law" referred to is believed to be a successor law to the general banking law. This is borne out by the second paragraph of Article 1 of the [now superseded] Credit Institutions Law which provides that: "In matters not foreseen in this Law nor in the Organic Law of the Central Reserve Bank of El Salvador, credit institutions and auxiliary organizations shall be governed by the provisions of the Commercial Code." Article 222 provides that negotiable instruments issued that cover deposited merchandise "and the other operations engaged in by the institutions and organizations referred to in this Chapter [covering general depositary warehouses] shall be governed by the Commercial Code."

Under Article 217, "credit institutions and auxiliary organizations authorized to provide general depositary warehouse services, may establish the installations required in any location within the

Republic and utilize these for different classes [e.g., classes 1 and 2] of storage," and that these installations "may consist of offices, lockers, silos, grain elevators, tanks, refrigerated storage facilities, or any other kind of warehouses that offer security for the custody and conservation of the merchandise." General depositary warehouses are required to be bonded up to an amount equal to 2 1/2% of the value of the merchandise on deposit and are required to insure such deposits against most forms of loss or damage.

3.0 COUNTRY COMPARISONS:EXPORT INCENTIVE LAWS

3.1 Country Comparisons

El Salvador's economy and its export promotion policies and legal regime operate within the context of both its membership in the Central American Common Market (Mercado Común de Centroamerica) or CACM and of the sharp competition among Central American and other Caribbean countries for increased exports and incremental foreign investment. So it was considered conducive to a better understanding of the dynamics of export promotion through incentives within El Salvador to undertake a comparative survey of export promotion laws in certain other neighboring countries that compete directly with El Salvador in attempting to enhance national exports through attracting new investment, particularly foreign, in export production facilities through the granting of fiscal and other benefits. The Study team examined the export promotion incentive regimes in Costa Rica, the Dominican Republic, Guatemala, and Honduras.

3.2 Costa Rica

Costa Rica innovated positive investment incentives for the specific purpose of encouraging increased exports in 1981. Recent macroeconomic policy changes and external pressures have resulted in considerable changes in its rather complicated export promotion legal regime but the following represents an effort to portray the regime as currently in effect. Costa Rica's export promotion incentives regime can be divided into three principal areas: Free Trade Zone operations; Export Contract operations; and the Temporary Admission Program.

3.2.1 Free Trade Zones

Costa Rica first experimented with Free Trade Zones with its Law for Export Processing Zones and Industrial Parks, Law No. 6695 of December 3, 1981, since repealed. That law established the basic structure of Free Zone incentives and provided the following benefits to companies locating export production operations in its Fee Zones:

- Total exemption from Customs duties and other imposts connected with the importation of raw materials, finished or semi-finished products, components and parts, packaging materials and containers together with other merchandise and goods required for normal [export production] operations;

- Total exemption from Customs duties and other imposts connected with importation of machinery, equipment, spare parts, models and accessories necessary for zone operations;

- Exemption from Customs duties and other imposts on imports of fuels utilized in zone operations to the extent they are not produced in the country in the quantity and quality required;

- Total exemption from Customs duties and other imposts on exports and other charges associated with the export or reexport of products as well as on the reexport of production machinery and equipment brought in for that purpose to the zone;

- Total exemption from sales and consumption taxes;

- The right of free use and remission of foreign exchange received from the sales of exported products; and

- Exemption from income taxes on earnings for a total period of ten years, with a 100% exemption thereof for the first six years and 50% exemption thereafter. These income tax exemptions were available also to dividends received by shareholders of companies operating in the zone. (This last benefit was limited, in the case of foreigners, to those companies whose home countries do not provide a tax credit against foreign income taxes.) Companies that decided to forego the income tax exemption (presumably for "grossing up" of intercompany accounts) could opt, instead, to receive Tax Credit Certificates based on the aggregate value of the goods exported, up to an amount of 10% thereof.

Since repeal of the 1981 Free Zones law, Free Zone incentives are governed by Law 7210 of November 23, 1990 and Law 7293 of March 4, 1992. These retain the basic structure of incentives set forth above except that current law reduces the period of income tax exemption from 10 to eight years with the 50% exemption for the latter four years and companies operating in the Free Zones are no longer eligible to receive Tax Credit Certificates.

3.2.2 Export Contract Operations

Costa Rica has also made export incentives to producers for export not located within its Free Zones. Originally under the Public Sector Financial Equilibrium Law, Law No. 6955 of March 2, 1982, the National Investment Council (Consejo Nacional de Inversiones) was authorized to enter into "Export Contracts" with locally-based producers of non-traditional products (e.g., other than coffee, bananas, cacao, sugar, tobacco, leather, canned beef, shrimp, certain wood products, unprocessed minerals, etc.) destined for export beyond Central America. The benefits granted under this incentive regime included:

- Duty-free import of inputs for production of non-traditional products exported beyond Central America;

- Duty-free temporary entry for inputs used in assembly operations, samples, and other inputs (solely for exports beyond Central America);

- 100 % exemption from income taxes on earnings realized from exports of non-traditional products beyond Central America as well as 50% of amounts paid in the free market for nominative shares of companies involved in the export of 100% of their production;

- Eligibility for the so-called "CATs" or Tax Credit Certificates (discussed below);

- Reduced port charges; and

- Bank financing at preferential rates.

The CATs scheme authorized the Central Bank, upon recommendation of the National Investment Council, to award a Tax Credit Certificate (Certificado de Abono Tributario) in a face value amount equal to 15% of revenues realized from the export of non-traditional products, calculated as the total amount of such exchange multiplied by the exchange rate in effect on the date of entry. The CATs were freely negotiable, non-interest-bearing, bearer documents, exempt from taxes of any kind, issued upon surrender to the Central Bank of foreign exchange from the export sales, together with: (a) a copy of the export license and corresponding invoice documenting the F.O.B. value of the export; (b) the Customs clearance certificate; (c) the relevant Waybill regarding freight payment; and (d) stamped registration of entry of the foreign exchange. The certificates could be used to pay Costa Rican direct or indirect taxes after 12 months from the date of issue and had a total effective life of three years. The CATs incentive, however, has been held by the U.S. Government to constitute an export subsidy subject to countervailing duties, and so the Government of Costa Rica determined to eliminate use of this incentive.

The basic Export Contract Operations law has since been amended and repealed to effect a number of changes in the above-enumerated benefits. Implementing regulations for the preferential financing scheme were never adopted and it is no longer applicable, while reduced port charges have been eliminated from the program. The Export Contract Operation was scheduled to expire in 1996, but because of Acquired Rights legal issues, pending contracts have been extended to 1999 with a lower level of income tax exemption. Upon its expiration, basic, non-Free Trade Zone export production incentives will be limited to duty free entry of materials and equipment needed in the production process as long as such items are not readily available in Costa Rica at price levels equivalent to those available internationally.

3.2.3 Temporary Admission Program

The Public Sector Financial Equilibrium Law of 1982, as amended by a number of subsequent laws, authorizes the temporary admission, for no longer than 12 months, of goods entering the country for production, processing, or assembly operations involving repair, reconstruction, incorporation into sets or apparatus of higher technological or functional complexity, or use for transport equipment or other purposes, and destined for export outside the Central American area, to enter the Customs territory without payment of import duties or other taxes thereon. Among the items allowed entry under the regime are raw materials, semi-manufactured products, finished products that are inputs for other finished goods that have been manufactured or assembled in the country, containers and packaging materials, and molds, dies, matrixes, components, parts, utensils, labels, etc. The regime, however, allows such entry only under a bond sufficient to cover all applicable import charges. Reexport of such materials is fully exempt from payment of any applicable export taxes. The Temporary Admission Program operates on the basis of five-year permits, automatically renewed. In the case of foreign enterprises that establish themselves permanently in the country and have to import machinery and equipment, the import period of 12 months may be extended for up to ten years by the Ministry of

Economic Affairs and Trade upon the recommendation of the Center for Export and Investment Promotion.

3.3 Dominican Republic

The Dominican Republic pursues export promotion through laws that provide incentives to export operations in its Free Zones and through an export promotion law that provides benefits to domestic producers for export. In incident and impact, however, the former far out shadows the latter.

3.3.1 Free Zones Law

The Dominican Republic first enacted a Free Zones Law by means of Law No. 4315 of October 22, 1955, which created its first Free Zones. But the nation's real involvement with such laws did not occur until enactment of the Free Zones Law, Law No. 299 of April 23, 1968 which provided the incentives that launched a tidal wave of investments, mostly foreign, in Free Zone facilities and led to a proliferation of such zones throughout the Dominican Republic. Since the first zone was established in La Romana in 1969, the number of operating Free Zones has grown to some 30 currently operating Free Zones with at least 436 companies operating therein. In 1993 alone, some 52 new industrial installations were approved. Free Zones employed over 150,000 Dominicans in 1993. In 1991, its Free Zones accounted for 52% of its total exports, generating some USS 825 million in gross exports and USS 252 million in net foreign exchange earnings for the country. In comparison with total Free Zone activity throughout the Caribbean Basin sub-region, the Dominican Republic, as of 1991, accounted for 62% of all exports, 60% of all Free Zone workers, and 42% of all companies operating in area Free Zones.

The current Dominican Free Zone regime is based on Law No. 8-90 of January 15, 1990 which supplanted Law 299. The law applies to foreigners and nationals alike without discrimination in scope, requirements, or benefits. Article 2 defines a Free Zone as "a geographical area of the country under special Customs and tax controls, as set forth in this law, in which enterprises will be licensed to devote their production of goods or services to foreign markets through the granting of incentives to stimulate their development." Article 5 indicates that the benefits of the law will run to Free Zone operators, investors in Free Zone Operators, and user enterprises. Article 5 b) defines a Free Zone enterprise as "persons, physical or moral, to whom have been granted a license for installation to avail itself of the provisions of this law and which devote their production or services to exporting." The law states, in Article 4, that "any person, physical or moral, may avail themselves of this law [through] increasing production [and] generating sources of employment and foreign exchange."

Law 8-90, in Chapter 3, establishes certain "types" of Free Zones based either on industrial activity or geographical location. These include: (a) Industrial or Service Free zones (which can be installed anywhere in the national territory to undertake the manufacture of goods or rendition of services); (b) Frontier Free Zones (which must be located at a distance of no less than three nor greater than 25 kilometers from the border separating the Dominican Republic and Haiti; and (c) Special Free Zones (zones which, because of the nature of the production process require their proximity to certain natural resources or when the nature of the process or the geographical, economic, or infrastructural situation so requires). The same paragraph provides that there may also be classified as Special Free Zones, certain enterprises (existing at the time of enactment of the law) that utilize raw materials under temporary entry in their production process, but these were required to have been approved within a year of the entry into effect of the law. Benefits under the law vary in accordance with the classification of the particular Free zone.

Companies are required to apply for and be licensed to operate in the Free Zones by the National Free Zone Council (Consejo Nacional de Zonas Francas) which is delegated authorities for the implementation of the law in terms of qualifying and approving Free Zone operators and users, issuing the regulations for implementation of the law, and providing oversight for Free Zone operations. Article 17 of the Free Zones law enumerates the various activities permitted to companies authorized to locate and operate in the zones. These include:

> "a) Introduce, store, unpack and re-pack, recycle, exhibit, manufacture, mount, assemble, refine, process and deal in any class of products, merchandise, or equipment.
>
> "b) Provide services, such as design, layout, marketing, telecommunications, printing, data processing, translation, software development, and any other similar or related services.
>
> "c) Introduce into the Free Zone all [types of] machinery, equipment, spares, parts, and tools that may be necessary to their operation.
>
> "d) Transfer raw materials, equipment, machinery, etc., and transfer labor and services between enterprises in the same Free Zone or between enterprises in different zones, provided they comply with the transit regulations from one to the other stipulated in Chapter 8 of the law.
>
> "e) Export up to 20% of its production to the local market and/or Dominican territory, when dealing with products fabricated in the country whose importation is permitted under Dominican] law under the control and surveillance of the General Directorate of Customs and the National Free Zones Council and upon prior payment of 100% of applicable taxes.
>
> "f) Export to Dominican territory goods and/or services from its production upon prior payment of 100% of the duties and taxes established for similar imports, provided that the following two conditions are met", [e.g., (1) the product to be exported is not outside of a Free Zone [anywhere] in the Dominican Republic and (2) the product to be exported contains local components, that is, national raw materials of no less than 25% of its total [value].]
>
> "g) Acquire from productive sectors not subject to a Free Zone regime [presumably in the local market], raw materials, packaging, labels, services, etc., required for its industrial processing services, exempted from export taxes, with the exception of sugar, coffee, cacao, gold, and products subject to an export duty regime greater than 20% of their net value or those whose importation is subsidized for public consumption. [In this respect, paragraph II of Article 17 provides that raw materials imported by local companies and destined to be used in the production of finished or semi-finished products to be exported from the Free Zones are exempt from payment of all tariffs, Customs duties, and taxes related thereto, with prior authorization of the National Free Zones Council and the Industrial Development Directorate.]
>
> "h) Change, as many times as may be necessary, the lines and processes of production employed, upon prior notification to the National Free Zones Council."

Article 24 of the Dominican Free Zones law provides that: "Operators of Free Zones and the enterprises established within them . . . shall receive 100% exemption over the following:

"a) Payment of income tax over earnings . . .

"b) Payment of construction taxes, taxes on loan agreements and on the registration and transfer of real property . . .

"c) Payment of the tax on the formation of companies and increases in the capital thereof.

"d) Payment of municipal taxes that may affect their activities.

"e) From any import taxes, tariffs, Customs duties, and other related imposts affecting raw materials, equipment, construction materials, parts for buildings, office equipment, etc., destined for construction, preparation, or operation in Free Zones.

"f) From all existing export or reexport taxes . . .[with certain exceptions]

"g) From the Business Tax on assets and property as well as the Tax on Transfer of Industrial property.

"h) From consular duties for all imports destined to operators or enterprises in Free Zones.

"i) Payment of import taxes relative to equipment and tools for the installation and operation of cafeterias, health services, medical assistance, child care centers, entertainment, or any other type of equipment made available for the well-being of the working corps. [and]

"j) Payment of duties on imports of [specified] transportation equipment."

In addition, Article 25 makes available certain exemptions from charges on imported construction materials as well as equipment necessary to construct housing for Free Zone operators and workers. Article 29 provides certain other benefits. These include subsidized rents for Free Zones and preferential interest rates on financing of such investments. With regard to export products subject to export quotas, the National Free Zone Council may assign preferential quotas to Free Zone enterprises. Finally, Article 28 limits the period of such benefits to Free Zone operators and users to 20 years from the first complete year of operation for operations in the Frontier Free Zones and 15 years for all others.

With regard to income tax exemptions, Article 26 provides that profits derived from or reinvested in Free Zones operating companies by shareholders thereof are exempt from income tax up to 100% for Frontier Free Zones, 80% for those in the National District and within a radius of 50 kilometers therefrom, and 90% as to all other locations. But Article 27 provides that, to avail themselves of such exemption, such investments must be concentrated in construction of buildings, purchase and development of land, and of equipment, construction materials, and working capital, and, such investments must be held for a period of no less than three years.

It should be noted the Dominican law also contains an "acquired rights" transitional provision. Article 49 provides that: "All physical or moral persons who, on the date of the promulgation of this law, were operating in a Free Zone by virtue of another law, a Decree of the Executive Authority, or a contract with the Dominican State, shall have this law applied to them without prejudice to their rights previously acquired."

3.3.2 Export Promotion Law

The Dominican Republic has an export promotion law but provides sparse benefits to domestic exporters. The current Export Promotion Law, Law No. 69 of November 7, 1979 provides two types of benefits: a CATs program for domestic direct exporters and a Temporary Admission Regime for reexporters. The law promotes exports of non-traditional exports, excluding sugar, coffee, cacao, leaf tobacco, ferronickel, bauxite, gold and silver, petroleum and its derivatives, and non-processed minerals.

Article 3 provides that: "Export activities of high national interest may be benefited with a Tax Credit Certificate (CAT) for an amount no more than 15% of the F.O.B. (or C.I.F. if the transaction utilizes Dominican companies for freight and transportation) for each export realized under the provisions of this law." In the case of exports containing a high percentage of agricultural inputs the beneficiary may be awarded a CAT in an amount up to 25% of the F.O.B. value of the export. Persons desiring to obtain such CATs must apply for a certification of their eligibility to the Executive Committee of the Dominican Center for Export Promotion (CEDOPEX) and a Special License therefor also issued by CEDOPEX which must be submitted with each request for issuance of a CAT. As in the case of the Costa Rican CATs, Article 6 of the law provides that the CATs may be used by the beneficiary or his endorsee for payment of national taxes or of any debt owing to the State and they are freely negotiable and exempt from income tax. Another benefit, under Article 7 of the law, is that the beneficiaries of the CATs may be exempted by the Dominican Monetary Board in whole or in part from the obligation to furnish all foreign exchange received for their exports to the Central Bank.

Article 12 of the law provides that CEDOPEX shall encourage the formation of Export Consortia (Consorcios de Exportación) formed principally of small and medium size producers for the purpose of enhancing their ability to increase exports from the country. Article 8 defines an Export Consortium as an "economic unit composed of associated exporters for any of the following objectives: a) Trade in products or a line of similar products in foreign markets; [and] b) trade in different products in a specific international market." Article 9 provides that Export Consortia may receive the benefits of CATs up to a limit of 10% of the F.O.B. value of its exports.

The Export Promotion law also provides benefits for reexporters of certain merchandise entered previously under a Temporary Admission regime. Among the products covered are raw materials, semi-manufactured products, and finished products which are themselves inputs into other finished products made, processed, or assembled in the country. It also covers molds, parts, tools and other items that serve to complement machinery or equipment destined for export. Paragraph I of Article 2 of the law provides that: "For purposes of implementation of this regimen, there shall be considered as imports of a temporary character those products destined for reexport [containing] an added national value." However, Paragraph III of Article 2 imposes a limitation, providing that [CEDOPEX]" . . . shall not authorize temporary importation for those products indicated above when the same are produced in the country in an amount, quality, and price competitive with foreign products."

3.3.3 Draft Export Promotion Legislation

There has been circulating recently in the Dominican Republic a draft of a proposed new Export Development Law, designed essentially to replace all or most of Law 69. The apparent motivation on the part of the Government in essaying the possibility of amending or repealing Law 69 is concern over the fate of the Costa Rican CAT program which was found to constitute an export subsidy giving rise under United States law to an action for imposition of countervailing duties. The draft currently circulating would replace the Dominican CAT program with the establishment of a special fund called the "Export Compensation Fund" to provide exporters with the resources necessary to effect payment of applicable Customs duties and other charges on imported items intended for use as inputs in or to facilitate assembly or processing operations for products ultimately intended for export.The export compensation figure is established as a proportion of the F.O.B. value of the beneficiary's exports - referred to as the "Compensation Rate" calculated as the product of the duty paid on an item multiplied by one of a set of percentages corresponding to products of differing levels of export value.The compensation is then paid to the exporter by means of a check denominated in local currency and drawn on the export compensation fund. An exporter would have ninety days from the date of shipment to request compensation.

The draft legislation also establishes a special "temporary" mechanism for textiles and shoe assembly companies. Under the program, for a year from the date the legislation would go into effect, the Government would establish a Customs Line of Credit account available at Customs for payment of charges on imports for companies working under international contracts in textile and shoe assembly operations. At the end of one year from the entry into effect of the law, the companies would be granted access to export compensation under the scheme described above. One might question the feasibility of the scheme given that, under Article 20 of the draft legislation, all charges to the Customs account must be backed by a bond covering 140% of all charges payable. Article 22 provides that all such charges must be written off in sixty calendar days from the date of Customs clearance. Under Article 24, at the end of the sixty calendar day period, any account showing an unpaid balance would be collected through liquidation of the Bond. Charges to the Customs line of credit would be written off when the exporter demonstrates that the export of inputs is equal to four times the F.O.B. value of total charges.

The draft Export Promotion Law also eliminates requirements for export licenses as well as requirements for permits and export quotas currently applicable to domestic products except for those that could negatively affect the country's environment. The likely fate of the draft promotion law is unknown.

3.4 Guatemala

In 1989, Guatemala passed two laws, currently in effect, specifically aimed at strengthening free trade and promoting exports of Guatemalan goods and services beyond Central America. They are the: Free Zones Law, Congressional Decree No. 65-89 of November 14, 1989 and the Law for the Promotion and Development of Export and Maquila Activities, Congressional Decree No. 29-89 of May 23, 1989. The latter repealed and the two laws, taken together, replace the prior Incentives Law for Industrial Export Enterprises, Decree Law No. 21-84 of 1984. Another Guatemalan law of relevance, however, is its Law Governing General Depositary Warehouses.

3.4.1 Free Zones Law

Law 65-89 was passed "to induce and regulate the establishment of Free Zones in the country that promote national development by means of activities undertaken therein that particularly tend to enhance the external commerce, the generation of employment, and the transfer of technology." Article 2 defines a Free Zone as "a physically delimited area of land, subject to a Special Customs Regime established in this Law, planned and designed so that individual and juridical persons can undertake both the production or commercialization of goods for exportation or reexportation as well as the rendering of services linked with international commerce." Article 40 of the law excludes certain types of firms or activities including: travel agencies and airlines; air, sea, or land transportation; activities governed by banking or financial sector laws; or services not linked to international commerce as described in the regulation implementing the law. Article 41 excludes from the Free Zones activities involving: petroleum or natural gas; fishing; hotels or recreation centers; wood processing; sugar; coffee; cardamon; cotton; fresh bananas; cattle; extractive mining; contaminants; explosives or radioactive materials; endangered plants or animals; and packaging or labeling of Guatemalan products subject to [export] quotas. Finally, Article 42 prohibits the importation into the zones of arms or explosives; jewelry, watches, or non industrial cameras; industrial wastes; or merchandise or goods from without the Central American region imported for the consumption of those working in the zones.

Incentives are granted depending on the class of beneficiary. The major distinction is between Administrative Entities (or operators) and Users. Article 3 defines an Administrative Entity as: "the juridical person legally registered and authorized to operate in the country and charged with investing in, developing, and administering Free Zones." The law establishes three separate classes of zone users: Industrial, Service, and Commercial. Article 4 defines generally a User as: "an individual or juridical person authorized by the Ministry of Economy to operate in a Free Zone in compliance with the requirements established by the Commercial Code, this law, and its regulation. An "Industrial" User is defined as one "which devotes itself to the production or assembly of goods for export beyond the national Customs territory, re exportation, or to technological investigation or development." A "Services" User is defined as one "which devotes itself to the rendition of services linked to international commerce." And a "Commercial" User is defined as one "which devotes itself to the commercialization of merchandise to be destined for export beyond the national Customs territory, as well as to the reexport thereof without having undertaken activities that change the characteristics of products or alter the origin of the same." The Ministry of Economy is charged with authorizing the establishment of Free Zones, the operation thereof, and the installation and operation of Users therein. The law provides an application and qualification procedure initiated at the level of the Industrial Policy Directorate of the Ministry leading to the issuance (or denial) of an authorizing resolution by the Ministry within a set of specified time limits, but it does not provide for presumption of approval if such time limits are not met.

Article 21 of the law specifies the benefits available to Administrative Entities, which include:

"a) Total exoneration from all taxes, Customs duties, and charges applicable to the importation of machinery, equipment, tools, and materials destined exclusively for the construction of the infrastructure, buildings, and installations utilized for the development of the Free Zone . . .

"b) Total exoneration from Income Tax with regard to profits arising exclusively from its activities as Administering Entity of the Free Zone, for a period of fifteen (15) years . . . [but] Administering Entities domiciled abroad which operate in Guatemala shall not enjoy this exoneration if their country of origin grants them a [tax] credit for income tax they pay in Guatemala.

"c) Exoneration from the Unitary Tax on Real Property, which corresponds to the Central Government, for a period of five (5) years on the real property that is destined exclusively for the development of the Free Zone.

"d) Exoneration from the Tax on Sale and [Mortgaging?] of Real Property (acabala) destined exclusively for the development and expansion of the Free Zone.

"e) Exoneration from the Sealed Paper and Stamp Tax which falls upon the documents by means of which real property destined for the development and expansion of the Free Zone is transferred in favor of the Administering Entity.

"f) Exoneration from the [Stamp Tax] upon the documents by means of which real property is transferred to Users of the Zone. [and]

"g) Total exoneration of all taxes, Customs duties, and other charges applicable to the importation and use of fuel oil, bunker, butane and propane gas, as is strictly necessary for the generation of electrical energy utilized for the operation and rendering of services to the Users of the Free Zone, from the date of authorization of the operation of the same."

As previously indicated, the type of benefits granted to Users of the zones depends on the beneficiary class into to which they are qualified. Article 22 sets forth the benefits granted to Industrial and Service Users of the zone and says that:

"a) Machinery, equipment, tools, raw materials, inputs, semi-finished products, packaging, containers, components, and, in general, merchandise used in the production of goods or the rendition of services are not subject to taxes, Customs duties, and charges applicable to the importation [of the same] into a Free Zone.

"b) Total exoneration from Income Tax for profits arising exclusively from its activity as an Industrial or Service User of the Free Zone for a period of twelve (12) years . . . [but] Industrial and Service Users domiciled abroad who operate in Guatemala shall not enjoy this exemption if their country of origin grants them a tax credit for income tax they pay in Guatemala.

"c) Exoneration from the Value Added Tax on transfers of merchandise within or between Free Zones.

"d) Exoneration from the Tax on Sales or Mortgaging of Real Property (alcabala) located in

Free Zones in transactions with the Administering Entity or Users of the Zone.

"e) Exoneration from the [Stamp Tax] upon documents by means of which real property located within the Free Zone is transferred.

With regard to Commercial Users of the Free Zones, Article 23 provides the following benefits:

"a) Merchandise in general or components that are stored in a Free Zone for commercial purposes are not subject to taxes, Customs duties, and charges applicable to their importation into the Free Zone.

"b) Exoneration from the Income Tax for profits arising exclusively from [the conduct of] activities as a Commercial User of the Free Zone for a period of five (5) years . . . [but] Commercial Users domiciled abroad that operate in Guatemala shall not enjoy this exemption if their country of origin grants them a tax credit for Income Taxes they pay in Guatemala.

"c) Exoneration from the Value Added Tax on transfers of merchandise within or between Free Zones.

"d) Exoneration from the Tax on Sales or Mortgaging of Real Property (alcabala) located in Free Zones in transactions with the Administering Entity or Users of the Zone. [and]

"e) Exoneration from the [Stamp Tax] upon documents by means of which real property located within the Free Zone is transferred.

Article 24 provides that dividends or profits distributed [to shareholders or partners] by beneficiary companies shall be considered income exempt from the Income Tax. Article 25 provides that Industrial Users established in a Free Zone under the Free Zone regime may export a maximum of 20% of their total production therein to the National Customs Territory subject to tariffs applicable to products originating from without Central America, in which case also, any income attributable to such sales shall not be exempt from income tax. The law permits inter-zone transfers (Article 29) and provides in Article 30 that exports of goods and services from the National Customs Territory into the Zones shall be considered as definitive (final) exports to beyond the Central American Territory and that domestic exporters thereof may avail themselves of incentives granted under other export promotion laws (such as the Law for the Promotion and Development of Exporting and Maquila Activities hereinafter described).

Article 31 of the law establishes a temporary admissions regime under which merchandise can be exported temporarily from the National Customs Territory into Free Zones for up to six months for finishing, transformation, processing, or repair and reentered into the National Customs Territory exempt of duties or taxes thereon except for the value added within the Zone upon which applicable duties and taxes must be paid. Such transfers into a Zone do not require institution of a covering bond. Article 33 permits the temporary exportation of merchandise from a Free Zone into the National Customs Territory for up to six months for the purpose of finishing, transformation, processing, or repair but requires the institution of a bond or deposit covering any applicable duties or charges that would otherwise be applicable if it is not reexported into the Zone within the six months.

3.4.2 Export Promotion Law

Article 1 of Law 29-89 states the law has as its purpose "to promote, reward, and develop, within the national customs territory, the production of merchandise destined for countries beyond Central America as well as regulate the operation of export or maquila activities within the framework of the regimes for Product Enhancement or Export of Total National Value Added." The law is intended to reward exports of non-traditional products, excluding from eligibility for incentive benefits: coffee; cardamon; fresh bananas; cattle; beef; sugar; cotton; crude oil; and wood, among others.

Article 4 describes the basic entitlements under the Law: "Those enterprises shall enjoy benefits under this law, whose activities utilize national or foreign goods identifiable [as such] in their production processes as well as by-products, waste and scrap resulting from such processes. The law conceptualizes a number of activities or operational regimes upon the basis of which it establishes certain categories of activity "regimes" and related classes of beneficiaries. Article 3 contains the activity/operational regime definitions, which include the following:

> "a) Product Enhancement Regime. Customs regime that permits the entry into the national customs territory of merchandise from third countries [non-CACM] to be submitted to enhancement operations and destined for export beyond the Central American area as finished products without being subjected to customs duties and import taxes.
>
> "b) Maquila. The national value added generated by labor services and other resources involved with the production or assembly of goods . . .
>
> "d) Assembly. Activity involving the connection of parts, pieces, subunits or units integrated into resulting products with characteristics distinct from such constituents.
>
> "e) Export. The exit from the national customs territory, in compliance with legal procedures, of national goods or [that which has been imported subject to the Customs regime].
>
> "f) Waste or Scrap. That part [of production inputs] that has been destroyed or which is used up during finishing operations through evaporation, drying up, escape in the form of gas, water, etc.
>
> "g) Indirect Exporter. An enterprise [whose] economic activity involves the provision of goods, raw materials, semi-finished products, material, packaging or containers, to another enterprise qualified under this law, which incorporates the same into goods destined for export to nations beyond the Central American area.
>
> "h) By-product. A usable product obtained incident to the manufacture of another, primary product.
>
> "i) Scrap. Scrap means the shards, residue, waste, or leftovers of raw material utilized for the production or assembly of exported goods which have become unusable.

"j) Reexport. The exit from the national territory, in compliance with legal procedures, of foreign goods entered in the country but not nationalized.

"k) National Customs Territory. The Territory within which Customs exercises its jurisdiction and in which the provisions of tariff and national customs legislation are fully applicable.

Upon the basis of these conceptualizations, Article 5 of the law establishes four categories of Customs regimes which, in turn, define five classes of beneficiaries and their rewarded activities. The Customs regimes comprise:

"a) Temporary Admission Regime: That which permits receipt within the national customs territory, with suspension of customs duties, import taxes, and the Value Added Tax - VAT - of goods destined to be exported or reexported within a period of one year after having undergone assembly or transformation.

"b) Drawback Regime: That which permits, once export or reexport have been realized, receipt of reimbursement of customs duties, import taxes, and the Value Added Tax - VAT - paid on deposit which would [otherwise] have been imposed on goods entered, products obtained therein, or consumed in processing.

"c) Customs Replacement License Regime: That which permits an indirect exporter to import, free of customs duties and import taxes, replacement goods in a value equivalent to the customs duties and import taxes [previously] paid. This license shall be utilized to replace raw materials, semi-finished products, intermediate products, packaging, containers, and labels directly related to its production process.

"d) Total National Value-Added Components Regime: That which applies to enterprises which, within their production process, utilize entirely national or nationalized goods for the manufacture or assembly of products for exportation.

With specific reference to Maquila operations, Article 7 of the law defines the term as follows: "Maquila activity is understood, under the Temporary Admission Regime, to be that oriented to the production or assembly of goods which, in terms of their monetary value, contain a minimum of fifty-one percent (51%) of foreign merchandise, which are destined to be reexported to countries beyond the Central American area, as long as their temporary stay is guaranteed by means of a bond, a guaranty specifically authorized by the Minister of Public Finance, a bank guaranty, or by means of depositary receipts of warehouses authorized to operate as bonded warehouses and which [themselves] have undertaken a specific bond for this type of operations.

The five beneficiary classes established under Article 6 of the law include the following: (a) Maquiladora [operating] under the Temporary Admission Regime; (b) Exporter [operating] under the Temporary Admission Regime; (c) Exporter under the Drawback Regime; (d) Exporter under the Customs Replacement License Regime; and (e) Exporter under the Total National Value-Added Components Regime.

"Export activities under the Temporary Admission Regime" are defined in Article 8 as: "those oriented to the production of goods destined for export or reexport beyond the Central American area as long as the stay of temporarily-admitted merchandise is guaranteed by means of a bond, a guaranty specifically authorized by the Minister of Public Finance, a bank guaranty, or by means of depositary receipts of warehouses authorized to operate as bonded warehouses . . ." Article 9 defines "export activity under the Drawback Regime" as: "that oriented to the production and/or assembly of goods destined for export or reexport to countries beyond the Central American area, as long as the stay of temporarily-admitted merchandise is guaranteed by a deposit in cash [of applicable import duties and taxes]." Article 10 defines "export activity under the Customs Replacement License Regime" as: "that oriented to the production of merchandise destined for sale to exporting enterprises, which are integrated, incorporated, or aggregated into merchandise before being exported to markets beyond the Central American area." And Article 11 defines "export activity under the Total National Value-Added Components Regime" as: "that oriented to the production or assembly of goods destined for export to countries beyond the Central American area which utilize in their entirety national and/or nationalized merchandise." It is on the basis of these classes and their defined activities that benefits are accorded under the law.

Article 12 provides that enterprises operating as maquiladoras or exporters under the temporary Admission Regime shall enjoy the following benefits:

> "a) Temporary suspension of payment of customs duties and import taxes - including the Value-Added Tax - VAT - on raw materials, semi-finished products, intermediate products, materials, packaging, containers and labels necessary for the export or reexport of merchandise produced in the country . . . up to a period of one year from the date of acceptance of the respective import certificate. [The period can be extended for up to another year].
>
> "b) Temporary suspension of customs duties and import taxes - including the Value-Added Tax - VAT - on samples, engineering plans, instructions, patterns, and models for the production process or for purposes of demonstration, investigation, or instruction, up to a period of one year . . . [also extendible] . . .
>
> "c) Total Exoneration from the Income Tax with regard to profits obtained or arising exclusively from the export of goods that have been processed or assembled in the country and exported beyond the Central American area. Such exoneration shall be granted for a period of ten (10) years . . . [except that] persons . . . domiciled abroad that have branches, agencies, or permanent establishments that operate in Guatemala and export merchandise originating in export and maquila activities shall not enjoy the exoneration from income tax if their country of origin grants a tax credit for income tax paid in Guatemala.
>
> "d) Temporary suspension of customs duties and import taxes - including the Value-Added Tax - VAT - on machinery, equipment, parts, components, and accessories necessary to the production process . . . for a period up to a year . . .[extendible] . . .[if provided for in the qualifying resolution issued by the Ministry of Economy].
>
> "e) Total exoneration from customs duties and import taxes - including the Value-Added Tax - VAT -on the importation of machinery, equipment, parts, components, and accessories necessary to the production process . . .[if provided for in the qualifying resolution issued by the Ministry of Economy] [and]

"f) Total exoneration from ordinary and/or extraordinary export taxes."

Article 13 provides Drawback Regime exporters with: (a) "reimbursement of customs duties, import taxes, and the Value-Added Tax - VAT - that have been paid on deposit to guarantee the entry of raw materials, semi-finished products, intermediate products, materials, packaging, containers and labels, utilized in the production or assembly of exported merchandise"; (b) "Total exoneration from Income Tax on profits obtained from or arising exclusively from, the export of goods that have been manufactured or assembled in the country and exported beyond the Central American area"; and (c) "total exoneration of ordinary and/or extraordinary export taxes." Article 14 provides that exporters operating under the Customs Replacement License Regime can obtain duty-free replacement of imported inputs upon which they have previously paid applicable duties and taxes up to the value thereof. Finally, Article 15 provides that exporters operating under the Total National Value-Added Components Regime, may receive:

> "a) Total exoneration of customs duties and import taxes - including the Value-Added Tax VAT - on the importation of machinery, equipment, parts, components and accessories necessary for the production process...
>
> "b) Total exoneration from the Income Tax of profits obtained from or arising exclusively from the export of goods beyond the Central American area . . . for a period of ten (10) years . . .[except that] persons . . . domiciled abroad that have branches, agencies, or permanent establishments that operate in Guatemala and export merchandise originating in export or maquila activities, shall not enjoy the exoneration from Income Tax if their country of origin grants them a tax credit against income tax paid in Guatemala." [and]
>
> "c) Total exoneration from ordinary and/or extraordinary export taxes."

Article 19 anticipates that and allows an enterprise to qualify itself under more than one of the beneficiary categories in terms of their activities or the regime under which they operate, but provides that such multiple activities shall not trigger duplication of benefits.

3.4.3 General Depositary Warehouses

The study elicited that, from about 1988 through 1992, there was a significant expansion of export apparel assembly operations in Guatemala, most of which did not take place under either of the laws just described. According to information received, most maquiladoras operate under the Law Governing General Depositary Warehouses (cite unavailable) which permit the importation of constituent goods under the general operating bond established by the warehouse with Customs. Even though the goods may be in the physical custody of the apparel maker whose operations are lodged in the warehouse, the warehouse itself retains responsibility for their reexport or payment of applicable duties and taxes.

According to information assembled on Guatemala, "General Depositary Warehouses" are enterprises whose purpose is the deposit, conservation, custody, management and distribution, and brokerage of merchandise or products of national or foreign origin [stored therein] and the issuance of negotiable title or credit instruments [thereto or based thereon]. Their operations may extend to specific individual merchandise or products; generically designated products (fungible items) as long as they are homogeneous, accepted, and traded in commerce; merchandise or products undergoing production or transformation; and merchandise or products which, although not yet received in storage facilities, are in secured transit thereto. Regulated by the Superintendency of Banks and the Monetary Board, one of the principal requirements for qualification as such is that they meet the minimum requirements for maintenance of value, security, and health.

3.5 Honduras

Honduras' original legislation authorizing Free Zones dates back to the 1970s. Its current legal framework for export promotion basically involves two specific laws: (a) the Law creating Industrial Export Processing Zones and Tourism Free Zones (Zonas Industriales de Procesamiento para Exportaciones or "ZIPs" and Zonas Libres Turísticas or "ZOLTs), Decree Law No. 37-87 of April 7, 1987 as amended by Decree Law 84-92 and (b) the Temporary Importation Regime established by Decree No. 37 of December 20, 1984, approved by Decree No. 8-85 of the National Congress as amended by Legislative Decree Law No. 190-86 of October 1, 1986. Honduran investment promotion literature suggests the existence of a Free Zone Law, but copies of such a law or information on it appear unavailable.

3.5.1 ZIP Law

Decree Law No. 37-87 created the Industrial Processing Zones (ZIPs), private enterprise operations, defined in Article 2 of the law as: "geographical areas of the national territory approved and delimited by the Executive Power by the Secretary of State for Economy and Commerce, placed under the fiscal supervision of the State and without resident population, created with the object of promoting, by means of the utilization of local hand labor, industrial manufacturing and services oriented exclusively toward exports, promoting the establishment and operation of a zone of industrial enterprises basically engaged in exportation and support services for industrial activities, whose purpose is the warehousing of goods and services within the zone under the regime established by this law."

Under Article 3, goods and merchandise imported or exported to or from the ZIPs benefit from the total exemption from payment of customs duties, consular duty charges and surcharges, internal consumption taxes, production and sales taxes, and other imposts as well as from state and municipal sales and production taxes on production generated within the ZIP and on real property and industrial and commercial establishments of the same. Merchandise that has been manufactured or transformed in a ZIP may be imported for definitive use or consumption in the country whenever there is no national production of the same upon payment of the corresponding customs duties and taxes. Goods of Honduran origin entered directly from Honduras into a ZIP which have thereafter undergone manufacture or transformation, may be exported free of any duties, taxes, or other imposts. Users of a ZIP may grant manufacturing contracts to other natural or juridical persons, national or foreign, located in other parts of the national territory. In such cases, they may enter goods from the ZIP temporarily into the national territory for use in the manufacturing process subject to the Temporary Importation Regime currently in effect (described below).

ZIP operators enjoy the following benefits: (a) importation free of customs duties, charges, surcharges, internal consumption taxes, consular fees, and other fees or taxes related, directly or indirectly, with customs operations on the entry of all imported goods utilized or incorporated exclusively for the development of the ZIP, including construction materials, equipment, spare parts, machinery and office equipment whenever these goods are not produced in the country . . .; (b) Exemption from the Income Tax for 20 years and from municipal taxes for ten years. The income tax exemption is not available to foreign companies whose countries of origin allow a tax credit or deduction for income tax paid in Honduras. The ZIP law is supplemented by a Regulation issued by the Presidency, the Regulation for the Law Constituting Industrial Export Processing Zones, Act No. 684-87 of July 31, 1987. Seven ZIPs are now in operation. What is extraordinary about the ZIP law is that it appears to apply only to operators of the zones and not to users so that there are no benefits under the ZIP law to induce users to invest and operate in such zones.

3.5.2 Free Zone Law(s)

As indicated previously, Honduran investment and export promotion literature suggests the presence of a Free Zone Law. According to such literature, "A special law has been established for export companies (apart from the ZIP law) operating in government Free Zones which provides the following benefits: [a] no import or export duties for material, equipment, office supplies, etc., required by the manufacturing plant; [b] companies are exempt from income tax, city and country taxes; [and][c] 100% repatriation of currency is permitted." According to the promotional literature, Government-owned Free Zones have been established in the cities of Puerto Cortes (see following), Omoa, Choloma, Tela, La Ceiba, and Amapala.

The Government of Honduras established and owns the Puerto Cortes Free Zone under Decree No. 356 of July 19, 1976. Commercial and Industrial enterprises may establish export and related activities in the Zone under the provisions of that Decree. Entry of merchandise into the Puerto Cortes Zone is exempt from payment of any class of customs taxes, charges, surcharges or consular fees, etc., related to its importation or exportation. Profits from operations of enterprises established in the Zone are exonerated from payment of income tax. Among the activities authorized to be undertaken in the Zone are: introduction, withdrawal, storage, manipulation, packaging, unpacking, exhibition, purchase, sale, pledging, manufacturing, mixing, transformation, refining, distilling, cutting, and, in general, any class of activities involving merchandise, products, and raw materials with the exception of the manufacture or export of articles prohibited under the law.

3.5.3 Temporary Admission Law

The Temporary Admission Regime was enacted to establish a mechanism for promoting exports for companies operating outside ZIPs or Free Zones which export 100% of production beyond Central America. The law permits temporary admissions of inputs with the suspension of payments of applicable duties and taxes. Article 1 of the law provides that the temporary regime covers:

> "a) Raw materials, semi-finished goods, packaging and other goods when these are assembled, transformed, modified, or physically incorporated into products [then] exported to other than Central American countries.
>
> "b) Machinery, equipment, tools, parts and accessories, if used exclusively for assembling, transforming, modifying, or producing articles destined for export to other than Central American countries.

"c) Samples, instructions, patterns, and models necessary to further the production of procedures and designs required in the international market and for purposes of demonstration, research or instruction."

Article 2 of the law, however, requires the posting of a bond with the Customs to cover the duties and taxes suspended and provides that, if such goods are entered within the local market or elsewhere in Central America, in addition to forfeiture of the bond, there will be imposed on the beneficiary a fine equivalent to 100% of the duties and taxes otherwise payable. Certain exclusions to the products that may be entered under the temporary regime are set forth in the Regulation subsequently issued to implement the law (Reglamento al Régimen de Importación Temporal, Action No. 174/85 of February 20, 1985 as substituted for by Action No. 545-87 of 1987). Article 23 of the current Regulation provides that the temporary regime does not include "raw materials of agricultural, sylvan, livestock, or marine origin which are produced within the country in adequate conditions and which are used in the production of exportable products." Article 1 b) of the law does provide, however, that, with prior authorization, "machinery, equipment, tools, parts and accessories that have been imported under the [Temporary Admission] Regime may be freely sold [in the country]after five year's use from the date of temporary admission, upon payment of the General Sales Tax and the 5% Customs administrative service fee."

As to incentives granted, Article 5 of the law provides that "Profits arising from the exportation under this Regime shall enjoy total exoneration from the Income Tax for a period of ten years from the date of the initiation of exportable production as long as the enterprise meets the following requirements: (a) it must be an industrial enterprise and (b) its entire production must be exported to other than Central American countries and generate direct employment." Like most such laws, it provides that foreign companies may not utilize the exemption from income tax if their country of origin permits them to credit or deduct taxes paid in Honduras. The law does not, however, exempt from municipal taxes. Article 6 provides that the beneficiaries of the Temporary Admission Regime law may not, at the same time, avail themselves of other export development laws (essentially the ZIP law).

4.0 PROBLEMS PRESENTED BY CURRENT SALVADORAN LAWS

4.1 Problems Presented in General

The purpose of this study is to determine what problems there may be with the content or application of the three laws focused upon in the study and upon this determination to suggest changes in or replacement of such laws. The review suggests there are problems in terms of the scope and content of El Salvador's foreign direct investment legal/regulatory regime and a number of problems arising out of its export promotion laws. Some of the problems identified arise out of the convergence of impacts flowing from all three laws.

4.2 Salvador's FDI Regime

The third paragraph of the Promotion/Guaranty Law's introductory premises provides that "It is indispensable to guarantee to foreign investors the legal safeguards for adequate protection of their investments." And, in Chapter IV, the Law guarantees the: (a) free remission of net profits generated by such investments; (b) free remission of amounts arising from liquidation thereof; (c) free transferability of such investment within the country; and (d) free remission of net capital earnings from such transfers.

As written, the Law presents both specific and general concerns. Addressing the specific concerns first, the most important of these is that the law fails, among its various guarantees, to accord foreign investors National treatment. "National" treatment means that an FDI host country will treat investments from another country and investors from such other country, at least as favorably as the most favorable treatment it accords investments by its own nationals and companies in the same circumstances, i.e., non-discriminatory treatment. Although it appears that, on an operating basis, the GOES does generally extend national treatment, explicit provision for such treatment in any FDI code or FDI-specific law is considered standard in international practice. Moreover, the United States has established the provision of National treatment or Most Favored Nation treatment, whichever is better, as a requirement for any Bilateral Investment Treaty (BIT) it negotiates with nations under its so-called "model BIT". In this regard, Most Favored Nation treatment means that an FDI host country will treat investments by another country's nationals and companies at least as favorably as the most favorable treatment it accords investments by those of any third country in the same circumstances. In the United States' model BIT, this requirement for non-discriminatory treatment (e.g., the better of National or Most Favored Nation treatment) applies both to the initial establishment of an investment as well as to all post-establishment investment and related activities. It should also be noted that the "Investment" Chapter of the NAFTA Agreement (to which El Salvador presumably aspires to accede or, at least, receive "Parity" treatment) establishes National Treatment and MFN treatment as requirements for the Parties thereto. For example, Article 1102 of the NAFTA Agreement provides that:

> "Each Party shall accord to investors of another Party treatment no less favorable than it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

Article 1103 of the Agreement provides that: "Each Party shall accord to investors of another Party treatment no less favorable than it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to . . ."etc. With respect to the overall standard of treatment, Article 1104 provides that: "Each Party shall accord to investors of another Party and to investments of investors of another Party the better of the treatment required by Articles 1102 and 1103."[Emphasis added.]

There are reasonable foreign investor concerns with regard to the lack of guaranty for National treatment. Salvadoran FDI law establishes a number of sectoral restrictions that do not accord with general international practice of limiting sectoral restrictions on FDI to national security-related areas. For example, both Article 115 of the Political Constitution of El Salvador and Article 5 of the Promotion/Guaranty Law prohibit foreign investment in small commercial and industrial enterprises and enterprises engaged in rendering services (see discussion under the section of the Promotion/Guaranty Law). Moreover, the Promotion/Guaranty Law prohibits FDI entirely in certain aspects of fishing activities, while Article 110 of the Constitution provides that only the State may provide Postal and Telecommunications services. As to the latter, it appears that, under Article 2 of the Law for the National Administration of Telecommunications, the prohibition of FDI extends to telephone, telegraph, radiotelephone and radiotelegraph communication services. Finally, Article 120 of the Constitution appears to require that concessions granted by the State for the operation of wharves, trains, canals, and certain other material forms of public service must revert after 50 years to the State without compensation. Generally, U.S. policy views efforts by governments to restrict foreign direct investment except in internationally-recognized national security sectors as a form of nontariff barrier to trade.

Secondly, Article 15 of the Promotion/Guaranty Law provides, among the guarantees for foreign investors, "a) free remission of net profits generated by such investments", but then goes on to provide that "Nevertheless, in the case of investments made in commercial and service activities, of net profits obtained in any year, they may remit only up to 50% of registered investment." This provision only deepens foreign investor concern over the sectoral prohibition on FDI in small commercial and service enterprises discussed above. Moreover, standard international practice suggests that all transfers related to profits arising out of approved investments should be permitted rather than restricted. The U.S. model BIT provides that no substantive restrictions on repatriation may be applied to foreign firms.

Another specific concern identified with the Promotion/Guaranty Law arises out of its dispute resolution provision. Article 21 of the Law provides that: "In the event of a dispute or difference between the State and foreign investors relating to their foreign investments, the parties may submit the decision to the Conciliation and Arbitration Tribunal contemplated by the Agreement on Differences Relating to Investments between States and Nationals of Other States . . ." (otherwise known as the "Washington Convention"). The only reference to the Convention in Article 21 is specifically to the Conciliation and Arbitration Tribunal, but the language of the article appears to ignore and not authorize the possibility of submitting disputes to conciliation and arbitration panels of the International Center for Settlement of Investment Disputes (ICSID) established under Article 1 of the Convention or to the Conciliation Commission established under Article 29 thereof. This appears to bar resort to any arbitration and/or conciliation procedures provided for in the Convention other than those before the Tribunal, which is a more "litigation" intensive form of arbitration than is the case with the ICSID or the Commission. In this regard, the U.S. model BIT requires each party thereto to consent to the submission of investment disputes to the ICSID as well as to the Tribunal.

In the area of "intangible property" there appears to be an inconsistency within the Promotion/Guaranty Law. Article 14 provides that "Foreign investors are guaranteed that nothing shall obligate them to <u>change or renegotiate</u> the terms of any private agreement or contract relating to intangible property during the term stipulated therein." But Article 28 states that "In those cases involving contracts for intangibles for undefined terms, such <u>should be renegotiated</u> to establish a specified term therefor." There seems no rational purpose from the point of view of the State to require renegotiation of indefinite contracts (although, in fact, they do not seem to be in the interest of any foreign licenser of intangible property). Nonetheless, the inconsistency should be eliminated.

There are a number of areas in which there should be guarantees built into the Promotion/Guaranty Law that do not appear in the Law. Of these, the most important has to do with the occurrence of expropriation and its remedies. International practice requires - as does the model U.S. BIT - that a host country's FDI regime should include and apply certain standards in the event of expropriation or "nationalization". These include that: (a) there be a public purpose therefor; (b) that the expropriation be effected under concepts of due process of law (including prompt review thereof by administrative and/or judicial authorities); (c) that it be undertaken on a non-discriminatory basis; and (d) that it be accompanied by prompt, adequate, and effective compensation. The U.S. model BIT adds more detailed provisions relating to compensation e.g., that the compensation be equivalent to the fair market value of the investment before the expropriation; that it be paid without delay; that it include interest at the applicable commercial rate from the date of expropriation; and that the form of compensation be freely transferable at the market rate of exchange on the date of expropriation. A second problem is that, although Article 15 paragraph a) provides for free remission of net profits from investments, the Promotion/Guaranty Law says nothing about the taxation (or exemption from or rate thereof) and/or withholding affecting profits remissions, an area of major concern to most foreign investors (but which may be covered in Salvadoran tax laws). Still another concern is that the Promotion/ Guaranty Law contains no provisions guaranteeing the right of foreign investors to introduce into the country such expatriate managerial and technical personnel as necessary for the proper management and operation of their enterprises.

Finally, there are certain, more general concerns about the Promotion/Guaranty Law and the FDI regime it establishes for El Salvador. Under guidelines that have been developed by a committee of the World Bank, International Monetary Fund, and the Multilateral Investment Guaranty Agency, there are essentially two types of investment regimes, "open investment regimes" and "authorization or approval regimes" (considered "closed" regimes). Open investment regimes impose no stated special restrictions on entry (e.g., prior approval, discretionary approval or registration) and no special constraints (sectoral, geographical) beyond basic, internationally-recognized public order considerations. "Open" regimes usually provide that investments may be "freely made" subject only to specific provisions necessary to safeguard public health, morals, the environment, and collateral requirements for business organization and establishment. "Authorization or approval" regimes require all or most foreign investors and all or most types of FDI to obtain prior authorization for entry of the investment. Authorization/approval regimes can be divided into two basic subtypes: "high discretion" and "limited discretion", reflecting the degree and parameters of discretion accorded public officials to examine, authorize, register, and regulate FDI. "Limited" discretion regimes confer clearly defined criteria or limits to the exercise of discretion by public officials in administering investment regimes, for instance, specifying narrow terms on which authorization or approval may be deemed or providing for appeals of preliminary decisions. "High" discretion regimes typically involve provisions that restrict FDI to certain geographical or sectoral areas or impose certain performance requirements (see later discussion) as conditions for authorization or approval.

Despite the Promotion/Guaranty Law's imposition of time limits for administrative action and its establishment of a presumption of registerability, the Law provides no specific, explicit, certain criteria that can be known in advance by prospective foreign investors and regarding which the Ministry of Economy is to "consider" the "nature, value, origin, destination, and date of entry of such investment." Moreover it conditions the administrative time limit for approval/registration of 30 days set forth in Article 11, clause three, on compliance by the applicant with any requests for further information that may be received from the Ministry, an open-ended possibility that bureaucrats around the world have often utilized to avoid or prevent substantive consideration of a proposed investment. Given (a) the effective requirement for "approval" of a proposed investment via "registration"; (b) the lack of explicit criteria for such approval/registration; and (c) the sectoral restrictions on FDI, El Salvador's current FDI legal regime would have to be characterized still as essentially "Closed/High Discretion" regime. The imposition of performance requirements, while not authorized in the Promotion/Guaranty Law, does occur in a related law that has served to induce most new FDI in El Salvador, the Law Governing Free Zones and Bonded Warehouses.

4.3 Export Subsidies

El Salvador's Free Zones/Bonded Warehouse law provides certain fiscal incentives to both Free Zone/Bonded Warehouse developers and/or operators of Free Zones and users of both Free Zones and Bonded Warehouses.. These incentives include: (a) total exemption from the Income Tax; (b) total exemption from "fiscal imposts upon . . . assets or property"; (c) exemption from stamp taxes; and, in the case of users, (d) total exemption from taxes imposed upon imports of machinery, equipment, etc., and (e) "free importation" into the Free Zones of raw materials, parts. . .", e.g., exemption from customs duties thereon. El Salvador's Export Reactivation Law provides a number of incentives to various classes of beneficiaries, but most of which involve: (a) "refunds" of a percentage of the value of exports "as compensation for import taxes . .paid"; (b) exemption from stamp taxes and "any other indirect taxes" in connection with generating exports; and (c) exemption from property taxes "in a percentage equal to the exported value . . .". In the case of the former Law, the incentives are available only to those users who export 100% of their production in either a Free Zone or a Bonded Warehouse, while in the latter Law, the incentives are available only to those who export either all or a portion of their production up to the extent of the percentage their exports bear to their total production. In both cases, the incentives are premised directly on exports and export generation.

This raises the question whether these fiscal-related exemptions constitute subsidies of a type that contravene basic international rules governing global trade or otherwise are inconsistent with international arrangements for such trade.

Article XVI of the General Agreement on Tariffs and Trade (GATT), the basic framework for regulating international trade among GATT "Contracting Parties", was amended in 1955 to deal with the problem of "subsidies". As amended, Article XVI, Paragraph Three provides that "the Contracting Parties hereto will no longer grant any direct or indirect subsidy, of any nature, for the export of any product other than a primary product. . .". In 1979, in the so-called "Tokyo" Round of GATT-sponsored multilateral trade negotiations, the Contracting Parties concluded the Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade (Relating to Subsidies and Countervailing Measures)" (hereinafter, the "Tokyo Round Subsidies Code"). That code, considered as supplementing and interpreting - rather than replacing - the subsidies provisions of the GATT itself, provides the basic international rules on subsidies that govern at this moment.

Article 8, paragraph 2 of the Tokyo Code provides that "Signatories agree not to use export subsidies in a manner inconsistent with the provisions of this Agreement." Article 9 of the Tokyo Round Code provides that "Signatories shall not grant export subsidies on products other than certain primary products." Article 10 Paragraph 3 provides further that "Signatories further agree not to grant export subsidies on exports of certain primary products to a particular market in a manner which results in prices materially below those of other suppliers to the same market." So the first question is whether the fiscal incentives made available under the Free Zones/Bonded Warehouses and Export Reactivation Laws constitute "export subsidies". But the Code does not, as such, explicitly define the terms "subsidy" or "export subsidy". Instead, Article 9, paragraph 2, simply provides that: "The practices listed in points (a) to (l) in the Annex are illustrative of export subsidies." However, among the "practices" enumerated in the Illustrative List of the Annex, may be found:

"(a) The provision by governments of <u>direct subsidies</u> to a firm or an industry contingent upon <u>export performance.</u>

"(b) Currency retention schemes <u>or any similar practices which involve a bonus on exports</u>. . .

"(e) The full or partial <u>exemption</u>, <u>remission</u>, or deferral <u>specifically related to exports,</u> of <u>direct taxes</u> . . . paid or payable by . . . enterprises.

"(g) The exemption or remission in respect of the production and distribution of exported products, of <u>indirect taxes</u> in excess of those levied in respect of . . . like products when sold for domestic consumption. . .

"(i) The remission or drawback of import charges in excess of those levied on imported goods that are physically incorporated. . . in the exported product. . .

"(l) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of the General Agreement." (emphasis added)

The Annex is footnoted to provide certain subsidiary definitions to be used in understanding the "practices" described therein. For instance, footnote <u>1</u>/ defines "Direct taxes" as "taxes on wages, profits, interest, rents, royalties, and all other forms of income, and taxes on the ownership of real property" (this would include El Salvador's exemptions from income and asset/property taxes). It also defines "import charge" to mean "tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports" (this would appear to include El Salvador's customs duties <u>and</u> import taxes), and defines "indirect taxes" as "sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes, and all taxes other than direct taxes and import charges" (which would appear to include the "other charges" in the exemption rubric, e.g., stamp or Value-Added taxes). So, at least for those non-primary, non-traditional products whose exports qualify the beneficiaries thereof for the fiscal incentives accorded under either the Free Zones/Bonded Warehouses Law or the Export Reactivation Law, it seems clear that such incentives constitute "direct subsidies" of a sort that appears to violate Article 9 of the Tokyo Round Code.

But Part III of the Code provides an "affirmative defense" to such violations. Article 14, paragraph 1 states that the "Signatories recognize that subsidies are an integral part of economic development programmes of developing countries" and so, in paragraph 2 thereof, provides that "this Agreement shall not prevent developing country signatories from adopting measures and policies to assist their industries, including those in the export sector", subject to certain conditions. Paragraph 5 of Article 14 also states that "a developing country signatory should endeavor to enter into a commitment to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with its competitive and development needs." What is unusual about the Tokyo Round as a form of international "discipline" on subsidies, however, is that it contains no procedures to deal with countries that deviate from their commitments. Moreover, from the standpoint of El Salvador's laws, if it were a signatory to the Tokyo Round Code [which it isn't], it could, in any case, shield its direct export subsidies from sanctions thereon under the GATT under the "affirmative defense" exemption provided for in Article 14. This would appear to be the case <u>for the moment.</u> But, in fact, since it isn't a signatory to the Tokyo Round Code, it technically isn't bound by the Code's provisions.

But hat will change, however, because, in the just completed and just signed Uruguay Round of multilateral trade negotiations, the members of GATT have concluded a new Agreement on Subsidies and Countervailing Duties (hereinafter, the "Uruguay Round Code") that supersedes and replaces the Tokyo Round Code and which is considerably more specific about the definition and uses of export subsidies. For instance, Article 1 of the Uruguay Round Code, defines "subsidy" in the following terms: " . . . a subsidy shall be deemed to exist if:

> "(a)(1) there is a financial contribution by a government or any public body . . . where:
>
> (ii) government revenue that is otherwise due, is foregone or not collected (e.g., fiscal incentives such as tax credits);
>
> and
>
> (b) a benefit is thereby conferred."

Article 2 provides some rules relating to the "specificity" of subsidies. Paragraph 2.1 (a) provides that "Where the granting authority, or the legislation pursuant to which the granting authority operates. explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific," and paragraph 2.2 then goes on to provide that "a subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction ot the granting authority will be specific." Article 3.1 then states a prohibition, e.g., " . . . the following subsidies . . . shall be prohibited:

> "(a) subsidies contingent, in law or in fact, whether solely or as one of several conditions, upon export performance, including those illustrated in Annex I."

The Annex to the Uruguay Round contains the same illustrations quoted above in explanation of the Tokyo Round Code. What is different about the Uruguay Round Code, however, is that, unlike the Tokyo Round Code, it contains no provision or language explicitly <u>exempting</u> developing countries from the coverage and prohibition on subsidies of the earlier code and it provides an effective <u>enforcement</u> or sanction procedure under the new, mandatory dispute resolution provisions. According to a U.S. Government trade official's testimony before the U.S.Congress, "the strict new disciplines and effective new dispute settlement system of the [Uruguay Round] Subsidy Agreement will apply to <u>all</u> 117 members of the World Trade Organization" (the successor "organization" to the GATT) [emphasis added], and, in particular,

> "Multilateral subsidy disciplines will be introduced for developing countries (another first) . . . Developing countries were virtually exempt from the 1979 Subsidies Code and the Code provided no incentive for them to bring their subsidy practices into conformity. Given that the Uruguay Round package must be accepted as a 'single undertaking' <u>all World Trade Organization members will be subject to a framework for the elimination of their export subsidies</u>. [Emphasis added].

The North American Free Trade Agreement (NAFTA) - to which most member countries of the CACM and many other Latin countries aspire to become parties, or to receive so-called "NAFTA parity" treatment - also contains certain provisions that deal with subsidies. First, Article 304, paragraph 1, provides that:

> "Except as set out in Annex 304.1, no Party may adopt <u>any new waiver</u> of customs duties, or expand with respect to existing recipients or <u>extend to any new recipient</u> the application of an existing waiver of customs duties, where the waiver is conditioned explicitly or implicitly, on the fulfillment of a performance requirement" (emphasis added).

Article 304, paragraph 2, goes on to add that: "Except as set out in Annex 304.2, no Party may , explicitly or implicitly, condition on the fulfillment of a performance requirement the <u>continuation</u> of any <u>existing</u> waiver of customs duties." [Emphasis added.] The term "Performance Requirement" as defined in Article 318 includes a requirement that "(a) a given level or percentage of goods be exported." The Annexes referred to effectively "grandfather" "existing Mexican waivers of customs duties" except that Mexico may not "(a) increase the ratio of customs duties waived to customs duties owed relative to the performance required under any such waiver; or (b) add any type of imported good to those qualifying [therefor]. . ." With regard to existing waivers, Annex 304.2 permits Mexico to continue to condition waivers of customs duties on the fulfillment of performance requirements before January 01, 2001, but not thereafter. It should also be noted that the Uruguay Round agreement on Trade Related Investment Measures (TRIMs) addresses export-related performance requirements. The Final Draft included an "illustrative list" of proscribed TRIMS, which included: "export performance requirements."

Article 19 subparagraph b) of the Salvadoran Free Zones/Bonded Warehouses Law provides users of Free Zones and Bonded Warehouses "Free importation" into the Free Zones of raw materials, parts, etc., necessary for the execution by the enterprise of the activities rewarded. We take this to mean "free of customs duties" or, in essence, a waiver thereof. The waiver is clearly conditioned upon the fulfillment of a performance requirement, e.g., it is available only to users of the Free Zones/Bonded Warehouses, who must, by definition in the law, export 100% of their production in such areas.

Article 303 of the NAFTA also provides certain rules regarding the refund of duties paid. Article 303, paragraph 1 provides, in pertinent part, that:

> ". . . no Party may <u>refund</u> the amount of customs duties paid, or waive or reduce the amount of customs duties owed, on a good imported into its territory, on condition that the good is:
>
> "(a) subsequently exported to the territory of another Party,
>
> "(b) used as a material in the production of another good that is subsequently exported to the territory of another Party . . .
>
> "in an amount that <u>exceeds</u> the lesser of the total amount of customs duties paid or owed on the good on importation into its territory . . ." (emphasis added).

This refers basically to a type of "drawback" situation in which customs duties or import taxes, once paid, are "rebated" or "refunded" upon the reexport of the covered items. In various places in the

Salvadoran Export Reactivation Law (Articles 3(a), 5, 7 paragraphs 1 and 3), incentives are accorded to exporters in a percentage (formerly 8%, now 6%) of the FOB value of the exports "as compensation for import taxes . . . paid . . ." This would not appear to violate Article 303 of the NAFTA (if, of course, El Salvador were a party - or to become a Party - or to receive NAFTA Parity treatment with application of NAFTA rules) if it were clear the refund was not in an amount in excess of the import taxes paid. However, the Export Reactivation does not relate the refund (6% of the FOB value of the export) strictly to the import taxes paid, so that, it is possible that the refund could actually exceed, admittedly by a small percentage, such import taxes, which would violate Article 303 of the NAFTA.

Finally, it should be noted that there is, at least an indirect relationship here to El Salvador's continuing status as a beneficiary country under the Caribbean Basin Initiative (CBI) to be considered, especially in view of its effort to achieve NAFTA "parity". Under the U.S. Caribbean Basin Economic Recovery Act, in addition to other mandatory conditions for designating CBI beneficiary countries, the U.S. President is also required to take into account "generally" "the degree to which the country follows accepted rules of international trade under the GATT" and, more specifically, "the degree to which the country uses export subsidies or imposes export performance or local content requirements which distort international trade."

The point to this discussion of Salvadoran legal provisions in the context of the GATT, NAFTA, and even CBI, is to note that the United States has always had a concern about the non-primary product export subsidies of foreign countries, even developing countries, and has been the most aggressive proponent of prohibiting and sanctioning such subsidies in the GATT and other international trade fora. U.S. officials have already indicated their belief that developing nations are not necessarily shielded from the explicit prohibitions on export subsidies contained in the Uruguay Round Code as they were under the Tokyo Round Code. They have also indicated that the provisions of the NAFTA, although they may constitute "ceiling" standards for the current Parties thereto, are in effect, only "floor standards" as to any other nations that may be considered for accession thereto, in the sense that the United States is likely to enlarge upon and demand even higher standards than those incorporated into the NAFTA.

So it is entirely likely that, at such time as El Salvador, either on its own, or as a member of the CACM, seeks accession to the NAFTA, or even a less broad scope of NAFTA Parity treatment, it may find itself confronting U.S. demands for eliminating the use of direct export subsidies and even some indirect subsidies as the price of admission to either the NAFTA or NAFTA Parity treatment. For this reason, it seems wise at least to consider the future relevance and meaning of such subsidies to possible negotiations and their elimination to hasten and reduce the areas of confrontation in advance thereof. El Salvador, the most recent Central American country to employ free zones, has the least to lose in reforming its own trade regime away from export subsidies. In this regard, El Salvador historically has been a leader in proposing economic integration initiatives in Central America, having launched its first proposal for a free trade agreement with Honduras in the second decade of this century. Its willingness to reform its trade regime to conform with global standards would position it once again to assume leadership of initiatives for Central American economic integration as well as of the effort to achieve accession to the NAFTA or other form of liberalized trade ties with North America.

The next question presented is: "what sort of regimen or scheme of incentives is permissible or likely to diffuse U.S. and other foreign objections to the current Free Zones/Bonded Warehouses Law and the Export Reactivation Law-based export promotion regime?" In effect, what kind of legal/regulatory regime will further the Salvadoran Government's goals for increased exports without creating problems for it in the present or future? To answer these questions, we must look at the concept and function of Free Zones.

4.4 Free Zones: Uses and Issues

4.4.1 Concept and Uses

The concept of extending certain tariff-related privileges to international traders to facilitate the handling of merchandise moving among nations by putting them in secured locations goes back to the Roman era. Later, a number of European trading city-states established so-called "free ports" located within their larger municipal units to facilitate the receipt and exit of such goods and, more importantly, in between these, the storage or other handling of such goods free of tariffs. In the modern context, "free zones" may be defined as areas in or adjacent to ports of entry into a nation's customs territory, which are treated as being "outside" such customs territory (a legal fiction) for trade and operational activities such as lading, unlading, sale (other than retail), storing, grading, labeling, cleaning, manufacturing, assembly, or processing, packaging, and exhibiting of goods thereafter either to be entered into the customs territory or exported to the customs territories of other nations. Essentially, the function of a Free Zone is to allow for foreign or domestic merchandise to be brought into a zone for storage or handling, with the zone operator legally responsible for the customs security of the goods while in the zone in accordance with the customs laws and regulations of the country involved. From the time the merchandise is entered in the zone until it is removed or destroyed, the supervision of and accounting for it is accomplished through forms of secured inventory control.

The basic utility of a Free Zone is that it allows a trader to deal in goods without having to pay either import or export taxes until they are in a more desirable stage, or fit within a more desirable schedule, for entry or exit. For example, importers intending to develop a domestic market in a given country for foreign merchandise, may hold it "offshore" in a zone for display or storage, until the market is established or favorable. By retaining inventory offshore, they can avoid having to bear the cash flow costs of applicable tariffs until such time as its entry into the customs territory becomes commercially feasible. Merchandise whose import or export is subject to import or export quota (as, for example, textiles and apparel under quotas negotiated bilaterally within the framework of the Multifibre Agreement) may be stored offshore to avoid exceeding an applicable quota or to take advantage of more favorable quotas in the future. These storage/warehousing options and the security regimes under which they operate, are essentially similar to the uses and regimes for Bonded Warehouses (a commercial device that also has a number of domestic uses as well) except that they operate under a "Customs" security regime reflecting concepts of international transactions rather than domestic transactions. Generally speaking, though, Bonded Warehouses only deal in the secured <u>storage</u> of merchandise.

Free Zones, on the other hand, provide a broader range of uses accommodating the particular conceptual requirements of international traders. One of the most significant benefits of a Free Zone for a country's importers is to permit them to bring into the zone manufacturing inputs the aggregate individual tariffs for which may exceed the total single tariff applicable on final products manufactured from them within the zone (sometimes referred to as "inverted tariffs"). Moreover, manufacturing, assembly, or processing of products from imported inputs may allow the export marketing of final products under new and more favorable country-of-origin labels if the value of such inputs exceeds that originating in the Free Zone nation. And, finally, importation of inputs into a free zone usually permits avoidance of drawback procedures requiring prepayment and subsequent refund of duties on inputs. An important consideration for an importing nation is that manufacturing, assembly, or processing operations utilizing foreign inputs to produce finished products for entry into its customs territory can generate jobs in the country. In summary, these are the basic benefits afforded by the operation of Free Zones: (a) reduction of duty on final products from the aggregate of individual tariffs otherwise chargeable on imported inputs utilized in the manufacture of such products; (b) deferral of duty on imports or deferral of taxes on exports; (c) quota avoidance (import or export); (d) duty avoidance on inputs that are expended or destroyed or left behind in the manufacture within a zone of finished products; (e) establishment of new country of origin; and (f) avoidance of drawback procedures. But, of course, Free Zones have other uses as well.

4.4.2 Free Zones as a Development Device

There are also legitimate concerns about the use of Free Zones as an economic development device as opposed to their historic role as a trade-facilitating customs regime. El Salvador illustrates another use for Free Zones that has become prevalent among developing countries, e.g., the effort to stimulate domestic economic growth from jobs created by the promotion of exports of services consisting primarily of labor performed on imported inputs. Based upon and intended to replicate the so-called "export-led" economic growth "miracle" of the Asian "tigers" - Hong Kong, Singapore, South Korea, and Taiwan - this strategy aspires to generate employment and earn foreign exchange through "exports", beginning with the only sector of comparative advantage least developed countries may have to offer global markets, e.g., unskilled and/or semi-skilled labor. This stage of development strategy attempts to go beyond the earlier stage of exclusive reliance upon exports of primary products or to operate in tandem with it. It has often been employed as a "last resort" option in situations in which global commodity gluts or volatile commodity prices make continued dependence on primary product exports counter-productive or uncertain at best and a country has no other internationally-competitive goods to sell in global markets, usually because of the residual impacts associated with the import-substitution model of development. Many countries confront the fact that their industries, which had been protected from external competition and the realities of market-oriented investment and production, are now unable to support newly-adopted macroeconomic reforms, restructuring, and market opening initiatives. Since the free market imperative is to compete from sectors of comparative advantage, they found provision of labor to be their only industrial vehicle for participation in global markets. And so they have entered into the highly competitive international auction of industrial incentives through which to attract manufacturers of products to their shores, offering low wages, tax holidays, fiscal exemptions, and other benefits.

The device of the Free Zone permits a nation to provide incentives insulating industrial users of its Free Zone from the Customs tariffs and other costs, procedures, and (sometimes) hassles of entry and exit, while reducing overhead costs of labor in a tax haven environment. In an early stage of economic evolution, when a country has little else to offer, it is a rational device for development. But it has its limitations - it does little to develop real domestic industrial capacity, productivity, and competitiveness or to attract new foreign direct investment to the country outside of the Free Zones. It produces few distributive economic impacts beyond the generally low wages paid local workers since the Free Zone concept generally requires all inputs other than labor to be sourced off-shore. It provides little in the way of domestic market participation by users of the Free Zones since these are either prohibited entirely from selling in the market, or are limited to small percentages of local sales subject to generally applicable tariffs on entry. It brings little new industrial technology since most user industries in such zones are relatively low tech operations. And, Free Zones often attracts only so-called "marginal" operators which operate via low investment ratios and paper-thin profit margins and who are highly vulnerable to market developments or easily lured away by any other country able to raise the incentive stakes for Free Zone operations. As has been seen, some of the incentives made available to such users of Free Zones may violate international rules dealing with export subsidies while most bring into question the net benefit of such incentives in terms of the fiscal costs borne by the country versus the service export values realized thereby.

Free Zone incentives intended to spur exports are, at best, a transitory economic development device that may, in fact, have the unintended result of postponing actual real economic development through misallocation of development priorities and resources. And, a Free Zone-based export promotion strategy designed to achieve "export-led" growth in the manner of the Asian Tigers also fails to recognize that most of the early industrial development that spurred their dramatic economic growth did not take place in or utilize Free Zone operations. The manufacturing, assembly, and processing that led to the accelerated productivity growth and increasing international competitiveness primarily took place within the domestic industrial establishment of these nations, not in free zones. Their industrial development and economic growth was catalyzed by significant public and private domestic investment, the adaptation of domestic manufacturing processes and inputs to foreign technology, and a policy of constant upgrading of the technological level of manufacturing operations. That is why Korean and Taiwanese low-tech manufacturers now operate in Latin American/Caribbean Free Zones. The bottom line, therefore, is that, while Free Zones have their uses in facilitating international trade, they should not be looked upon - or used - solely as a device for so-called "export-led" economic development.

Free Zone-based export-led economic growth based solely on the single comparative advantage factor of cheap labor is only one stop along a well worn economic evolutionary path for developing nations. It made sense when El Salvador was engaged in unresolved domestic political turmoil. But El Salvador is still evolving economically and appears to have passed the point of reliance for economic growth on Free Zones. For example, El Salvador has realized annual real growth in its economy (measured by the percentage growth of GDP) of five percent or more in 1992 and 1993 with growth of 5.5 percent projected for this year. Little of this growth can be ascribed to its Free Zones. Most of it is directly attributable to a combination of the new domestic political stability and social tranquility and to the strong macroeconomic reform initiatives and accomplishments of the Christiani Administration, which rivaled those of even the most progressive Latin countries. As a result, in terms of its likely continued stability and tranquility, its projected economic growth, its membership in the CACM, its large population, and its reputation as having among the most productive workers in Central America, El Salvador is now positioned to become one of the most attractive countries for FDI in all of Central America. It can now reasonably expect to attract incremental FDI in its industrial sectors with the benefits of new technology and increased sourcing of more than just labor inputs from its domestic economy. Indeed, as the most active country promoting economic integration in the ithmus, foreign multinationals can now look forward not only to developing markets in El Salvador's own growing economy but, producing in and regionalizing from El Salvador, penetrating markets throughout Central America. So El Salvador should begin to reorient its economic growth planning and strategy focus beyond the Free Zones to concentrate on building and realizing its opportunities for greater domestic and foeign direct investment into the heart of its economy.

5.0 RECOMMENDATIONS

5.1 Approach

This study has focused upon three laws of El Salvador affecting international trade and investment; compared its export promotion laws with those of other, neighboring countries; and analyzed the problems and issues they pose for the forward economic development of El Salvador. Our recommendations therefore address the two main areas of focus: El Salvador's foreign direct investment regime as represented by the Law for the Promotion and Guaranty of Foreign Investment and its export promotion regime as represented by its Law Governing Free Zones and Bonded Warehouses and its Export Reactivation Law.

5.2 Foreign Investment

Amend the Law for the Promotion and Guaranty of Foreign Investment to provide guarantees, as well, for certain other rights recognized in standard international practice, or to eliminate constraints on foreign investment that do not accord with standard international practice, e.g., (a) add: guarantee of National Treatment; (b) eliminate: non-national security-based sectoral restrictions; (c) eliminate: percentage restrictions on the repatriation of profits; (d) add: procedural requirements for expropriation and internationally-accepted remedies therefor; and (e) clarify and/or add: international investment dispute resolution procedures.

We recognize that some of the concerns addressed in this recommendation, in particular sectoral restrictions on investment, proceed not only from legislation but from provisions incorporated in the nation's constitution and that effecting changes therein is not as easily accomplished as simple legislation. But we understand that, under the organic constitution of the State, change in the Constitution may be effected by legislative initiatives to that end if passed by two successive Legislative Assemblies. And the sectoral restrictions described above and in this recommendation have, at least partially been the subject of change in the current Legislative Assembly. Legislative Decree No. 860 of April 21, 1994 (Diario Oficial No. ___, Book 323 of May 13, 1994) has amended the Constitution to repeal the provision of Article 110 that reserves Postal Services and Telecommunications to the State. If this is passed again in the incoming Legislative Assembly, this constraint on foreign investment will be removed. Similarly, on April 29, 1994, the current Legislative Assembly enacted an omnibus Constitutional reform measure that effectively removes the impediments of Article 120 regarding docks, wharves, etc. If reenacted, this impediment will also be removed. We have not suggested the guarantee of "the better of National Treatment <u>or</u> Most Favored Nation Treatment, because the latter guarantee is usually a matter of a commitment based on international agreements, like BITs. Based on experience with Latin bureaucrats in the foreign investment registration process, the time limits specified in the existing law seem unusually short, a desirable goal, but more likely to ressult in bureaucrats' ignoring such limits. In our amendments, we have suggested more realistic time limits that would permit effective consideration without prejudicing prospective investors. Our draft Amendments to the Law for the Promotion and Guaranty of Foreign Investment may be found in Appendix <u>D</u> hereof.

5.3 Export Promotion

(01) The Free Zones and Bonded Warehouses Law should be retained to accommodate standard international commercial usages, but that Law and the Export Reactivation Law should be amended to eliminate all incentives associated with the use of Free Zones (except for acquired rights) that do not accord with international rules governing subsidies or standard international practices for use of such zones and the GOES should cease all future grants or offers of such incentives.

Based upon the analysis earlier in this report, this recommendation would extend to the: (a) exemption from income taxes; (b) exemption from payment of applicable Customs duties or import or export taxes for entry/exit into or from the zones, e.g., "free entry"; (c) "refund" of the F.O.B. Value of Exports as "compensation" for payments of Customs duties that exceeds the actual value thereof; (d) exemption from property taxes; and (e) exemption from prepayment of any applicable indirect taxes. Free Zones could continue to provide non-incentivated manufacturing, processing, and assembly operations. With regard to "acquired rights" (derechos adquiridos), such rights should be respected and fully implemented for any existing user of a Free Zone for the duration of the period for which incentives under the current law are authorized, but should not be extended for any subsequent period under any discretionary authority provided the Government under the law. The provision of the Export Reactivation Law authorizing "refunds" as "compensation" for Customs duties actually paid should be related directly and only to the amounts of actual payments thereof and not determined from the value of exports, whether related thereto or not.

(02) The Free Zones and Bonded Warehouses Law should be amended to delete any reference to, authority for, or regulation of Bonded Warehouses. Authority for and regulation of Bonded Warehouses should revert to the relevant provisions governing Operations of Auxiliary Credit Organizations (Operaciones de Organizaciones Auxiliares de Crédito) of Title Four of the Law [Governing] Credit Institutions and Auxiliary Organizations (Ley de Instituciones de Crédito y Organizaciones Auxiliares).

Under the existing Free Zones and Bonded Warehouses Law, the latter are indistinguishable from Free Zones in terms of their operations and the only apparent reason for incorporating them into the Law appears to be to accord users thereof the same fiscal incentives and other benefits provided to users of Free Zones. Developers and Administrators of Bonded Warehouses are not, apparently, accorded the same incentives as are those for Free Zones. The only apparent purpose for adding Bonded Warehouses to the Law must be divined from Article 6 of the Law, which states:

> "Natural or juridical persons who apply for the benefits established hereunder, should be located in a Free Zone, or if not the case, should operate within the establishments declared [to be] Bonded Warehouses . . ."

Standard international practice involving Free Zones recognizes that there may be valid reasons why industrial operations otherwise appropriate for a Free Zone-type of Customs regime may be unable to locate in established Free Zones, such as the need for proximity to natural resource inputs or to ulilize certain primary products that are more economically utilized where they occur. So most Customs laws or Free Zones laws provide for the declaration and establishment of so-called "subzones", e.g., an area separate from an existing zone established for one or more of the specialized forms of handling, storing, manipulating, manufacturing, or exhibiting goods authorized when existing zones are not appropriate for or convenient to such operations. Subzones are usually discontinued when their purposes have been accomplished. They operate under the same Free Zones Customs regimen as existing zones.

Bonded Warehouses have their own uses, some of which may not, in fact, be appropriate to an international trade-oriented Customs regime. They are generally utilized for storage only of goods and normally do not involve other industrial operations, although they can accommodate operations other than storage depending on the non-international exigencies confronted. While they require and need security regimes similar to those of Free Zones, they generally do not involve transfers from one sovereignty to another (e.g., Customs "territories") necessitating the invocation of specific concepts and provisions of international entry and exit and data recording for fiscal and balance of payments purposes. They are generally maintained to facilitate trade finance and credit transactions employing liens on the goods that are the subject of the transaction and their security regimes are intended to safeguard the respective rights of the owners thereof and holders of liens thereon. These are the purposes and uses authorized and regulated under Title Four of the Law Governing Credit Institutions and Auxiliary Organizations described in detail above.

An enterprise involved in international trade can avail itself of the Free Zones law. Domestic owners and operators of and enterprises requiring the secured storage services of Bonded Warehouses can avail themselves of the already existing Salvadoran law governing such operations. Elimination of the export-related incentives of the current Free Zones/Bonded Warehouses Law would obviate any need for associating the two under a single legal regimen.

(03) Article 216 of the Law Governing Credit Institutions and Auxiliary Organizations should be amended to delete authority for and regulation of "class 2" general depositary warehouses and to delete all references to and authority for operations thereof relating to the receipt, storage, or handling of merchandise under Customs legal regime or control.

As described in the section on Salvadoran laws, the law referred to was enacted some 20 years before the Free Zones law was enacted and, prior thereto, was the only Salvadoran legislation relating to Free Zone-type services of storage and other operations affecting foreign merchandise other than the Customs law in force at the time. So, in a sense, it was the precursor legislation to the Free Zones/Bonded Warehouse law. However, it is now outdated because the operations and the security regime referred to therein are provided in greater detail in the Free Zones Law. Its continued existence in effect only confuses the interpretation and application of the more appropriate laws governing both Free Zones and bonded warehouses and it should, therefore, be eliminated.

(04) Salvadoran Customs law and/or tariff schedules should be amended to eliminate all tariffs or Customs duties imposed on products imported by domestic enterprises as inputs in the manufacture, assembly, or processing of final products (whether or not exported or for export) that are not produced in or otherwise available in El Salvador in the quantity, and/or quality required to effect the production of such final products.

Given the additions to the country's fiscal base resulting from the cancellation of the fiscal incentives in the Free Zones/Bonded Warehouses Law and Export Reactivation Law recommended above, it seems a reasonable "trade off" to eliminate such tariffs which neither protect domestic enterprises (because there is no domestic production) nor appear to have any other trade-related purpose, but do act to increase the input costs of domestic manufacturers of final products for Salvadoran consumers and, perhaps, for export, thereby undermining the price competitiveness of such products in global markets. We recognize that elimination of such tariffs may result in certain indirect effects on the allocation of resources within an economy available for investment toward or away from certain economic sectors (the "effective rate of protection"). But such a diffused impact would probably not be dispositive in itself in affecting the future economic growth prospects of the country, since it would be only one of very many such factors impacting on its economy, while the elimination of unnecessary tariffs can directly affect a country's level of imports, its level of compensating exports, its productivity, its global competitiveness, its range of consumer choice, and, ultimately, its standard of living.

(05) The current Export Reactivation Law should be repealed and an Export Promotion Law enacted which encourages exports and production for export by facilitating international trade and providing incentives therefor that are compatible with applicable international rules and standards of conduct. Such facilitating services and incentives should be made available to beneficiaries <u>wherever located</u> within the country and the incentives should be made available <u>in direct proportion to</u> the percentage that the beneficiary's final exports in any year bears to its total exportable production in that year.

It is essential to its overall Global competitiveness, access to foreign markets, and ultimate economic success that El Salvador "play by the rules" established under the international codes and other agreements affecting the offering of incentives to encourage exports. Non-reciprocal concessions to developing nations are rapidly becoming a policy of the past among the developed nations, certainly the United States, and if El Salvador aspires to participate meaningfully in the U.S. market as a result of liberalization of access thereto through accession to the NAFTA or other bilateral trade accord with the United States, it will have to be found a member "in good standing" of the GATT (or the new World Trade Organization - the WTO) and its related disciplines and prepared to accept the rules for trade incorporated in the NAFTA or that otherwise may be advanced by the United States as a condition to such access. Nonetheless, there are "GATT-able" methods for encouraging exports, including drawback of Customs duties and refunds of value-added and certain other indirect taxes. If these forms of "GATT-able" incentives are discounted by individuals and enterprises within El Salvador because of delays or other complications encountered thereby, the GOES will have to take such action as is appropriate to restructure and/or reform its bureaucratic infrastructure and procedures to ensure public confidence in the Government's willingness and ability to provide such incentives. In our annexed draft Law for the Encouragement of Exports, we have attempted to craft and impose disciplines on the refund process that may allay concerns of Salvadoran exporters. International development agencies, including the U.S. Agency for International Development, should be solicited to provide funding and technical assistance to train and enhance the capability and productivity of GOES personnel in implementing such incentive programs.

(06) The GOES should consider the enactment of an Industrial Incentives law providing <u>non-export-related</u> general fiscal and other incentives open to all (domestic, foreign) investors in sectoral or geographical areas deemed critical to the future industrial and economic development of the nation.

The single best stimulant for increased exports is a healthy, growing, economy that provides a climate favorable for the new investment that develops industrial potential, attracts new technology, and generates productivity at home and competitiveness abroad. Foreign investment, in particular, is essential to the successful economic development and growth of under-developed nations. Foreign investment, in particular, creates markets abroad for a host country's products and services. It has been estimated that a third of all U.S. trade represents inter-company transactions. But foreign investors will not invest in a country if its own domestic investors do not. The use of limited, carefully-targeted, non-export-related incentives for investment in productive industries is one of many tools for economic advancement and industrial restructuring. A number of developing nations with which El Salvador must compete in attracting new, incremental foreign direct investment utilize such incentives. The connection of investment incentives with geographical or sectoral development priorities through certain performance requirements is not necessarily prohibited in the NAFTA. For example, while Article 1106 of the Investment chapter of the Agreement generally prohibits performance requirements, the prohibition is subject to a number of exceptions. Paragraph 4 thereof provides that:

> "Nothing . . . shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party . . . on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development in its territory."

Our draft of a wholly new Law Governing Customs Free Zones, which repeals the existing Free Zones and Bonded Warehouses Law, may be found in Appendix E, while our draft of a new Law for the Encouragement of Exports, which repeals the current Export Reactivation Law, may be found in Appendix F hereof.

APPENDIX A

ENGLISH TRANSLATION OF THE

LAW GOVERNING THE PROMOTION AND GUARANTY OF FOREIGN INVESTMENT

DECREE NO. 960

LEGISLATIVE ASSEMBLY OF THE REPUBLIC OF
EL SALVADOR

CONSIDERING:

I. - That, in conformity with Article 102 of the Constitution, it is the State's duty to encourage investment for the economic and social development of the country, thereby obliging it to establish the necessary conditions for its promotion with the goal of enhancing the national wealth for the benefit of the greatest number of its inhabitants;

II. That it is necessary to promote foreign investment and transfer of proprietary technology in a manner that favors employment generation and encouragement of the process of growth and diversification of the economy;

III. That is indispensable to guarantee to foreign investors the legal safeguards for the adequate protection of their investments;

IV. That, for the purposes of accomplishing the goals set forth in the foregoing premises, it is useful to set forth the provisions that regulate and guarantee foreign investment,

THEREFORE

In exercise of its constitutional authorities and upon the initiative of the President of the Republic through the Ministries of Planning & Coordination of Economic and Social Development; of Economy; of Treasury; and Foreign Commerce, Agriculture, and Livestock,

DECREES the following:

LAW FOR THE PROMOTION AND GUARANTEE OF FOREIGN INVESTMENT

CHAPTER I
REGARDING FOREIGN INVESTMENT

Art. 1.- This law has as its goal the promotion and guarantee of foreign investment and regulates the rights and obligations of foreign investors who, for themselves or in combination with [Salvadoran] private investment, can contribute to the economic and social development of the nation, with the impacts of enhancing productivity, generating employment, exporting goods and services, and increasing and diversifying production.

Art. 2.-* For purposes of the application of this Law, foreign investment shall mean every form of capital transfer to El Salvador originating from other countries, effected through natural or juridical foreigners, for the production of goods and services and duly registered with the Ministry of Foreign Commerce.

Art. 3.-* The capital referred to in the prior article includes the following forms:

a) financial resources in freely convertible foreign exchange;

b) tangible property such as: machinery, equipment, accessories, spare parts, and raw goods, among others;

c) intangible property as described in Art. 12 of this Law;

ch) reinvestment of profits obtained in the country by foreign investors as long as they have originated out of foreign investment duly registered in conformity with this Law;

d) foreign exchange loans to natural or juridical persons domiciled in El Salvador as well as those transfers in foreign exchange intended for the acquisition of [debt] obligations issued by juridical persons domiciled in the country;

e) shares and participations acquired by foreign investors for the capitalization of companies domiciled in, or for the increase of capital of branches registered in, El Salvador in conformity with this Law derived from profits, reserves, asset revaluation, or duly registered credits of such companies or branches by their creditors.

Art. 4.- For purposes of this Law, natural or juridical foreigners may transfer capital to El Salvador to effect investments in any economic sector, concluding contracts or acquiring, under whatever rubric, in conformity with applicable laws, real or personal property or whatever other rights have economic value.

Art. 5.-* Small businesses, industry, and services are the exclusive endowment of Salvadorans by birth and naturalized Central Americans as well as net fishing; therefore, foreign investors shall have no access to such activities, applying to these instances the rules with regard thereto of the Law Regulating the Conduct of Commerce and Industry and the Law of Fisheries and Marine Hunting.

Net fishing does not include acquacultural activities when these are undertaken in estuaries, bays, or within the twelve mile sea limit determined from the line of low tide.

Art. 6.- Repealed by Legislative Decree number 189 of March 01, 1989, published in Diario Oficial Number 49, Book 302, of March 10, 1989.

In the case of profits realized by the foreign investor in the country, for purposes of registration, there shall be used the exchange rate current as of the date of the general balance of the business year in which they were generated.

Art. 7.- Foreign investors may establish regional offices in El Salvador intended to coordinate and manage more efficiently their investments in other countries.

CHAPTER II
REGARDING REGISTRATION OF FOREIGN INVESTMENT

Art. 8.-@ The Ministry of Economy shall have charge of the Foreign Investment Register. For purposes of effecting such registration, it shall consider the nature, value, origin, destination,

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and date of entry of such investment as well as any modifications [therein] during its permanence in and departure from the country.

Art. 9.- * Registrable foreign investments are those forms of capital referred to in Art. 3 of this Law.

Art. 10.-* For purposes of registration, foreign investment shall be recorded according to its form in the amount and class of foreign exchange received in the country.

In cases of tangible property, the value thereof shall be established in their respective documentation. Nevertheless, the Ministry of Economy, prior to registration, if it considers it appropriate, may assess a new value in conformity with the criteria specified in the Customs valuation legislation and whatever other criteria it deems appropriate.

In the case of earnings obtained by the foreign investment in the country, for purposes of registration, there shall be applied the rate of exchange current upon the date of the general balance of the business year in which it shall have been generated.

Art. 11.-*To obtain registration of its investment, the foreign investor, itself or through its legal representative, shall apply for recording of the same to the Ministry of Economy.

These steps may also be undertaken by the lawyer or legally-authorized representative of the Salvadoran company in which the foreign investment has been or is to be made.

The Ministry should register such investment within the thirty working days following the date of presentation of the application or of conclusion of the period of the most recent [request for further information] if that has been complied with by the applicant.

Upon expiration of such period, if registration has not been effected, it shall be presumed that the Ministry of Economy has authorized and therefore is obliged to effect such registration.

CHAPTER III
REGARDING INTANGIBLE PROPERTY

Art. 12.- Intangible properties [include] licenses for use of patents of invention, trademarks, and other commercial indiciae, trade names, and copyrights; contracts for lease of equipment, for marketing and technical assistance services, for managerial know-how, and, in general, any right having an economic value conferred thereon by law or under agreement or contract relating to the activities regulated under this Law, without regard to the relationship existing or which may exist between the person providing such service and the recipient thereof.

Art. 13.- The value of contracted intangible assets which includes amounts relating to industrial property, technical assistance and services, shall be set forth in their respective documentation even though the sums thereof exceed 10% of net sales realized in the respective uses thereof.

Art. 14.- Foreign investors are guaranteed that nothing shall obligate them to change or to renegotiate the terms of any private agreement or contract relating to intangible property during the terms stipulated therein.

CHAPTER IV
REGARDING GUARANTEES FOR FOREIGN INVESTMENT

Art. 15.- Registered foreign investment shall be guaranteed the following:

a) Free remission of net profits generated by such investments. Nevertheless, in the case of investments made in commercial and service activities, of net profits obtained in any year, they may remit only up to 50% of registered investment.

b) Free remission of amounts arising from total or partial liquidation of enterprises in the proportion that reflects their [percentage] of foreign capital.

When the company or enterprise in which the investment has been made has suffered losses, the repatriation shall be for the remainder of the foreign investment registered after subtracting accumulated losses determined in accordance with the duly audited balance.

c) There shall be recognized as a tax credit against earnings of the foreign investor realized as a result of its foreign investment that proportional part attributable to its foreign investment of income taxes paid by the company in which such investment has been made.

In this case, the company in which the investment has been made is not obliged to withhold for purposes of income tax those profits or dividends which are paid or credited or presumed legally to have been distributed to the foreign investor.*

ch) Free transfer of its foreign investment in the country.

d) Free remission of net capital earnings that the foreign investors obtains from the transfer of its registered investment in the country.

Art. 16.-* Rights acknowledged to a foreign investment are extinguished by cancellation of the respective registration in the Ministry of Economy, which shall do so only for the following reasons:@

a) for the foreign investor having remitted the whole of its registered investment or the entire balance remaining after deducting losses suffered.

b) for the transfer by the foreign investor of his registered foreign investment in the country without prejudice to its right to freely remit such investment as profits that have been realized.

In this last case, in order to avail itself of the benefits of this Law, [the foreign investor] should effect the registration in the Ministry of Economy.

Art. 17.- Transfers of foreign exchange originating in registered foreign investments shall be effected in the currency in which recorded.

Such transfers shall be made at the exchange rate applicable on the date [such foreign exchange was] requested of the Central Reserve Bank of El Salvador.*

Art. 18.- Repealed by Legislative Decree Number 189 of March 01, 1989, published in Diario Oficial No. 49, Book 302, of March 10, 1989.

Art. 19.- Natural or juridical persons who have registered investments in accordance with this Law shall have access to financing in the country and to the opening of foreign exchange accounts in the financial system with the goal of facilitating the greatest development of its operations.*

Foreign investors who have been authorized to open foreign exchange accounts shall be guaranteed that the balances therein shall not be converted to national currency by action of the monetary authorities.

CHAPTER V
REGARDING APPEALS AND RESOLUTION OF DISPUTES

Art. 20.-@ The party-in-interest may appeal to the Minister of the Economy for reconsideration of the value of any foreign investment assessed by the Ministry of Economy or against any action thereof denying registration of a foreign investment within eight working days following notification thereof, who [the Minister] shall determine the matter within fifteen working days thereafter if the interested party has complied with all pertinent requests. If, upon the passage of such period of time, a decision has not issued, the Ministry of Economy should effect the requested registration.

Art. 21.- In the event of dispute or difference between the State and foreign investors relating to their foreign investments, the parties may submit the decision to the Conciliation and Arbitration Tribunal contemplated by the Agreement on Differences Relating to Investments between States and Nationals of Other States according to Decree No. 111 of the Revolutionary Council of Government of December 07, 1982, published in Diario Oficial No. 230, Book 277, of the 14th of the same month and year.

Art. 22.- If registration of the foreign investment is denied, the foreign investor shall have the right to immediate repatriation of the foreign exchange and to the reexport of tangible property that have already entered the country.

CHAPTER VI
REGARDING GENERAL AND TRANSITIONAL PROVISIONS

Art. 23.-@ The Ministry of Economy shall have authority for the application of this Law.

Art. 24.- The provisions of this Law shall override any provisions of law to the contrary.

Art. 25.-@ All governmental agencies and autonomous entities whose activities relate to foreign investment shall cooperate with the Ministry of Economy in the implementation of this Law.

Art. 26.-Foreign investments registered as of the date this Law enters into effect shall remain legally registered with full rights under the law, enjoying the benefits granted thereby.

Art. 27.- This Law shall not prevent any foreign investor from continuing to enjoy the rights granted by any administrative action or agreement whenever such rights were greater than those contemplated in this Law.

Art. 28.-* In those cases involving contracts for intangibles for undefined terms, such should be renegotiated to establish a specified term therefor.

CHAPTER VII
REGARDING REGULATORY AUTHORITIES AND ENTRY INTO EFFECT

Art. 29.- The President of the Republic shall issue the Regulation implementing this Law.

Art. 30.-This Decree shall enter into effect eight days following its publication in the Diario Oficial.

DONE IN THE BLUE ROOM OF THE LEGISLATIVE PALACE: San Salvador, on the twenty-eighth day of April, Nineteen Hundred and Eighty-Eight.

Guillermo Antonio Guevara Lacayo
Presidente

Alfonso Aristides Alvarenga
Vicepresidente

Hugo Roberto Carrillo Corleto
Vicepresidente

Pedro Alberto Hernandez Portillo
Secretario

Jose Humberto Posada Sanchez
Secretario

Rafael Moran Castaneda
Secretario

Ruben Orellana Mendoza
Secretario

PRESIDENTIAL HOUSE: San Salvador, on the ninth day of the Month of May of Nineteen Hundred Eighty-Eight.

LET IT BE PUBLISHED

Jose Napoleon Duarte
Constitutional President of the Republic

Remo Bardi Cevallos
Minister of Planning and Coordination
of Economic and Social Development

Ricardo J. Lopez
Minister of the Treasury

Raul AntonioGochez Gil
Vice-Minister of Economy
By Delegation

Jose Antonio Morales Ehrlich
Minister of Agriculture and Livestock

Carlos Aquilino Duarte Funes
Minister of Foreign Commerce

Published in Diario Oficial No. 85, Book 299, of May 09, 1988.

***. - Repealed by Legislative Decree No. 189 of March 01, 1989. Published in Diario Oficial No. 49, Book Number 302, of March 10, 1989.**

@.- Amended by Legislative Decree No. 413 of December 08, 1989. Published in Diario Oficial No. 231, Book Number 305, of December 13, 1989.

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APPENDIX B

ENGLISH TRANSLATION OF THE

LAW GOVERNING FREE ZONES AND BONDED WAREHOUSES

DECREE NO. 461.*

THE LEGISLATIVE ASSEMBLY OF THE REPUBLIC OF EL SALVADOR,

CONSIDERING:

I. That having repealed the Law for the Promotion of Exports, it is now necessary to regulate the operation of the Free Zones and the economic activities that generate employment, investment, and economic well-being;

II. That it is appropriate that those persons who develop, administer, or are users of the Free Zones, enjoy benefits equivalent to those granted in international practice;

III. That, in accord with the Constitution, it is the function of the State to establish the legal instruments necessary to enhance investment, both national and foreign, for the purposes just expressed;

NOW THEREFORE,

in the use of its constitutional authorities and upon the initiative of the President of the Republic by means of the Minister of the Economy,

DECREES the following:

LAW FOR FREE ZONES AND BONDED WAREHOUSES

CHAPTER I
GENERAL PROVISIONS

Art. 1.- This Law has for its goal to regulate the operation of Free Zones and Bonded Warehouses, as well as the benefits [granted] to the owners of enterprises which develop, administer, or use the same.

Art. 2.- Free Zone means those areas of the national territory "beyond Customs" previously qualified [and] subject to a special regime, where enterprises, national or foreign, may be established and operate, which undertake the production or commercialization of goods for exportation, as well as the rendition of services linked to international commerce and the activities related or complementary thereto.

Art. 3.- Establishment, administration, and operation of Free Zones should be authorized by the Ministry of Economy. The enforcement and control of the fiscal regime in such Zones shall be delegated to the Ministry of Treasury in conformity with this Law, its Regulations, and other fiscal legislation.

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* As amended by Legislative Decrees No. 753 of April 19, 1991 and No. 211 of April 03, 1992.

Art. 4. - Natural or juridical persons, nationals or foreigners, [who are tbe] owners of enterprises, shall enjoy the benefits and fiscal incentives of this Law in accord with the terms established therein, who:

a) Develop Free Zones;

b) Administer Free Zones; and

c) Are users of Free Zones.

Art. 5. - The benefits and fiscal incentives of this Law [shall not be available to] those natural or juridical persons who, within a Free Zone, undertake the following activities:

a) Travel Agencies and Airlines;

b) Air, Sea, or Land Transportation;

c) Activities governed by the banking or financial laws of the Country;

d) Services unrelated to international commerce in accord with the provisions of the Regulation for this Law.

Similarly, the following shall not enjoy the benefits and incentives of this Law:

1) Natural persons for whom the benefits conferred by this Law have been suspended; [and]

2) Companies involving directors or shareholders who were formerly directors or shareholders in other companies for whom benefits conferred under this Law have been suspended or revoked.

Art. 6.- Natural or juridical persons who apply for the benefits established hereunder, should be located in a Free Zone or, if not the case, should operate within establishments declared [to be] Bonded Warehouses and should not enjoy the provisions of the Law for the Reactivation of Exports. In exceptional cases, if persons benefited thereunder renounce the incentives granted by this Law, they may avail themselves of the provisions of the Law for the Reactivation of Exports.

Art. 7.- For the interpretation and application of this Law, preference shall be given to the purpose of the same and the nature of the economic activities [regulated thereby]. Only when it is impossible to determine the meaning of its provisions, concepts or terms from the letter or spirit thereof shall there be resort to the provisions, concepts, or terms of common law.

Art. 8. Neither the provisions of Chapter XIII, Title II of Book One of the Commercial Code nor the Law for the Supervision of Companies and Mercantile Enterprises shall be applicable to foreign companies that are owners of enterprises referred to in this Chapter.

Every nonresident person who is the owner of an enterprise of the kind mentioned above shall empower a representative in this country with sufficient authority to legally represent them in the country.

Art. 9.- The following activities may not be conducted in the Free Zones:

a) Petroleum and natural gas exploitation.

b) Hotels.

c) Mining in its extraction phase.

d) The production or storage of contaminating merchandise.

e) Activities involving the processing or management of explosives or radio-active materials.

Art. 10. - Repealed by Decree 753 of April 19, 1991.

CHAPTER II
REGARDING THE DEVELOPMENT AND ADMINISTRATION OF FREE ZONES

Art. 11. - Private natural or juridical persons, nationals or foreigners, who are authorized to establish Free Zones, shall enjoy the following benefits and fiscal incentives:

a) Total exemption from import taxes on the importation of machinery, equipment, tools, parts and implements necessary for its establishment and operation.

b) Total exemption from the Income Tax for a period of fifteen years counted from the accounting year in which they initiate operations in the activity undertaken in the Free Zones.

This exemption, in the case of companies, shall be applied both to the Company which is the proprietor of the Zone as well as to the individual partners, with respect to the earnings or dividends arising out of the favored activity.

c) Total exemption from the fiscal imposts upon the assets or property of the enterprise from the accounting year in which the Qualification Resolution is issued for the activities undertaken in the Free Zone.

This exemption shall be applied also to the partners, in the case of companies, for their investment related to the activity benefited.

Art. 12.- The Economic Arm of the Executive Branch may delegate by agreement the administration of the Free Zone properties of the State to private natural or juridical persons, nationals or foreigners, to which end there should be concluded the respective contract for purposes of which the State shall be represented by the Minister of the Economy or the person he designates.

The Administration of Private Free Zones may be delegated to natural or juridical persons, nationals or foreigners, by means of a notarized public document that shall evidence such delegation.

Art. 13.- The authorized Administrator is directly responsible for the direction, administration, and management of the Private Free Zones and shall have the following responsibilities:

a) Process applications for installation in the Free Zone under his administration that may be presented by interested parties;

b) Contract with natural and juridical persons regarding the conditions that shall govern their installation in the Free Zone as well as the sale of lots for the establishment of enterprises therein;

c) Any other matters related to the direction, administration, and management of the Free Zone.

Art. 14.- Duly authorized natural or juridical persons who administer Free Zones shall enjoy the following benefits and fiscal incentives:

a) Total exemption from the Income Tax for a period of fifteen years counted from the accounting year in which they commence their operations;

This exemption, in the case of companies, shall be applied both to the company that is the administrator of the Zone as well as to the individual partners, with respect to the earnings or dividends arising out of the favored activity.

b) Total exemption from fiscal imposts upon the assets or property of the enterprise from the accounting year in which it commences operations related to the administration of the Free Zone;

This exemption shall be applied also to the partners, in the case of companies, for their investment related to the activity benefited.

c) Exemption from stamp taxes or any other indirect tax upon the rental contracts in the Free Zone.

Art. 15.- In the event that any person is both the developer and the administrator of Free Zones, such person shall enjoy the benefits granted in both capacities.

Art. 16.- For purposes of this Law, the following shall be reasons for the termination of a [Free Zone] user's lease contract:

a) For default in payment under the lease contract;

b) For the suspension or revocation of benefits granted under this Law;

c) For noncompliance with this Law or for any other legal cause.

CHAPTER III
REGARDING USERS OF THE FREE ZONE

Art. 17.- A user shall be understood to mean a natural or juridical person, national or foreign, authorized in accord with this Law to operate in the Free Zone and undertaking industrial or service activities or engaged in international commerce as well as maquila or assembly operations for export outside of the Central American area.

Art. 18.- Natural or juridical persons domiciled in the country, may conclude service contracts, known as maquila or assembly [operations], with a contractor domiciled abroad, pursuant to the agreed terms and conditions of which [the latter] shall supply raw materials, parts, pieces, components, or [other] elements that the [former] shall transform for account of the contractor who, for his part, shall utilize or trade therein according to their contract.

Art. 19.- Every natural or juridical person, national or foreigner, [who is] the owner of an enterprise [which is a] user of the Free Zone, who devotes itself exclusively to exportation, shall have the right to enjoy the following benefits and fiscal incentives:

a) total exemption from the taxes imposed on imports of machinery, equipment,

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tools, parts and accessories, utensils, and other appliances necessary for production for export;

b) Free importation into the Free Zones of raw materials, parts, pieces, components or other elements, semi-finished products, intermediate products, containers, labels, samples and models, necessary for the execution by the enterprise of the activities benefited;

c) Total exemption for a period of ten years, extendible for an equal period, of taxes imposed on the importation of lubricants and combustibles necessary for the production activity whenever these are not produced within the country;

d) Total exemption from the Income Tax for a period of ten years, extendible for an equal period, counted from the tax accounting year in which the beneficiary commences its operations;

This exemption, in the case of companies, shall be applied both to the Company entitled thereto as well as to the individual partners with respect to the earnings or dividends arising out of the favored activities.

e) Total exemption from fiscal imposts upon the assets and property related to the activities benefited, for a period of ten years counted in the same manner as in the foregoing paragraph and similarly extendible for an equal period.

This exemption shall also be applied, in the case of companies, to the partners for their investment related to the benefited activity when it is an individual enterprise.

CHAPTER IV
REGARDING BONDED WAREHOUSES

Art. 20.- natural or juridical persons, nationals or foreigners, who are owners of enterprises which export their entire production or are devoted to international trade, and which, for technical or economic reasons are not located in a Free Zone, may request that their establishment be declared a Bonded Warehouse by the competent authorities.

Art. 21.- Every natural or juridical person, national or foreigner, who is the owner of an enterprise that operates in a bonded warehouse shall have the right to enjoy the benefits and fiscal incentives established in article 19.

CHAPTER V
CUSTOMS REGIME

Art. 22.- The Customs regime that shall govern temporary admission for elaboration and subsequent exportation of imports effectuated by companies located in Free Zones or areas declared bonded warehouses, shall operate on the basis of temporary admission permits.

With reference to the transit of merchandise to be admitted to Free Zones or Bonded Warehouses, they shall operate by means of provisional import permits or intra-Customs guidelines.

With respect to the importation of machinery, equipment, parts and accessories, they shall operate by means of final exemption permits, with the exception of those goods that have been entered under a form of lease or other [arrangement] which does not imply transfer of ownership, in which case they shall enter under the temporary Customs admission regime.

Art. 23.- The period for the stay of goods entered under the Temporary Admission regime in Free Zones or Bonded Warehouses for their elaboration shall be 18 months counted from the date of their initial Customs registration. Upon the application of the interested party, filed thirty days prior to the expiration of the original period, the Ministry of Treasury may extend this [period] for a maximum of 60 days on a one-time basis in cognizance of the purposes of this Law.

For those goods that have been entered under the lease rubric or other arrangement that does not imply transfer of ownership, the respective contracts shall determine the stay period under the Temporary Admission Regime.

Art. 24.- The owner of an enterprise invoking this Law may temporarily export merchandise from the Free Zones or Bonded Warehouse to the national customs territory so that third parties or subcontractors can process without the Free Zone or Bonded Warehouse products destined for export and [it] shall guarantee payment of customs and import duties if these same goods are not exported within a period of six months counted from the date on which they left the Free Zone or Bonded Warehouse, for purposes of which it should institute a bond in favor of the Treasury authorized by the appropriate authority.

Art. 25.- Merchandise may be exported temporarily from the national customs territory into a Free Zone or Bonded Warehouse so that it may undergo enhancement, transformation, processing or repair operations.

The maximum period for its reexport back to the national customs territory shall be six months counted from the date of the permit for export into the Free Zone. There shall be paid with regard to such merchandise, upon its reexport into the national customs territory, the duties and imposts which correspond solely to the aggregate components incorporated therein in such process, each such entry being considered an import from a country beyond the Central American area.

Art. 26.- Exports of goods and services by natural or juridical persons established in the national customs territory to a user of a Free Zone or Bonded Warehouse located within the Central American area shall be considered, for customs purposes, as a substantive export to countries beyond the Central American area.

Natural or juridical persons who export goods and services in conformity to the provisions of this article may avail themselves of the Law for the Reactivation of Exports upon compliance with the requirements established therein.

Art. 27.- Merchandise resulting from a maquila assembly process may be exported by the [processor] to destinations other than the country of the client with the prior permission of the respective authorities. In the event there exist [international] payment agreements [between El Salvador] and the country to which exported, the conditions established therein should be observed.

Art. 28.- Upon prior permission of the Ministry of Treasury, products introduced into the country under this Law may be transported within the national customs territory without payment of the respective imposts when it involves their transfer to another Free Zone or Bonded Warehouse, as long as there is a guarantee in favor of the Treasury covering the stay of such temporarily admitted merchandise in the form of a bond specifically authorized by the competent authority.

Art. 29.- Byproducts, defective products, and production which, for reasons beyond the will of the exporter, cannot be exported, may be nationalized or exported to Central America, upon payment of the import taxes upon the related final product upon prior authorization of the competent authority.

Art. 30.- Owners of enterprises referred to in this Law, while not benefiting from the corresponding fiscal exemptions, may import items necessary and indispensable for the manufacturing or marketing process by granting in favor of the Treasury a bond for faithful compliance with [their] obligations in an amount equal to one hundred percent of the applicable imposts as if a substantive
import were involved. This bond should be approved by the Court of Accounts of the Republic within a period of five working days counted from the day following its presentation.

CHAPTER VI
REGARDING OBLIGATIONS AND PENALTIES

Art. 31.- Beneficiaries of the fiscal incentives granted under this Law shall have the following obligations:

a) Notification to the Administrator of the Free Zone and the Ministry of Economy with regard to any modifications realized in the plans and projects of its enterprise within a period of ten working days from the date thereof;

b) record and annotate the operations of the enterprise in books and registers that permit a true accounting thereof.

c) Furnish to the competent authorities the information requested regarding the use and destination of articles imported under the provisions of this Law as well as confirmation of the same by them whenever they deem it appropriate.

d) Bear the direct costs of customs controls and fiscal oversight related to their enterprises whose installations have been declared Bonded Warehouses such that they enjoy the benefits granted under this Law.

e) All other obligations arising out of this Law and its Regulation.

Art. 32.- In addition to the sanctions which may be applicable in accord with the Penal Code, beneficiaries of the fiscal incentives granted by this Law, in the event of noncompliance with the requirements therein contained, may be penalized administratively by the Ministry of Economy on the basis of information furnished by other public institutions or the Ministry itself. Penalties shall be imposed in proportion to the gravity of the infraction and may consist of:

a) Fine

b) Temporary suspension of benefits

c) Revocation of benefits.

Sanctions set forth in clauses b) and c) do not exclude the imposition of fines.

Art. 33.- The fines referred to in the foregoing Article may be [imposed] up to a value equal to the entire value of import charges that would have been payable except for the incentives granted under this Law, without prejudice to payments of corresponding taxes and surcharges. Payment of such fine should be made within the sixty days following the administrative ruling imposing the penalty. In the event the violator fails to pay the fine, the Ministry involved shall suspend its benefits.

If further instances of violation of the provisions of this Law occur, the Ministry shall impose the corresponding fine and shall suspend benefits for the remainder of the tax year and an additional tax year.

If violations of this Law continue, the Ministry shall impose the corresponding fine and shall revoke entirely all benefits.

Art. 34.- The Ministry shall impose a fine, temporarily suspend, or revoke the grant of incentives provided for in this Law whenever it documents that machinery, equipment, raw materials, semi-finished products or any other articles acquired under the incentives granted by this Law have been given a use different from that specified therefor in the Law.

Art. 35.- If the infractions committed involve crimes or [misdemeanors], the Ministry of Economy shall certify such conduct to the Attorney General of the Republic to prosecute or take other actions indicated against those responsible for such infractions.

Art. 36.- If any person, natural or juridical, availing himself of the benefits of this Law, ceases to operate the enterprise of which it is owner during any tax year, they shall lose any right to the category of bonded warehouse and lose any benefits granted them.

Art. 37.- In event of the abandonment of any enterprise located in a State-owned Free Zone for more than one year counted from the date of the granting of benefits, judicial procedures shall be invoked for compliance with any unfulfilled obligations and for possession of the realty even though the lessor may not be in default of any lease payments.

Art. 38.- If any benefits of this Law that have been granted to a natural or juridical person, the owner of an enterprise, have been suspended or revoked, such person may not [thereafter] apply for them on behalf of any other enterprise nor may they become a shareholder or director of any company applying therefor.

Art. 39.- Companies among whose Directors or Shareholders are persons who were Directors or Shareholders of other companies that have been penalized by suspension or revocation of benefits conferred under this Law shall have no right to the benefits granted hereunder.

CHAPTER VII
PROCEDURES AND APPEALS

Art. 40.- Parties interested in obtaining the benefits granted under this Law should file the relevant application therefor with the Ministry of Economy through their Legal Representative or a representative specifically designated [for such purpose].

Art. 41.- In its application, the applicant should indicate the activity in which it engages, the fiscal regime of which it desires to avail itself, general characteristics of the enterprise, as well as its legal [status] documentation and such other necessary information as may be required by the Regulation.

Art. 42.- If the application is [found to be] complete [as to the requirements therefor], it shall be accepted by the Ministry of Economy which shall process it within a maximum period of ten days and request the opinion of the Ministry of Treasury which should issue the same within a maximum period of ten days. If no response is received within such period, its report shall be presumed favorable.

Art. 43.- Upon receipt of the opinion referred to in the foregoing article, or should it be pre-

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sumed favorable as provided for therein, the Ministry of Economy shall issue the Resolution granting or denying benefits within fifteen days thereof. If the Resolution is favorable, an Agreement shall issue which should be published in the Diario Oficial.

Art. 44.- If the Resolution of the Ministry of Economy is unfavorable, the applicant may, within three working days of the notification thereof, petition the Ministry of Economy for reconsideration thereof together with such proofs and arguments as it considers pertinent, which shall decide thereon within the fifteen days following acceptance thereof.

Art. 45.- Any other appeal [or other request] which the applicant should make under this law should be pursued in conformity with the foregoing articles applicable thereto.

Art. 46.- Whenever it deems it appropriate, the Ministry of Economy may investigate persons enjoying the benefits of this Law for the purpose of ensuring compliance therewith.

Art. 47.- If, incident to any investigations undertaken by the Ministry of Economy, there appears to be any violations of, or infractions with respect to, the provisions of this Law, the Ministry shall investigate the same and, within three days, afford a hearing to the supposed violator for the purpose of offering him the opportunity to disprove the same.

The Ministry of Economy shall determine the matter within eight days following the conclusion of such hearing.

Art. 48.- Within the prescribed period of eight days counted from the notification of such determination, an appeal for reconsideration may be lodged with the Ministry of Economy. Pertinent documentation or supporting arguments may be submitted with the written appeal.

Art. 49.- Once the determination of the Ministry of Economy suspending or revoking benefits and fiscal incentives has been signed, the respective Decision shall be communicated to the appropriate authorities and shall be ordered published in the Diario Oficial.

Art. 50.- The Ministries of Economy and Treasury, within their respective purviews, are authorized to issue the instructions, orders, and other provisions necessary to implement and fill out the principles established in this Law for purposes of facilitating the implementation of the same.

Art. 51.- The President of the Republic shall issue the Regulations necessary to facilitate application of the Law.

CHAPTER VIII
FINAL AND TRANSITIONAL PROVISIONS

Art. 52.- Owners of enterprises qualified in accordance with the Law for the Promotion of Exports repealed by Legislative Decree No. 460 of this same date, shall be entitled to enjoy the benefits granted by this Law at such time as they fulfill the requirements established therein with regard to the activities in which they engage.

Art. 53.- Executive Branch authorities whose competence includes the granting of benefits and fiscal incentives referred to in the Law for the Promotion of Exports, repealed by the Law for the Reactivation of Exports, should conform their corresponding Executive Actions thereunder with the provisions [of this Law] issuing the respective modifications and revocations of benefits and incentives granted to natural or juridical persons who export any part of their production. Such modifications or revocations should be issued within a period of ninety calendar days from the date of entry into effect of this Decree.

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Art. 54.- Merchandise which as been shipped prior to the entry into effect of this Decree to the order of persons who, as of the date of such shipment, have enjoyed the benefits and fiscal incentives established in the Law for the Promotion of Exports, shall enter the country subject to the provisions under which they[formerly] were covered, so that the beneficiary thereof shall have one hundred and fifty days from the date of entry into effect of this Decree within which finally to register the same.

Merchandise which may be found in the custody of the Customs Authorities of the Republic or in Bonded Warehouses, [consigned] to the order of persons who have enjoyed the exemptions referred to in the Law for the Promotion of Exports, shall remain free of duties and fiscal charges as long as the substantive registration of the same is verified within the forty five calendar days following the entry into effect of this Decree.

Art. 55.- Applications for benefits which, at the moment this Law enters into effect, are being processed by the Ministry of Economy, should be [considered as filed and processed under the provisions of this Law]. The Ministry is authorized to decide upon such applications and to grant benefits [hereunder] unless the applicant decides otherwise.

Art. 56.- This decree shall enter into effect eight days following its publication in the Diario Oficial.

DONE IN THE BLUE ROOM OF THE LEGISLATIVE PALACE: San Salvador, on the fifteenth day of March of nineteen hundred and ninety.

RICARDO ALBERTO ALVARENGA VALDIVIESO
PRESIDENTE

JULIO ADOLFO REY PRENDES
VICEPRESIDENTE

MAURICIO ZABLAH
SECRETARY

MERCEDES GLORIA SALGUEROGROSS
SECRETARY

RAUL MANUEL SOMOZA ALFARO
SECRETARY

NESTOR ARTURO RAMIREZ PALACIOS
SECRETARY

DOLORES EDUVIGES HENRIQUEZ
SECRETARY

PRESIDENTIAL SEAL: San Salvador, on the twenty-seventh day of March of nineteen hundred ninety.

LET IT BE PUBLISHED,

ALFREDO FELIX CRISTIANI BURKARD,
President of the Republic

MARIO ERNESTO ACOSTA OERTEL
Vice-Minister of the Economy
(Acting)

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APPENDIX C

ENGLISH TRANSLATION OF THE

LAW FOR THE REACTIVATION OF EXPORTS

DECREE NO. 460

NATIONAL ASSEMBLY OF THE
REPUBLIC OF EL SALVADOR

CONSIDERING:

I. That, within the gradual scheme of economic liberalization, it is necessary to facilitate exports utilizing those resources in which the nation has [certain] advantages in relation to other markets;

II. That it is necessary to ordain the legal provisions that will contribute to the competitiveness of national products both in regional and extraregional markets;

III. That the existing legal regime relating to foreign commerce does not reflect the tendency toward global commerce and that it is the function of the State to establish a means to permit the adequate utilization of those resources for the purposes of realizing economic development, an adequate level of employment, and the promotion of the social welfare of all its inhabitants;

THEREFORE,

in the use of its constitutional faculties and upon the initiative of the President of the Republic through the Ministers of Economy and of the Treasury,

DECREES the following:

LAW FOR THE REACTIVATION OF EXPORTS

Art. 1.- This Law has for its purpose to promote exports of goods and services outside Central America by means of adequate provisions for the owners of export enterprises gradually eliminating the anti-export orientation generated under the structures of import substitution-based industrial protectionism.

Art. 2.- Natural or juridical persons, nationals or foreign, who are owners of enterprises that export goods and services - with the exception of exports of the following traditional products: coffee, sugar, and cotton - shall enjoy the benefits established under this Law.

Art. 3. Natural or juridical persons, nationals or foreigners, who are owners of enterprises that are exporters of goods and services or trade therein, may enjoy the following:

(a) refund of 6% of the F.O.B. value [of the export] as compensation for importation taxes required to be paid on those goods necessary for the realization of exporting activities. Such refund shall be exempt from payment of income tax thereon. In the case of exports of services, the refund shall be made on the basis of invoiced value. In no case shall such refund exceed 6% and it shall be paid by the Ministry of [the Treasury] within a period no longer than 45 calendar days upon presentation of the respective application therefor and compliance with the following requirements:

(1) Proof that the export was effected under the terms established by this law and other applicable requirements;

(2) Proof of the entry of [the relevant] foreign exchange;

(3) Proof that the beneficiary [of the refund] is in compliance with the requirements established in the various Tax Laws and has, in fact, paid the corresponding taxes upon importation into the country of the goods originating in other countries and that such goods will, in fact, be used in exporting activities.

(b) Total exemption from stamp taxes on exports and from any other indirect taxes required in connection with generating the export.

Art. 4. Owners of enterprises that export, trade in, or partially [assemble] or temporarily process goods or services, shall also enjoy exemption from the property tax in a percentage equal to the exported value thereof, in conformity with the provisions of this Law for each type of qualification therefor. Such exemption shall take effect as of the date of the filing of their application for such benefits.

This exemption shall apply as well to the shareholders, in the case of companies, in proportion to their capital invested therein or [to the extent of] their investment in the activities [subject to such] incentives when involving an individually-owned enterprise.

Owners of enterprises that export less than one hundred percent and who have been qualified under their respective agreements [under the prior export promotion law] and who have, as well, been granted such benefits [under the prior law], shall also enjoy proportional exemption from the tax on property from the effective date of this decree.

Art. 5. Notwithstanding the provisions of Art. 2 of this Law, natural or juridical persons who export traditional products that have undergone a transformation process that incorporates, at a minimum, 30% added value of national origin after such processing, shall have a right to the benefits granted in articles 3 and 4 hereof, upon having qualified therefor with the Ministries of the Economy and the Treasury.

The interested party should file an application [for the incentives] with the Ministry of Economy and provide the requisite proof required under the directions therefor. The Ministry shall evaluate the application within a period not to exceed ten working days and decide whether or not to grant the application.

If the application is denied, the applicant may appeal to the Ministry, within a period of three working days, for reconsideration thereof. This appeal should be decided within a period of no more than five working days from the date of submission thereof.

Art. 6. Temporary exportations of goods for the purpose of repair, maintenance, or similar operations shall not be entitled to enjoy [the incentives] established in Art. 3 of this Law until such goods are finally exported.

Art. 7. Natural or juridical persons, national or foreign, who devote themselves to partial assembly or temporary processing [of goods] may apply for temporary admission status for the temporary importation of goods under an assembly or processing contract.

They as well shall enjoy the benefit of repayment of 6% of the amount of national origin value added thereto incident to temporary assembly or processing operations.

In the same manner, they shall have the right to exemption from the property tax in a percentage that reflects the national origin value added to their exports as a result of such assembly or processing operations.

Persons referred to in the first clause hereof shall have the right to the benefits referred to in articles 3 and 4 of this Law for those exports of theirs that do not involve assembly or processing.

Art. 8. The Ministries of Economy and Treasury are authorized to issue the orders and directions necessary to implement the provisions established in this Law for the purpose of facilitating the application of the same.

Art. 9. The Ministry of Economy, in coordination with the Central Reserve Bank of El Salvador, may establish and regulate special commercial foreign exchange systems as circumstances so require. Under such systems they may authorize, inter alia, [activities such as] barter, payments, assignments, and sales on consignment.

The Central Reserve Bank of El Salvador and the Ministry of the Treasury shall furnish the Ministry of Economy with such information as may be required in connection with [the implementation of] this Law.

Art. 9-A. There is created herewith the Center for Export Procedures - which shall be abbreviated as "CENTREX" - for the purpose of centralizing, speeding up, and simplifying the administrative procedures relevant to exporting activities.

The offices of CENTREX shall be located in the Central Reserve Bank of El Salvador, which institution shall be charged with its administration.

Art. 10. For purposes of the application and interpretation of this Law, preference shall be given to the goals thereof and the nature of the economic activities [regulated thereby]. Only when it is impossible to determine the meaning of its provisions, concepts, or terms from the letter or spirit thereof shall there be resort to common law.

Art. 11. Owners of enterprises qualified in conformity with the Law for the Promotion of Exports repealed by this Law shall have full right to enjoy the benefits granted under this Law so long as they meet the requirements established with regard to their activities.

Natural or juridical persons, national or foreign, who, upon the entry into effect of this Law, have residual raw materials awaiting liquidation that were imported under the coverage of the aforementioned Export Promotion Law, shall enjoy the benefit of [repayment] of 8% thereof, whenever they have paid the amounts taxable upon such residual raw materials that qualify for the repayment of the 8% applied for, [but they shall be] obliged to secure the cancellation of the temporary admission certificates in the Auditing Department of the General Directorate of Customs Receipts.

Art. 12. Executive Branch agencies delegated the authority for the granting of incentives and benefits under the Export Promotion Law which is repealed hereunder shall conform the Executive Agreements approved thereunder with the provisions hereof, [either] issuing the respective modifications or terminating the benefits and incentives granted, within a period of ninety calendar days counted from the entry into effect of this decree.

Art. 12-A. The President of the Republic shall issue the regulations necessary to facilitate and assure the application of this Law.

Art. 13. There is repealed herewith the Export Promotion Law contained in Legislative Decree No. 315 of March 13, 1986 published in Diario Oficial No. 55, Book 290 of March 21, 1986.

Art. 14. This decree shall enter into effect eight days from its publication in the Diario Oficial.

DONE IN THE BLUE ROOM OF THE LEGISLATIVE PALACE: **San Salvador, on the fifteenth day of the month of March of nineteen hundred and ninety.**

Ricardo Alberto Alvarenga Valdivieso
Presidente

APPENDIX D

[DRAFT]

Amendments to the Law for the Promotion/Guaranty of Foreign Investment

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LEGISLATIVE ASSEMBLY OF THE REPUBLIC OF EL SALVADOR

CONSIDERING:

I. - That, by Legislative Decree No. 960 of May 9, 1988, published in Diario Oficial No. 85, Book 299 of May 9, 1988 as amended by Legislative Decree No. 189 of March 1, 1989 published in Diario Oficial No. 49, Book 302 of March 10, 1989 and Legislative Decree No. 413 of December 8, 1989 published in Diario Oficial No. 231, Book 305 of December 13, 1989, there was promulgated the Law for the Promotion and Guaranty of Foreign Investment, with the goal of promoting the economic and social development of the country through foreign investment by regulating the rights and obligations of foreign investors in El Salvador; and

II.- That, there exists within such Law certain provisions that need to be clarified or modified as to their content, or expanded, with the purpose of achieving a better, more attractive framework for foreign investment and a more effective implementation of said Law, so that it is appropriate to introduce the following modifications therein;

NOW THEREFORE,

In the exercise of its constitutional authorities and upon the initiative of the President of the Republic through the Minister of the Economy and the Minister of the Treasury,

DECREES:

The following amendments to the Law for the Promotion and Guaranty of Foreign Investment enacted by means of Legislative Decree No. 960 of May 9, 1988, published in Diario Oficial No. 85, Book 299 of May 9, 1989 as amended by Legislative Decree No. 189 of March 1, 1989 published in Diario Oficial No. 49, Book 302 of March 10, 1989 and Legislative Decree No. 413 of December 8, 1989 published in Diario Oficial No. 231, Book 305 of December 13, 1989:

Art. 1.- Article 2 is amended by removing the reference to the "Ministry of Foreign Commerce" and replacing it with the term "Ministry of Economy".

Art. 2. - Article 5 First paragraph is repealed in its entirety.

Art. 3. - Paragraph 4 of Article 11 is repealed in its entirety and the following new text substituted therefor:

"Upon expiration of such period, if registration has not been effected, it shall be presumed that the Ministry of Economy has authorized and registered the same as described in the application for such registration, and the foreign investor and its investment shall be entitled by operation of law to every one and all of the guarantees for foreign investment set forth in Chapter IV of this Law."

Art. 4. - Chapter IV is repealed in its entirety and the following new text substituted therefor:

"CHAPTER IV
REGARDING GUARANTEES FOR FOREIGN INVESTMENT

"Art. 15. - All registered foreign investment and foreign investment presumed registered under the terms of Paragraph Four of Article 11 hereof and all foreign investors who have effectuated such investments shall be entitled to and are guaranteed to receive the same treatment with regard to the acquisition, establishment, authorization, registration, expansion, management, conduct, operation, sale or other transfer or disposition of such investment as is accorded nationals of El Salvador and their investments.

"Art. 16. - Registered foreign investment and foreign investment presumed registered under the terms of Paragraph Four of Article 11 hereof and all foreign investors who have effectuated such investments shall be guaranteed the following:

a) Free remission of net profits generated by such investments.

b) Free remission of amounts arising from total or partial liquidation of enterprises in the proportion that reflects their percentage foreign capital.

When the company or enterprise in which the investment has been made has suffered losses, the repatriation shall be for the remainder of the foreign investment registered or presumed to have been registered under Paragraph Four of Article 11 hereof after subtracting accumulated losses determined in accordance with the duly audited balance.

c) There shall be recognized as a tax credit against earnings of the foreign investors realized as a result of its foreign investment, that proportional part attributable to its foreign investment of income taxes paid by the company in which such investment has been made.

In this case, the company in which the investment has been made is not obliged to withhold for purposes of income tax those profits or dividends which are paid or credited or presumed legally to have been distributed to the foreign investor.

d) Free transferability of its foreign investment in the country.

e) Free remission of net capital earnings that the foreign investor obtains from the transfer in the country of its registered investment or investment presumed registered under Paragraph Four of Article 11.

f) Unrestricted immigration into the country of such expatriate managerial and technological personnel as may be necessary for the proper management and operation of involved enterprises.

"Art. 17. - Rights acknowledged to a foreign investment are extinguished by cancellation of the respective registration in the Ministry of Economy, which shall do so only for the following reasons:

a) For the foreign investor having remitted the whole of its registered investment or the entire balance remaining after deducting losses suffered.

b) For the transfer in the country by the foreign investor of his registered foreign investment or investment presumed to be registered under Paragraph Four of Article 11 hereof without prejudice to its right to freely remit such investment as profits that have been realized.

In this latter case, in order to avail itself of the benefits of this Law, a foreign acquirer of such investment should effect its registration in the Ministry of Economy.

"Art. 18. - Transfers of foreign exchange originating in registered foreign investments or investments presumed registered under Paragraph Four of Article 11 hereof shall be effected in the currency in which recorded. Such transfers shall be made at the exchange rate applicable on the date such foreign exchange was requested of the Central Reserve Bank of El Salvador.

"Art. 19. - Foreign investment registered under the provisions of this Law and foreign investment presumed registered under the terms of Paragraph Four of Article 11 hereof shall not be expropriated or otherwise taken or subject to taking by the State or any subdivision or public or private agency thereof except: (a) for a public purpose authorized and defined in enacted laws; (b) in a manner that does not discriminate between such investment and that of nationals of El Salvador; (c) upon payment of prompt, adequate, and effective compensation; and (d) in accordance with rights and procedures established therefor under the Political Constitution and laws of El Salvador, including judicial review thereof, and subject to the dispute resolution provisions of Article 22 of this Law.

"Art. 20. - Natural or juridical persons who have registered investments in accordance with this Law or whose investments are presumed registered under Paragraph Four of Article 11 hereof shall have access to financing in the country and to the opening of foreign exchange accounts in the financial system with the goal of facilitating the greatest development of its operations.

Foreign investors who have opened such foreign exchange accounts shall be guaranteed that the balances therein shall not be converted to national currency by action of the monetary authorities."

Art. 5. - Article 20 is renumbered Article 21 and Article 21 of the existing Law is repealed in its entirety and the following new text substituted therefor:

> "Art. 22. - In the event of a dispute or difference between the State and foreign investors relating to their foreign investments, the parties may submit such dispute for arbitration, conciliation, and/or resolution: (a) under the provisions of the Agreement on Differences Relating to Investments Between States and Nationals of Other States according to Decree No. 111 of the Revolutionary Council of Government of December 7, 1982 published in Diario Oficial No. 230, Book 277 of the 14th of the same month and year if the country of such foreign investor is a Party thereto; or, if such country is not a Party to such Agreement, then (b) in accordance with the Arbitration Rules of the United Nation's Commission on International Trade Law (UNCITRAL), or (c) to any other arbitration institution or in accordance with any other arbitration rules as may be mutually agreed to between the parties to the dispute."

Art. 6. - Article 28 is repealed in its entirety.

Art. 7. - All articles of the Law not specifically repealed or amended herein, are renumbered as necessary to accord with the modifications established herein.

Art. 8. - This Decree shall enter into force eight days from the date of its publication in the Diario Oficial.

DONE IN THE BLUE ROOM OF THE LEGISLATIVE PALACE: San Salvador, on the _____ day of the month of _________ of Nineteen Hundred Ninety ___."

APPENDIX E

[DRAFT]

LAW GOVERNING CUSTOMS FREE ZONES
(ZONAS FRANCAS ADUANALES)

LEGISLATIVE ASSEMBLY OF THE
REPUBLIC OF EL SALVADOR

CONSIDERING:

[Premises]

NOW THEREFORE,

In the exercise of its constitutional authorities and upon the initiative of the President of the Republic through the Minister of the Economy and the Minister of the Treasury,

DECREES the following:

LAW GOVERNING CUSTOMS FREE ZONES

CHAPTER I
GENERAL PROVISIONS

Art. 1. - This Law has for its purpose to authorize and to regulate the establishment and operation of Customs Free Zones in the national Customs Territory of El Salvador.

Art. 2. - "Customs Free Zone" means a secured area of the national territory previously approved as such and set aside for the purposes described herein subject to a special customs regime wherein enterprises, national or foreign, upon approval of the Ministry of Economy, may establish and install themselves for the purpose of undertaking under bond: (a) the establishment and administration of such Zones; (b) the storage, warehousing or commercialization of goods destined either for importation into or exportation beyond the national customs territory; (c) the repair or maintenance of goods; or (d) the production, assembly, or processing of goods from inputs, foreign or domestic, for eventual importation into or exportation beyond the customs territory of El Salvador, as well as the realization of services to support the foregoing.

Art. 3. - Establishment, administration, and operation of Customs Free Zones shall be authorized and regulated by the Ministry of Economy in accordance with the provisions of this Law and of the Regulation(s) issued to implement it. The enforcement and control of the customs regime in such Zones shall be the responsibility of the Ministry of Treasury in accord with the provisions of this Law, it Regulation(s), and other applicable customs and fiscal legislation.

Art. 4. - The provisions of this Law shall apply to persons, natural or juridical, national or foreign, which: (a) develop Customs Free Zones; (b) administer them; or (c) are users of the same.

Art. 5. - The following activities shall not be authorized or undertaken in the Customs Free Zones: (a) travel agencies and airline operations; (b) air, sea, or land transportation (except as support services made available in such Zones for the developers, administrators, or users of the same); (c) activities governed by the banking or financial laws of the country; (d) services unrelated to international commerce in accord with the provisions of the Regulation(s) for this Law; (e) petroleum and natural gas exploitation; (f) mining in its extractive phase; (g) hotels; (h) production or storage of contaminating merchandise; or (i) activities involving the processing or management of explosives or radioactive materials.

Art. 6. - The following persons shall not be authorized to operate in or conduct activities of any kind in the Customs Free Zones: (a) natural or juridical persons which have been suspended from operating in or expelled from such Zones under the provisions of Chapter VI of this Law or prior laws authorizing and regulating the establishment and operation of Free Zones; and (b) companies among whose directors or shareholders are persons which are or have been directors or shareholders of enterprises which have been suspended from operating in or expelled from such Zones under the provisions of Chapter VI of this Law or prior laws authorizing and regulating the establishment and operation of Free Zones.

Art. 7. - For purposes of the interpretation and application of this Law, preference shall be given to the purpose of the same and the nature of the economic activities regulated herein. Only when it is impossible to determine the meaning of the provisions, concepts, or terms herein from the letter or spirit thereof shall there be resort to the provisions, concepts, or terms of common law.

CHAPTER II
REGARDING THOSE WHO DEVELOP AND ADMINISTER CUSTOMS FREE ZONES

Art. 8. - Private natural or juridical persons, nationals or foreigners, who are authorized to establish and approved to administer Customs Free Zones under the provisions of this Law shall enjoy:

a) total exemption from the Income Tax for a period of fifteen years counted from the accounting year in which it initiates operations, in the case of developers, or from the accounting year in which it commences the administration of a Zone, in the case of administrators.

This exemption, in the case of companies, shall be applied both to the Company which is the proprietor and/or administrator of the Zone as well as to its individual partners and shareholders, solely with respect to the earnings or dividends arising out of activities authorized under this Law.

and

b) total exemption from fiscal imposts upon the assets or property within a Customs Free Zone of an enterprise which is a developer and/or administrator of the same from the accounting year in which it initiates operations, in the case of developers, or from the accounting year in which it commences the administration of such Zone, in the case of administrators.

This exemption also shall be applied, in the case of companies, both to their individual partners and shareholders to the extent only of their registered investment in the assets or property so exempted.

Art. 9. - The Economic Arm of the Executive Branch may delegate by agreement the administration of Customs Free Zones which are properties of the State to private natural or juridical persons, nationals or foreigners, to which end there shall be concluded a contract for which purpose the State shall be represented by the Minister of the Economy or the person he designates therefor. The administration of private Customs Free Zones may be delegated to natural or juridical persons, nationals or foreigners, by means of a notarized public contractual document evidencing such delegation and the terms thereof.

Art. 10. - An authorized administrator of a Customs Free Zone shall be directly responsible for the direction, administration, and management of such Zone and shall have the following specific responsibilities:

a) processing of applications for installation in the Zone under his administration that may be presented by parties approved for operations in such Zone under the provisions of Chapter V hereof;

b) contracting with approved users for the sale or lease of lots in the Zone and the conditions governing their operations therein; and

c) any other matters related to the direction, administration, management, and security of the Zone.

Art. 11. - For purposes of this Law, the following shall be reasons for the termination of a Customs Free Zone user's lease contract: (a) default in payment(s) under the lease contract; (b) suspension of approval to operate or expulsion from the Zone in accordance with the provisions of Chapter VI of this Law; and (c) any other just cause therefor under Salvadoran common law.

CHAPTER III
REGARDING USERS OF CUSTOMS FREE ZONES

Art. 12. - An "user" of a Customs Free Zone shall be understood to mean a natural or juridical person, national or foreign, duly registered with and authorized under the provisions of Chapter V of this Law to operate in such Zone and to undertake one or more of the activities described in Article 2 of this Law.

Art. 13. - Users of Customs Free Zones may conclude service contracts for in-bond production, assembly, and/or processing operations in the Zone with contractors, national or foreign, domiciled in El Salvador or abroad, pursuant to the agreed terms and conditions of which the contractor may supply raw materials, parts, pieces, components, semi-finished products, intermediate products and any other inputs that the Zone user utilizes in such operations on behalf of and for the account of the contractor according to the terms of such contracts and in accord with the provisions of this Law.

CHAPTER IV
TEMPORARY ADMISSION CUSTOMS REGIME

Art. 14. - Except as specifically provided otherwise in this Law, the provisions of this Chapter shall apply only in the Customs Free Zones authorized under this Law and only to the activities and operations of developers, administrators, and users thereof duly registered and approved by the Ministry of Economy under Chapter V of this Law. Any activities and/or operations other than those specifically authorized under this law and approved by the Ministry of Economy for purposes of this Law conducted in any Customs Free Zone by any persons, natural or juridical, national or foreign, whether or not approved by the Ministry of Economy under Chapter V hereof or not, shall be subject to the Customs Laws and Regulations of El Salvador.

Art. 15. - There is authorized herewith the Temporary Admission Regime, which shall apply to and govern only those activities in the Customs Free Zones specifically authorized under this Law and approved by the Ministry of Economy to developers, administrators, and users of such Zones registered with and approved by the Ministry of Economy.

Art. 16. - The Temporary Admission Regime shall be applied to all developers, administrators, and users of Customs Free Zones registered with and approved by the Ministry of Economy under the provisions of Chapter V of this Law which: (a) develop, establish, or administer Customs Free Zones; (b) deal in or commercialize the importation into or exportation beyond the customs territory of goods and their in-bond storage or warehousing in such Zones pending their withdrawal therefrom, in whole or in part, either for importation into the customs territory upon payment of applicable customs duties, import taxes, and other charges or exportation beyond the customs territory upon payment of applicable export taxes and other charges; (c) provide in-bond repair and maintenance services on goods entered into the Zone for that purpose from either the customs territory or beyond the same; and (d) engage in in-bond production, assembly, or processing within such Zones resulting in the enhancement or goods or the transformation of inputs, foreign or domestic, into final products destined either for importation into the customs territory upon payment of applicable customs duties, import taxes, and other charges or for exportation beyond the customs territory upon payment of applicable export taxes and other charges.

Art. 17. - For purposes of this Law "Temporary Admission" means the authorized entry into and retention and use within a Customs Free Zone for an approved temporary period of time of products, goods, or materials originating within or beyond the customs territory utilized in or related to: (a) the development, establishment, or administration of such Zones; (b) the in-bond storage or warehousing of goods within such a Zone; (c) the in-bond repair or maintenance of products, goods, and/or materials originating within or beyond the customs territory; or (d) the in-bond production, assembly, or processing of products, goods, and/or materials originating within or beyond the customs territory, incident to which the payment of customs duties, import or export taxes or other related charges otherwise applicable to such entry, is suspended or deferred subject to the establishment in favor of the State of an acceptable bond for the entire value of such duties, taxes, or charges and the security requirements established in the Regulation(s) implementing this Law.

Art. 18. - Entry of products, goods, or materials into any Customs Free Zone in accordance with the Temporary Admission Regime established in this Chapter shall be authorized and occur only upon the prior issuance by the Ministry of Treasury to an approved developer, administrator, or user of such Zone of a written Temporary Admission Permit specifying for each such entry the nature and amount of products, goods, and/or materials whose entry is authorized thereunder, the period of temporary admission authorized, and establishing the value of the bond required covering applicable customs duties, import or export taxes, or other charges, PROVIDED THAT, the Ministry of Treasury, upon written request of the Ministry of Economy, may issue General Temporary Admission Permits covering multiple entries of specified types and/or volumes of such products, goods, or materials, for a period not to exceed one year from the date of issuance thereof, subject to the conditions and procedures provided for in the Regulation(s) issued for the implementation of this Law.

Art. 19. - The period of retention within a Customs Free Zone for products, goods, and/or materials entered therein under the Temporary Admission Regime shall not exceed 18 months counted from the date of their initial entry into such Zone, PROVIDED THAT, the period of authorized Temporary Admission for products, goods, and/or materials entered to facilitate and/or support the operations of developers and/or administrators in the establishment, installation, and administration of such Zone may be fixed for a period not to exceed the period authorized for their activities or operations within the Zone in the resolution registering and approving such activities. Upon application of a developer, administrator, or user of a Customs Free Zone, the Ministry of Treasury may extend this period of approved Temporary Admission for a maximum of 60 days on a one-time basis only in cognizance of the purposes of this Law.

For those products, goods, and/or materials which have been entered into a Customs Free Zone pursuant to a lease or other contractual arrangement that does not imply transfer of ownership, the respective contract therefor, if approved in advance by the Ministry of Economy, shall determine the period of Temporary Admission under the Temporary Admission Regime.

Art. 20. - For purposes of this Chapter only, the terms "National Value-Added" and "Foreign Value-Added" shall have the following meanings:

"National Value-Added" of any product, good, or material shall mean the total value of the item itself if it wholly originated within the national customs territory of El Salvador or, if it did not, the aggregate value of any tangible inputs that have been added to, incorporated within or used up or consumed incident to its manufacture, fabrication, elaboration, or other production that originated within the national customs territory of El Salvador and/or within a Customs Free Zone, plus the value of any services of storage or warehousing, repair or maintenance, or production, assembly, or processing performed thereon or with regard thereto that occurred within the national customs territory of El Salvador or within a Customs Free Zone, plus the value, of all customs duties, import and/or export taxes, or other charges, if any, associated with its importation into or exportation beyond the customs territory.

"Foreign Value-Added" of any product, good, or material shall mean the total value of the item itself if it wholly originated beyond the national customs territory of El Salvador and/or a Customs Free Zone, or, if it did not, the aggregate value of any tangible inputs that have been added to, incorporated within or used up or consumed incident to its manufacture, fabrication, elaboration or other production that originated beyond the national customs territory of El Salvador and/or a Customs Free Zone, plus the value of any services of storage or warehousing, repair or maintenance, or production, assembly, or processing performed thereon or with regard thereto that occurred beyond the national customs territory of El Salvador and/or a Customs Free Zone, less the value of all customs duties, import and/or export taxes, or other charges associated with its importation into the national customs territory of El Salvador and/or its entry into a Customs Free Zone.

Art. 21. - Under the Temporary Admission Regime established in this Chapter, approved developers, administrators, and users of Customs Free Zones may, upon presentation of the required Temporary Admission Permit or General Temporary Admission Permit, enter into such Zones without payment of applicable customs duties, import taxes, or other charges, but subject to the posting of an acceptable bond in favor of the State in the entire amount of any customs duties, import taxes, and/or other charges assessable on the Foreign Value-Added thereof, the following:

a) machinery, equipment, tools, parts, spare parts, accessories, implements, or utensils and any other similar such items that are essential to the establishment and/or administration or use of such Zones for any of the purposes authorized under Article 16 of this Law;

b) products, goods, or materials intended for in-bond storage or warehousing within a Zone for subsequent withdrawal, in whole or in part, for importation into or exportation beyond the national customs territory;

c) products, goods, or materials entered into a Zone for in-bond repair and/or maintenance services;

d) raw materials, parts, pieces, components, semi-finished products, intermediate products, and any other inputs utilized in in-bond production, assembly, and/or processing operations within a Zone; and/or

e) containers, labels, samples, models, packaging materials, brochures, manuals, blueprints, other similar such items normally utilized in any of the operations authorized under Article 16 of this Law,

PROVIDED THAT, such products, goods, and/or materials are either: (a) consumed entirely, used up, or destroyed incident to such operations; (b) imported into or exported beyond the national customs territory upon payment of applicable customs duties, import or export taxes, and other charges; (c) are destroyed within the Zone under procedures approved by the Ministry of Economy and the Ministry of Treasury; or (d) are donated to the State free of any applicable liens or liabilities under procedures specified in the Regulation(s) implementing this Law.

Art. 22. - Notwithstanding the foregoing PROVISO to Article 21, machinery, equipment, apparatus, instruments, tools, implements, and utensils entered into a Customs Free Zone, may be sold, leased, or otherwise transferred for value by an approved user of the Zone upon cessation of its operations in the Zone to a developer, administrator, or other users operating in the same Zone subject to the transferee's presentation of an acceptable bond in favor of the State for the entire value of any customs duties, import taxes, or other charges assessable on the Foreign Value-Added thereof under procedures specified in the Regulation(s) implementing this Law.

Art. 23. - The Ministry of Treasury may, upon application therefor and concurrence of the Ministry of Economy, authorize by issuance of a Temporary Admission Permit the entry into a Customs Free Zone under the Temporary Admission Regime of products, goods, or materials determined by the Ministry of Treasury to be essential to operations in the one authorized in Article 16 hereof, which were not foreseen in the application and approval resolution, under procedures specified in the Regulation(s) implementing this Law.

Art. 24. - Upon the prior written approval of the Ministry of Economy and issuance by the Ministry of Treasury of the corresponding Temporary Exit/ReAdmission Permit, an approved user of a Customs Free Zone may enter temporarily into the national customs territory those products, goods, and/or materials specified in such Permit for purposes of repair and maintenance thereof or production, assembly, and processing by a subcontractor located therein, which the Ministry of Economy has determined in advance are not economically or technologically feasible for undertaking within the Zone and subject to the user's presentation of an acceptable bond for the entire value of any Customs duties, import or export taxes, or other charges assessable upon the Foreign Value-Added thereof, under procedures specified in the Regulations(s) implementing this Law. Such products, goods, and materials may be reentered thereafter into the Customs Free Zone under the Temporary Admission Regime. Upon reentry into such Zone, there shall be paid only those customs duties, import or export taxes, or charges assessable upon the National Value-Added directly related to such temporary exit from the Zone. The maximum period for any such temporary exit/readmission shall be six months from the date of issuance of the Temporary Exit/ReAdmission Permit for the products, goods, or materials specified therein. Failure to return the products, goods, or materials specified in the Permit within the period established therein for such temporary exit may result in forfeiture of the bond.

Art. 25. - Export of goods and services by natural or juridical persons operating in the national customs territory or in Customs Free Zones to enterprises operating in Free Zones located in other Central American countries shall be considered, for customs purposes, as a substantive export to countries beyond the Central American area.

Art. 26. - Upon the issuance by the Ministry of Treasury of the appropriate Temporary Exit/ReAdmission Permit, products, goods, or materials entered into a Customs Free Zone under the Temporary Admission Regime may be transported through the national customs territory to another Customs Free Zone without payment of the corresponding customs duties, import or export taxes, or other charges upon presentation of an acceptable bond in favor of the State for the entire value of customs duties, import or export taxes, or other charges assessable upon the Foreign Value-Added thereof under procedures specified in the Regulation(s) implementing this Law.

CHAPTER V
REGISTRATION AND APPROVAL PROCEDURES

Art. 27. - Natural or juridical persons, national or foreign, desiring to establish, administer, or become users of Customs Free Zones authorized under the provisions of this Law, should file the appropriate application therefor with the Ministry of Economy through their attorney or designee for such purpose for registration and approval to operate within any such Zone. The Ministry of Economy, with the concurrence of the Ministry of Treasury, shall prescribe the form and content of such application and include the same in the Regulation(s) implementing this Law.

Art. 28. - In its application, the applicant shall indicate the activity in which it currently engages, the activity it proposes to undertake in the Customs Free Zone, the general characteristics of the enterprise and industry involved; in the case of developers, the size in area and in number of enterprises likely to operate within the Zone, the financing thereof, the services and utilities to be furnished; in the case of administrators the background and experience of the enterprise and its personnel in similar activities; and, in the case of users, the volume of products, goods, or materials it contemplates storing or warehousing, repairing and maintaining, or producing, assembling and/or processing, the volume of entries likely in any year under the Temporary Admission Regime; and, in the case of all applicants, appropriate legal documentation of establishment, status, creditworthiness, prior operational history, and such other information as may be required by the Ministry of Economy as specified in the Regulation(s) implementing this Law. The Ministry of Economy, with the concurrence of the Ministry of Treasury, shall produce separate application forms for developers, administrators, and users of Customs Free Zones and shall append thereto a complete statement of informational requirements for each type of application.

Art. 29. - If the application as filed is found to be complete as to the informational and documentary requirements therefor, it shall be accepted by the Ministry of Economy who shall proceed to process it. A copy of the application shall immediately be forwarded to the Ministry of Treasury for its written opinion which shall be issued to the Ministry of Economy within ten days of the date of its receipt. If no response from the Ministry of Treasury is received within such period, the Ministry of Economy shall presume the Ministry of Treasury's response is favorable to the application.

Art. 30. - Within ten days of receipt of the Ministry of Treasury's opinion, or, in lieu thereof, within twenty days from the receipt of the accepted application, the Ministry of Economy shall issue either a Final Resolution approving the application and registering the applicant as an approved developer, administrator, or user of one or more Customs Free Zones and entitled to the benefits of the Temporary Admission Regime, and, in the case of developers and administrators, to the benefits set forth in Article 8 of this Law, or it shall issue a Proposed Resolution denying the application for such causes as shall be described in full in the Proposed Resolution and justifying its denial thereof. If the denial was based in whole or in part upon an unfavorable opinion of the Ministry of Treasury, a copy of such opinion shall be annexed to the Proposed Decision denying the application.

Art. 31. - If an application is not accepted by the Ministry of Economy for failure of the application to provide the information or meet such other requirements therefor as specified in the Regulation(s) implementing this Law and the directions appended to the application, the Ministry shall inform the applicant in writing of the inadequacies of the application, specifying the information applicant has failed to submit or describing any other problems reflecting failure to meet the informational or documentary requirements therefor and noting the date upon which the application was presented by the applicant to the Ministry. The Ministry of Economy shall afford the applicant thirty days from the date of such communication within which to provide any missing information or to cure any other problems reflecting its failure to meet the informational or procedural requirements therefor within which to resubmit the application. Any applicant that fails to resubmit the application with the information and documentation required within such period of time shall forfeit any right of appeal under this Law for failure of the Ministry to take further action on the application and shall not be entitled to apply for approval and registration under the provisions of this Law for one calendar year following the expiration of such thirty days.

Art. 32. - If the Ministry of Economy issues a Proposed Resolution denying the application, the applicant shall have thirty days from the date thereof within which to submit to the Ministry of Economy a written petition for reconsideration thereof together with such arguments and documentation as it considers relevant to such denial. The Ministry of Economy shall decide the matter by means of issuance of a written Final Decision either approving the application or affirming its denial thereof within 15 days of its receipt of applicant's petition for reconsideration. If it affirms its prior denial of the application, it shall indicate therein its response particularly to any new information or documentation or arguments of the Applicant in its petition. The Ministry of Economy shall prescribe the form of such petition and basic content required therefor in the Regulation(s) implementing this Law and in the Directions appended to the application form.

CHAPTER VI
PENALTIES, APPEALS AND CESSATION OF OPERATIONS

Art. 33.- Developers, administrators, and users of Customs Free Zones approved and registered under Chapter V of this Law shall have the following obligations:

a) notification to the Administrator of the Customs Free Zone and the Ministry of Economy with regard to any modifications realized in the plans and projects of their operations within a period of ten working days from the date thereof;

b) to record and describe their operations in books and registers that permit a true accounting thereof;

c) furnish to the competent authorities the information requested regarding the use and the destination of articles entered into the Zone under the provisions of this Law as well as confirmation of the same by them whenever they deem it appropriate; and

d) compliance with all other obligations and requirements of this Law and the Regulation(s) implementing it.

Art. 34. - Whenever deemed appropriate, the Ministry of Economy and/or the Ministry of Treasury, in the areas of their respective authority specified in this Law, may investigate persons enjoying the benefits of this law and their operations in the Customs Free Zones for the purpose of ensuring and enforcing compliance with the provisions of this Law.

Art. 35. - In addition to the sanctions which may be applicable in accordance with the Penal Code, beneficiaries of this Law, in the event of any noncompliance with the requirements herein, may be penalized administratively by the Ministry of Economy or by the Ministry of Treasury on the basis of information furnished by other public institutions or the Ministries themselves. Penalties shall be imposed in proportion to the gravity of the infraction and may consist of: (a) fine; (b) temporary suspension of benefits and rights under this Law; (c) expulsion from the Customs Free Zone and revocation of any benefits granted under this Law; and (d) seizure of products, goods, and/or materials involved with such noncompliance, if the noncompliance also constitutes a violation of criminal law. The sanctions of temporary suspension or expulsion and revocation of benefits shall not prevent the imposition of fines.

Art. 36. - The fines referred to in the foregoing Article may be imposed up to a value equal to the entire value of the customs duties, import or export taxes, and other charges that would have been payable except for the deferral or suspension thereof under the Temporary Admission Regime, without prejudice to payments of corresponding taxes and charges. In the event a bond in favor of the State has been accepted and instituted by a beneficiary of this Law covering applicable customs duties, import and export taxes, and other charges, the violator shall forfeit the entire amount of such bond to the State and the forfeiture thereof shall be in lieu of the imposition of any fine.

Art. 37. - In the event of repeated instances of noncompliance which have been sanctioned previously with fines or of noncompliance which also constitutes violation of criminal laws, a beneficiary of this Law may be expelled from a Customs Free Zone and deprived of all further benefits under this Law.

Art. 38. - If the noncompliance with the provisions of this Law also constitutes violation of criminal laws of the Republic, the Ministry of Economy or the Ministry of Treasury shall certify such matter to the Attorney General of the Republic to prosecute or take other actions indicated. In the event of a final conviction for violation of criminal law, the products, goods, and materials involved with such noncompliance and criminal violations present in the Zone shall be seized and converted to the use of the State.

Art. 39. - No action regarding any alleged noncompliance with the provisions of this Law may be taken pursuant to this Chapter until the Ministry involved shall have notified in writing a beneficiary of this Law of the alleged noncompliance, setting forth the specific facts and circumstances of the non-compliance asserted, and afforded the alleged violator the opportunity to respond in writing with respect to the substance of the assertion of noncompliance. Such notification shall include notice to the alleged violator that it is entitled to request a hearing on the matter prior to any final action being taken by the Ministry to impose sanctions for any noncompliance and to present witnesses or documentation to refute the allegation of noncompliance. If the alleged violator requests such a hearing in writing, the Ministry shall provide him with such a hearing before an appropriate official of the Ministry within ten working days of the date of such request. Any decision thereafter to impose and enforce sanctions for noncompliance with the provisions of this Law shall be referred to, made, and communicated in writing by the Minister of the Economy or the Minister of Treasury, as the case may be. Such decision shall be communicated to the appropriate authorities and ordered published in the Diario Oficial.

Art. 40. - Any beneficiary of this Law which ceases the activities approved for it in a Customs Free Zone for any continuous period in excess of four months, shall lose any right to continue further operations under this Law and any benefits accorded thereby, including fiscal incentives corresponding to the accounting year in which it ceased its activities, as well as use of the Temporary Admission Regime, and shall be required to reapply for approval to operate in the Zone under the same procedures set forth in Chapter V of this Law.

Art. 41. - In the event of the cessation of operations and abandonment of any enterprise located in a State-owned Customs Free Zone for more than four months counted from the date of the initiation of such operations therein, judicial procedures may be invoked for compliance with any unfulfilled obligations and for possession of the realty even though the lessee may not be in default of any lease payments or provisions.

Art. 42. - Any natural or juridical person who has been approved for the benefits of this Law and registered as a developer, administrator, or user of a Customs Free Zone with regard to whom the benefits of this Law have been suspended or which has been expelled from a Customs Free Zone in accordance with this Chapter, may not thereafter reapply for such benefits or apply for such benefits on behalf of any other enterprise nor may they become a director or shareholder of any company receiving or applying therefor.

Art. 43. - Companies among whose directors or shareholders are persons who were directors or shareholders of enterprises that have been suspended from operations or expelled from Customs Free Zones under this Law shall have no right to any benefits granted hereunder beginning from the accounting year in which the noncompliance upon which such sanctions were imposed occurred.

CHAPTER VII
TRANSITORY AND FINAL PROVISIONS

Art. 44. - The Law Governing Free Zones and Bonded Warehouses contained in Legislative Decree No. 461 of March 15, 1990 published in Diario Oficial No. 88, Book 307 of April 18, 1990 is repealed in its entirety and the provisions of this Law are substituted therefor.

Art. 45. - Article 216 of Chapter I, Title Four of the Credit Institutions and Auxiliary Organizations Law contained in Legislative Decree No. 94 of September 17, 1970, published in Diario Oficial No. 199, Book 299 of October 30, 1970 is repealed in its entirety and the following new text substituted therefor:

> "Art. 216. - The operations of general depository warehouses shall include the guardianship and custody of products produced or legally introduced into the country."

Henceforth, said law shall not govern or apply to any activities or operations carried on in Customs Free Zones and/or under the provisions of this Law or to any goods, merchandise, products, or materials subject to this Law or to the Customs laws and regulations of this country.

Art. 46. - Owners and partners or shareholders of enterprises qualified in accordance with the Law Governing Free Zones and Bonded Warehouses contained in Legislative Decree No. 461 of March 15, 1990, published in Diario Oficial No. 88, Book 307 of April 18, 1990 shall continue to enjoy all benefits, including fiscal incentives, granted them under such law for such fixed periods of time as provided for therein as long as they fulfill the requirements therefor specified in said law, but the periods for such benefits shall not be extended beyond the initial period therefor specified in said law and the Resolution issued thereunder. Nor shall any other incentives or benefits be granted under or applications therefor accepted under said law.

Art. 47. - Natural or juridical persons, national or foreign, who have been approved for operations in the Customs Free Zones under the provisions of Chapter V of this Law and who export products to destinations beyond the countries that are members of the Central American Common Market may avail themselves of the incentives and benefits provided under the General Law for Exports contained in Legislative Decree No. ___ of_______, 19__, published in Diario Oficial No. ___, Book No. ___ of __________, 19__ in accordance with the substantive and procedural provisions and requirements of that law.

Art. 48. - Merchandise which has been shipped prior to entry into effect of this Decree to the order of persons who, as of the date of such shipment, enjoyed the benefits and fiscal incentives established in the Law Governing Free Zones and Bonded Warehouses repealed by this Law, shall enter the country subject to the provisions of the former law and a beneficiary thereof shall have one hundred and fifty days from the date of entry into effect of this Decree within which finally to register the same.

Art. 49. - Merchandise found in the custody of the Customs Authorities of the Republic or in Bonded Warehouses consigned to the order of persons who enjoyed exemptions referred to in the Law Governing Free Zones and Bonded Warehouses, shall remain free of duties and fiscal charges as long as the substantive registration of the same is verified within the forty-five calendars following entry into effect of this Decree.

Art. 50. - Executive Branch authorities whose competence includes the administration and implementation of the Law Governing Free Zones and Bonded Warehouses repealed under this Law, shall conform their actions and the performance of functions thereunder to the provisions of this Law except in those instances in which the provisions of this Law are clearly inconsistent with the rights of beneficiaries and the mandatory substantive provisions of the former law.

Art. 51. - The Ministries of Economy and of Treasury, within their respective authorities specified under this Law, are authorized to issue the regulations, instructions, orders, and other provisions necessary to implement and realize the principles and goals of this Law.

Art. 52. - The President of the Republic shall issue the Regulation(s) necessary to facilitate implementation of this Law.

Art. 53. - This Decree shall enter into effect eight days following its publication in the Diario Oficial.

DONE IN THE BLUE ROOM OF THE LEGISLATIVE PALACE: San Salvador, on the _______ day of ______ of Nineteen Hundred and Ninety-___.

APPENDIX F

[DRAFT]

LAW FOR THE ENCOURAGEMENT OF EXPORTS

LEGISLATIVE ASSEMBLY OF THE REPUBLIC OF EL SALVADOR

CONSIDERING:

[Premises]

NOW THEREFORE,

in the exercise of its constitutional authorities and upon the initiative of the President of the Republic through the Minister of the Economy and the Minister of Treasury,

DECREES the following:

LAW FOR THE ENCOURAGEMENT OF EXPORTS

Art. 1. - This Law has for its purpose the encouragement and increase of exports of Salvadoran goods and services from El Salvador and beyond the Central American area by means of the granting of benefits to exporters consistent with international standards governing global trade in goods and services.

Art. 2. - This Law shall apply to all natural or juridical persons, national or foreign, in El Salvador who are engaged in the exportation beyond the Central American area of goods and services of Salvadoran origin.

Art. 3. - The term "Qualified Goods and Services" shall mean all products, goods, and materials of Salvadoran origin other than Coffee, Sugar, and Cotton, actually exported from El Salvador beyond the Central American area and any services performed in El Salvador directly involved in the production, fabrication, elaboration, or assembly or processing of goods exported from El Salvador beyond the Central American area. The term "Qualified Exporter" shall mean those Salvadoran persons, natural or juridical, national or foreign, who have effected exports of qualified goods in any calendar year, but shall not include any user of a Customs Free Zone approved and registered for operations therein under the Law Governing Customs Free Zones, Legislative Decree No. ____ of __________, _____ published in Diario Oficial No. ____, Book ____ of _________, 19__.

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Art. 4. - Natural or juridical persons, nationals or foreign, who are exporters of qualified goods and/or services shall be entitled to the refund of import taxes and other charges, other than Customs duties, actually paid in any year upon the importation into the national customs territory of El Salvador of products, goods, and materials consumed in or utilized in the production, fabrication, elaboration, or assembly or processing of qualified goods or services that have actually been exported in such year. Such refunds shall be exempt from the payment of income or other taxes thereon.

Art. 5. - In the case of qualified goods, the amount of such refund shall be calculated as that percentage of total import taxes and charges, other than Customs duties, actually paid in any year equal to the percentage of total production actually exported during such year. In the case of qualified services, the amount of such refund for any year shall be equal to six percent of the total invoiced value of such services actually exported during such year.

Art. 6. - The Application for Import Tax Refund shall include the following information:

a) the amount and proof therefor of payments of import taxes and other charges, other than Customs duties, actually paid upon which the application for refund is based;

b) proof that the imported products, goods, and materials upon which the import taxes that were paid for which refund is sought were actually thereafter consumed or utilized directly in the production, fabrication, elaboration, or assembly or processing of goods actually exported;

c) information detailing the nature, volume, and value of the exports realized that were manufactured or produced using the products, goods, and materials for which import taxes and other charges, other than Customs duties, were paid for which refund is claimed;

d) proof that the goods described in paragraph c) hereof were, in fact, exported;

e) proof of the entry of the foreign exchange realized as a result of payment received for such exports or, if such payment has not been received, proof of the invoiced value thereof due and payable on such exports; and

f) proof that the applicant is in compliance with the requirements of the nation's income and other tax laws.

Art. 7. - The Ministry of Treasury, with the concurrence of the Ministry of Economy, shall prescribe the form and content of such application in accord with Article 6 hereof and include the same in the Regulation(s) implementing this Law. The Ministry of Treasury, with the concurrence of the Ministry of Economy, shall produce an "Application for Import Tax Refund" form reflecting the informational requirements established in Article 6 hereof and in the Regulation(s) implementing this Law to each copy of which shall be appended detailed instructions for the filling out and presentation of such Application form.

Art. 8. - Applications for the refund of import taxes and other charges authorized under Articles 4 and 5 of this Law shall be presented for any year to the Ministry of Treasury no later than thirty days after the expiration of the first quarter of the year following the year in which the import taxes and other charges were paid that form the basis for the application for refund. The Ministry of Treasury shall not accept or process applications for such year received after the expiration of said thirty day period. All Applications for Refund of Import Tax shall be date stamped with the date on which such applications were actually presented to the Ministry of Treasury.

Art. 9. - The Ministry of Treasury shall determine the sufficiency of any Application for Refund of Import Tax within five working days of its stamped receipt date and shall decide on the basis of such determination whether to accept or reject such Application. If an Application is deemed insufficient in terms of required information and/or documentation and rejected, the Ministry of Treasury shall notify the applicant in writing thereof specifying the information or documentation the applicant has failed to submit, which notification shall be communicated no less than ten working days of the stamped receipt of the Application. In its notification of insufficiency, the Ministry shall afford the applicant 15 working days from the date of such notification within which to submit the required information and documentation. In the event of the failure of the Ministry of Treasury to provide such notice of insufficiency of information and/or documentation with regard to any Application for Refund of Import Taxes, the sufficiency of such Application shall be presumed and the Ministry shall be required to refund the amount claimed in the Application. If an applicant fails to submit the information or documentation described in the Ministry's notification of insufficiency of the Application within the 15 days specified therein, the applicant shall be deemed to have waived such refund and shall not be entitled to any such refund for the year involved.

Art. 10. - The refund authorized in Articles 4 and 5 of this Law, upon acceptance of the corresponding Application for Refund of Import Taxes, shall be paid to qualified exporters not later than forty days after the expiration of the second quarter of the calendar year in which the import taxes and other charges which form the basis of the application for refund were actually paid. Failure of the Ministry of Treasury to effect such payments by or before such date shall oblige it to add to the amount of such refund the additional payment of interest thereon in the amount of the average rate of interest on bonded indebtedness of the State issued by the Government of El Salvador in the prior year.

Art. 11. - Notwithstanding Article 3 of this Law, natural or juridical persons, national or foreign, who export Coffee, Sugar, or Cotton that have undergone a process of substantial transformation resulting in a new or finished product that incorporates, at a minimum, 30 percent of national origin value-added therein, shall also be considered "qualified exporters" and shall be entitled to refund of import taxes and other charges, other than Customs duties, under the provisions of Articles 4 and 5 of this Law upon having submitted an application therefor in accord with Article 6 of this Law.

Art. 12. - The Direction General of Customs of the Ministry of Treasury shall provide receipts to all importers evidencing all payments made in connection with the importation of any products, goods, or materials into the national customs territory, indicating therein specifically, the import taxes and other charges, other than Customs duties, actually liquidated and paid on each entry into the national customs territory and shall stamp the same with the dates of entry and of payment and seal such receipts with the seal of the Direction General of Customs. Thereafter, such receipts shall constitute definitive and irrebutable documentation of payments of import taxes and other charges for purposes of the fulfilling the informational and documentary requirements of Article 6 a) of this Law.

Art. 13. - The Ministers of the Economy and Treasury are authorized to issue the Regulation(s), orders, and directions necessary to implement and apply this Law.

Art. 14. - The Ministry of Economy, in coordination with the Central Reserve Bank of El Salvador, may establish and regulate special commercial foreign exchange systems as circumstances so require. Under such systems, they may authorize, inter alia, barter, consignment, assignments, and sales on consignment. The Central Reserve Bank of El Salvador and the Ministry of Treasury shall furnish the Minister of Economy with such information as may be required in connection with implementation of this Law.

Art. 15. - The Center for Export Procedures - which shall be abbreviated as "CENTREX" - shall continue as the office charged with the centralizing, acceleration, and simplifying of administrative procedures relevant to exporting. The offices of CENTREX shall be located in the Central Reserve Bank of El Salvador, which institution shall remain charged with its administration.

Art. 16. - Owners and partners or shareholders of enterprises previously qualified for fiscal incentives and other benefits in accordance with the Law for the Reactivation of Exports contained in Legislative Decree No. 460 of March 23, 1990, Diario Oficial No. 88, Book 307 of April 18, 1990, shall continue to enjoy the benefits of said law with regard to all exports effected prior to the date of entry into effect of this Law for the Encouragement of Exports and shall have full right to claim refunds available under this Law with regard to all import taxes and other charges and exports occurring on or after the date of entry into effect of this Law.

Art. 17. - Executive Branch agencies delegated competence for the granting of benefits and fiscal incentives under the Law for the Reactivation of Exports cited in Article 16 which is repealed in this Law shall conform their actions and the performance of functions under the former law with the provisions of this Law, except in those instances in which the provisions of this Law are clearly inconsistent with the rights of the beneficiaries under and the mandatory substantive provisions of the former law.

Art. 18. - For purposes of the application and interpretation of this Law, preference shall be given to the goals thereof and the nature of the economic activities regulated thereby. Only when it is impossible to determine the meaning of its provisions, concepts, or terms from the letter or spirit thereof shall there be resort to the provisions, concepts, or terms of common law.

Art. 19. - The Law for the Reactivation of Exports contained in Legislative Decree No. 460 of March 23, 1990, published in Diario Oficial No. 88, Book 307 of April 18, 1990 is repealed in its entirety and the provisions of this Law are substituted therefor.

Art. 20. - The President of the Republic shall issue the Regulation(s) necessary to facilitate and assure the implementation and application of this Law.

Art. 21. - This Decree shall enter into effect eight days following its publication in the Diario Oficial.

DONE IN THE BLUE ROOM OF THE LEGISLATIVE PALACE: San Salvador, on the ____day of the month of ____, One Thousand Nine Hundred and ____.

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APPENDIX G

STATEMENT OF WORK

1. Legal review, analysis, and evaluation of existing Salvadoran trade and investment laws, including, specifically, (a) the Law for the Promotion and Guaranty of Foreign Investment; (b) the Law Governing Free Zones and Bonded Warehouses; and (c) the Export Reactivation Law.

2. Collection, review, and comparison of equivalent trade-related laws (Free Zone laws, Export Promotion laws) of Costa Rica, the Dominican Republic, Guatemala, and Honduras for comparative analysis purposes.

3. Drafting of one or more proposed legislative initiatives - in conformity with international standards - for purposes of the amendment or repeal and replacement of existing Salvadoran trade and investment laws.

4. Consultation with USAID/El Salvador and the public and private sectors in El Salvador regarding existing Salvadoran trade and investment laws and the draft legislative initiatives to amend or repeal and replace them.

APPENDIX H

BIOGRAPHICAL INFORMATION ON STUDY TEAM

The following is biographical information on the consultants who formed the Technical Service Order No. 013 Study team:

James L. Kenworthy, the Team Leader and Author of this report, is Director of the Latin American and Caribbean Trade and Investment Development Project for Nathan Associates, Inc. He is a lawyer and consultant with more than 20 years' experience in international trade and investment, including legal practice in Colombia and the Dominican Republic. He has served as an attorney for the Foreign Claims Settlement Commission of the United States, as Assistant Director - Tax/Legal of the National Foreign Trade Council, and as an attorney on the staff of the Office of Foreign Direct Investment. During some nine years, he served as an attorney on the staff of the General Counsel of the U.S. Department of Commerce advising officials of the International Trade Administration during which time he was assigned as counsel to the Office of Foreign Investment in the United States, among other duties. He taught International Trade and Investment Law for two years as an Adjunct Professor of Law at the University of Missouri at Kansas City School of Law.

Francisco Armando Arias is an attorney practicing law in San Salvador, El Salvador. A graduate in Law of the University of El Salvador, Dr. Arias practices administrative and commercial law as well as serves as Executive Director and Legal Advisor to the Sugar Association of El Salvador and as a professor on the Law faculty of the University Dr. José Matías Delgado in San Salvador. He was a founding member of the Salvadoran Foundation for Economic and Social Development (FUSADES) and served as an attorney consultant for the Salvadoran Ministry of the Economy in connection with the privatization of the San Bartolo Free Zone.

Wesley D. Boles currently serves as Project Manager of the Latin American and Caribbean Trade and Investment Development Project for Nathan Associates, Inc. He is an experienced international business consultant with extensive experience in Latin America. His recent specialization has been as a consultant in international marketing and business development, and in investment analysis and planning. Previously, he was a senior staff executive at AFM Incorporated and a U.S. Foreign Service officer with assignments that included service as U.S. Consul in Monterrey, Mexico and Mexican Desk Officer in the U.S. State Department.