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REVIEW OF THE COMMERCIAL CODE
REPUBLIC OF EL SALVADOR

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for

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REVIEW OF THE COMMERCIAL CODE REPUBLIC OF EL SALVADOR

INTRODUCTION

USAID El Salvador asked for a review of the Commercial Code of El Salvador with the idea of determining its impact on the costs and time required to establish a new business in the country. It was thought that the process was cumbersome, that it added unnecessary costs for new investment and that it served to inhibit new investment and thus economic development. The consultants' review was expected to generate recommendations for appropriate USAID future activities to ameliorate or eliminate some of the perceived obstacles.

Had the review taken place in 1999 there would have been ample scope for cataloguing unnecessary processes, excessive costs and an often negative impact on new business formation. Salvadorans themselves were well aware of many of the problems and beginning in late 1997 began the process of legislative reform. Draft legislation to modify many sections of the Commercial Code and replace the existing Investment Law was prepared with the decree legislation for the new investment law passing the Legislative Assembly on October 21, 1999 and that for reform of the Commercial Code on January 26, 2000. Thus by April 1, 2000 a reformed Commercial Code and a new Investment Law entered into effect.

The consequences are positive as the new laws while still not ideal represent substantial improvement over previous conditions and have resulted in a situation where neither the Commercial Code nor the Investment Law can be considered a significant barrier to investment or new business formation.

STATUS OF COMMERCIAL CODE

The reforms to the Commercial Code simplified inscription into the Commercial Registry essentially by combining into one process the registration of the business (*empresa)*, the corporation (*sociedad),* and the physical business site (*establecimiento).* The accounting requirements were simplified with now only a Unified Balance Sheet inscribed into the registry. The Superintendency of the Commercial Registry has had its responsibilities limited with new Superintendencies created for the Financial System, Securities and Pensions. With respect to supervisory oversight of obligations established by the Commercial Code the Superintendent's responsibility is to monitor compliance with the Code and to impose sanctions on those found in violation. It no longer is involved in the authorization of proposed inscriptions to the Registry.

Other changes included raising to 100,000 colones the limit below which small enterprises need not meet the full registry requirements. Yet other changes eliminated several requirements for notarization of documents and generally simplified the process. The new Investment Law has recreated a "one-stop shop" for investors, the *Oficina Nacional de Inversiones,* which has sufficient authority delegated to it to manage the registration and other regulatory requirements for a new investor in a period of approximately seven business days. Under the previous system the time required is said to have varied between 200 and 400 business days. The ONI does not intervene, however, in assisting investors with respect to municipal registrations. Nor is it involved in those cases where the investor's area of activity requires an environmental permit before operations can commence.

The Commercial Registry is only a part of the overall array of official approvals required to establish a new business. ONI assists in the Commercial Registry but also in obtaining a tax registration number, inscription into the Valued Added Tax registry, obtaining a business identification number, temporary residence for foreign investors and, in the case of foreign investment, the registration of that investment. Once established, the company is required to register with the Social Security System and with the Department of Labor. For companies with 10 or more employees, the company's work regulations must be registered with the Ministry of Labor and monthly lists of employees and salaries paid are submitted to the Labor Ministry and to the Social Security Institute. Employment contracts must also be registered with the Labor Ministry.

The commercial registration must be renewed annually while interim changes in corporate capitalization, location, lines of business, stockholders, officers and legal representatives must also be listed with the Commercial Registry.

The Salvadoran set of business requirements remains cumbersome in many of its features, but compared to other Latin American countries and to the previous system in El Salvador, its not all that bad. In countries such as Bolivia, the Commercial Registrar not only accepts applications but is required to authorize them, adding substantial time and some uncertainties to the process. Inscription in the Commercial Registry requires submission of proof of compliance with all of the company's tax obligations. For a new company this may just be the identification number, but in El Salvador the commercial registration itself is not contingent upon this. In many Latin American countries companies are obligated to join a chamber or a trade association, and the inscription process can be nearly as cumbersome as the original commercial registration. In El Salvador such association is voluntary. In short, El Salvador is well advanced in the modernization of many aspects of its commercial code.

There is some intervention in the financial life of firms imposed by the Code. Article 38 states that one cannot distribute profits in excess of net earnings. There is also a requirement to set aside a percentage of net earnings until the capital reserve reaches the prescribed limit. In the case of most corporations, the reserve set aside is 7% of annual net earnings that accrue until they are the equivalent of 20% of the firm's paid in capital.

The Code contains provisions regulating unfair competition (*competencia desleal).* With respect to sales agreements that delimit the area, product line and length of time of exclusivity, none may exceed ten years in duration. However if such agreements create monopolies or damage the national economy or the rights of third parties, injured parties can seek redress as can the Public

Prosecutor. Principals may specify conditions to be observed in terms of quality, quantity and service standards for products covered in representation agreements. Article 491 lists proscribed activities, many of which tie in closely with consumer protection, proscribing a variety of fraudulent or misleading actions on the part of the merchant. Actions against other merchants such as misuse of trade names, trade marks or patents are forbidden as is promulgating information that discredits or disparages products or services of another enterprise. You are also not to bribe employees of another firm to get that firm's customers or place obstacles to access of other firms. Forbidden as well are direct and public comparisons of price and quality of one firm's services with those of other firms in a manner that makes clear the identity of the other firm. Firms are also expected to honor exclusivity agreements and are forbidden to induce employees of other firms to break employment contracts to take employment with them. Acts of unfair competition which affect professional groups, e.g. the Association of Public Accountants, are considered to affect the individual members as well as the association or chamber involved.

The Code also spells out the rules for sales or distribution contracts. Either party may cancel the agreement with three months' notice, but if the principal cancels the agreement without cause (acts of fraud, negligence, incompetence or violation of trust), the representative has the right to demand compensation for expenses incurred and investments made in behalf of the principal, the value of remaining inventory, outstanding credits and an amount equal to net profits form the sale of the products in question for the previous three years.

One should keep in mind two factors in considering the Commercial Code. First, the Roman/Latin philosophy is that the "State" has both the obligation and the capacity to regulate all aspects of life, so that "top down" control and regulation of economic activity is a centuries old tradition. Second, the Commercial Code in El Salvador comprises the whole range of commercial law and regulation that in the US, for example, is divided between federal and state jurisdiction and by area of activity. The Salvadoran Code governs not only business formation and conduct, but some elements of banking, insurance, financial instruments, real estate transactions, lending, bankruptcy, transport, intellectual property, warehousing, securities and corporate governance among other things.

Having noted the positive aspects to the modernization of the Commercial Code, it nevertheless has yet a number of weaknesses that need to be corrected. Basically these problem areas reflect: 1), the failure of the Code to keep pace with new developments in technology and business practices; and 2), residual provisions reflecting legalistic traditions of the past together with some inconsistencies that have developed over time.

Problem areas as outlined by the Salvadoran Chamber of Commerce and Industry are four:

- No legal base for activities such as leasing or factoring.
- Weaknesses in the area of conflict resolution.
- No legal base in the regulations for freight transport that permit consolidation of shipments or shipment of "Less than Container" Loads.
- A general lack of a legal base for "electronic commerce". This includes not only the question of the validity of offers and purchase agreements via the internet but secure

transfer of funds and authentication of signatures and financial actions as well as consumer protection against misrepresentation and fraud.

A more fundamental problem is the treatment within the Commercial Code of the very nature of the firm as a legal entity. There are Salvadoran legal experts who believe that the Code's provisions for the establishment of *sociedades de personas, sociedades colectivas y sociedades de capitales* fail to result in partnerships or corporations with clearly delineated limits of personal responsibility, corporate governance and transparency.

Other Code provisions that retain burdensome procedures and impede business actions are found in the sections governing liquidation, bankruptcy and transfer of assets upon death of a principal. Liquidation procedures, for example, involve numerous steps and substantial costs that in effect impede a group of investors from admitting a mistake and transferring their remaining capital to a new, and hopefully, more productive enterprise.

Another wide-ranging problem in legal matters in El Salvador is the great number of individual laws in force leading to unresolved or unregulated contradictory provisions. New legislation generally details other specific laws being derogated or replaced but in the course of time anomalies build up as new laws overlook provisions of older laws which touch on the substance of the new one. Current legal summaries of just the "commercial" sector list 17 laws in addition to the Commercial Code itself. This does not include the Law for Reactivation of Exports, the legal basis for Centrex, which is considered to be a "tax law".

It should be noted, however, that leasing and franchising activities are carried out successfully in El Salvador through contracts specifically designed for the leasing or franchising activity at hand. Factoring arrangements are also possible through specific contracts. The Commercial Code offers wide latitude for contracts in areas not covered by technical sections of the Code, e.g. transport, payments, etc. There is some thought, therefore, that efforts to codify the legal base for these activities may make matters worse rather than better, imposing rigidities through attempting to encompass all possibilities for leasing, franchising or factoring in chapters of the Commercial Code.

Finally, there is a question of checks and balances. The new Commercial Code establishes a superintendent for commercial obligations, the instrument for overseeing compliance with the Code. Unlike the other superintendencies established, (financial systems, securities and pensions) the one for commercial obligations is not autonomous, but reports to the Ministry of Economy. That the new Law for the Regulation of the Practice of Accounting (passed in January 2000) brings public accountants and auditors under the control of an Accounting Council that is also tied to the Ministry of Economy raises the issue of concentration of authority. A step in the right direction could be to make the superintendent for commercial obligations autonomous as well.

RESPONSE TO SPECIFIC QUESTIONS LISTED IN THE TERMS OF REFERENCE

Clarity and Understandability: the provisions of the Commercial Code appear to be reasonably clear and not difficult to understand, but this assumes a familiarity with a specific legal vocabulary and a knowledge of the general legal tradition. It is far easier to read and to understand than the Internal Revenue Code of the US.

Incentives: the Commercial Code itself offers few if any specific incentives in the formation of new companies. The rationale to form a corporation and probably the greatest incentive to go through the legal process is the facility to limit investor's liability to invested capital rather than to all personal assets. This is an incentive not widely used in El Salvador where a majority of "sociedades" are still "sociedades de personas" or partnerships rather than "sociedades de capitales" with most of the partnerships formed under provisions that do not establish clear limits to liability. Salvadoran companies remain overwhelmingly family businesses, even though some are sizeable firms, and are generally not open to outside investors or shared control and thus not candidates for public equity issues. Probably most Salvadoran businesses remain informally organized so questions of limited liability, corporate structure and corporate governance are not addressed. Advantages to formal corporate organization other than limited liability include easier access to bank finance and entry into contracts with other corporations.

Conflict Resolution: the Commercial Code encourages the choice of conciliation and arbitration as means of resolving business disputes. Article 68 provides that "sociedades de personas" should have in their statutes whether disputes between partners go to court or to arbitration. If neither is specified, the legal presumption is that the partners have accepted arbitration. Similar provisions apply to "sociedades de capitales". All these arbitration provisions apply only within El Salvador, that is, the arbitrators and the arbitration process takes place within prescribed Salvadoran laws. It is understood, however, that foreign investors may specify in business agreements or articles of incorporation that disputes be subject to arbitration courts outside of El Salvador. A major flaw in the current situation is the failure of the Commercial Code to formalize arbitration and conciliation processes that do not require intervention on the part of the judicial system to enforce.

Not in the Commercial Code, but the Law Governing the Promotion and Guaranty of Foreign Investment permits (Article 21) the submission of disputes between the GOES and foreign investors with respect to their investment to the Conciliation and Arbitration Tribunal (in Geneva) in accord with the "Washington Convention" which El Salvador signed in 1982. There is also a bilateral investment treaty with the United States dating to 1960 which among other things permits the Overseas Private Investment Corporation (OPIC) to operate in El Salvador.

"Excessive Costs": The various business registration requirements imposed not only by the Commercial Code but by tax, labor, social security, environmental and local municipal requirements clearly impose costs on new business start-ups, business operations, factors of production and do impose a degree of impediment to new market entry. The impact of these costs varies directly with the size of the firm. For large firms they comprise mostly an administrative nuisance that can be handled by the firm's internal administration or by contract with outside service providers. For the small entrepreneur, they are costs to be evaded through the simple expedient of not registering the business. Thus the whole administrative panoply of doing business formally despite concessions and efforts on the part of government to ease the burden remains a major barrier to formalization of economic activity.

For the small firm it is not solely a matter of monetary cost, but more a reflection of the very limited human resources available and the economic cost to diverting the time and effort of the owner, often the driving force of the enterprise, away from economic survival to coping with the bureaucracy. For many of the small firms, management understanding of the complexities of the law and its confidence in ability to deal with officialdom are low.

For foreign investors this array of government-related costs is just one factor, and not a very important one, in the decision to invest or not. For national investors of consequence it's part of the normal landscape and the decision to invest will depend almost exclusively on the projected return on the investment taking into account all costs. For small investors, the problem is avoided by formalization limited perhaps to tax and VAT registration.

These costs can be more significant for industries with low profit margins, the most significant of which is apparel assembly. If in fact a significant part of the profit margin for Salvadoran apparel exports is due to the 6% export subsidy (due to expire in 2005) then reducing government-imposed administrative costs becomes important.

The area that appears to offer more opportunity to reduce the administrative burden at present is not the Commercial Code but the Labor Code and its regulations. The need to register all labor contracts with the Ministry of Labor becomes burdensome when a firm, for reasons of employment policy (to avoid unionization), enters into individual employment contracts with each of its employees who number between ten and twelve thousand. As employees leave or new ones enter and employment levels increase or decrease, appropriate changes in the contracts on file are required. (Reportedly many firms ignore the requirement to register employment contracts with the Ministry.) Additionally there is the requirement to submit monthly a total list of employees and salaries paid. This process was intended to protect the worker in cases of dispute by giving the government a record of wages paid and contributions made. But is this the most economical way to protect workers interests and does it need to be done monthly or could monthly submissions of the same data to Social Security not achieve the desired effect?

A second burden imposed by the existing Labor Code and one that inhibits compliance as well as unionization is the lack of flexibility permitted in the use of labor. For example working hours are mandated with little provision for flexibility for manufacturing firms. There is also no means for adjusting workload to match work requirements.

An area of complaint by the Free Zone apparel assemblers is the rigid interpretation on the part of Customs of the Free Zone provisions for import and export of merchandise. Customs micromanages the process by insisting on each shipment of a detailed bill of materials which specifies precisely the amount of material contained in each garment. There is no provision for scrap or waste, which is inevitable in production. And should there be any change in customer specifications, altering the bill of materials per garment, an administrative nightmare begins. As to the Free Trade Zones, there have been complaints by companies which began operations under a set of guarantees established in the original Free Trade Zones law but which were changed or reduced under the new law which contained no provision for "grandfathering" of concessions previously granted.

Effect on Competition: the commercial code in and of itself would not appear to be a significant factor in evaluating the degree of business competition in El Salvador. On balance it is somewhat biased against open competition. Its sections governing the rights of sales representatives and distributors are rather protective of these rights, for example, making difficult changes in distribution by principals simply looking for more dynamic results. The section on unfair competition appears at least as protective of business as of the consumer. Requirements to have all financial balances or other accounting documents submitted to government only by accountants who are members of the Association of Accountants and having the commercial code specify the requirements and terms for this association reflects a long time tradition of market maintenance by law for such professions as accountants, lawyers and notaries.

While not a part of this survey it would appear that El Salvador does not have an openly competitive local economy. The difference in economic power between large firms and smaller ones often makes infeasible entry into the market, or creation of new national markets, by medium or small firms. Commonly assumed is that Salvadoran firms, including small and medium enterprises, prefer to operate within recognized shares or sectors of the market and generally do not challenge one another's position in the agreed market set up. What may be required is new or improved competition or anti-trust laws. However, this could well be more of a social problem, one of economic structure and business culture of the country, rather than a legal one.

Consistency with Market-led Economic Growth: again, the Commercial Code itself is essentially neutral with respect to economic growth. Economic growth is a function of investment in factors of production. Modern economies cannot function without a legal and regulatory framework. The overall burden of public administration and state regulation in El Salvador on economic activity involved in providing this framework may well exceed the optimum level for maximizing economic growth or attracting investment but in itself does not necessarily make El Salvador uncompetitive with neighboring countries nor pose a major barrier to investment. Within this burden the Commercial Code is a small factor.

FINDINGS

Based on the information collected during this review, the Commercial Code appears not to be a serious impediment to economic growth in El Salvador. The country and the Code could benefit from further improvement in the areas listed in Section 2.2 above. Initiatives to develop a legal framework for electronic commerce are underway. The US Embassy was involved in a seminar on this topic earlier this month and the need for action in this area appears widely accepted. ANEP and the Camara Nacional de Comercio e Inversiones are developing legal initiatives to strengthen mediation and arbitration of business disputes. With support from the Ministry of Justice, technical assistance from Colombian sources is being utilized. Reform of the provisions in the Code's transport chapter to permit freight consolidation is on the agenda of the Chamber of Commerce. Whether the Code should have specific provisions for leasing, franchising and factoring is problematic. The current system where each arrangement is covered by a detailed contract specific to the proposed activity may be preferable to trying to cover all arrangements in specific chapters of the Commercial Code.

For a prospective investor or exporter the administration of the Code and of related laws and regulations is important. In this, El Salvador has made significant progress. The new Investment Law has created a "one-stop shop" to handle the key registration requirements for new business formation and by all accounts it has been very successful in reducing the time and effort required. The Law for Reactivation of Exports is the legal base for CENTREX, an institution operating with the support of the central bank to process export documentation. These documentation requirements have become much simpler with the elimination of foreign exchange and export revenue controls. Currently CENTREX is focused on providing certificates of origin, expediting issuance of phytosanitary certificates and the administration of US textile import quotas that apply to El Salvador. At present only one category of apparel is subject to quota. Progress has been made in the computerization of customs procedures and the ability to clear export shipments in minimal time.

Looked at in economic terms, the need for an investment law and obligatory registration of foreign investment is questionable. Bolivia, which has wide open banking laws and no controls over capital flows, has no investment law. Its commercial code and other business-related laws apply equally to all, foreigner or national. The one downside is that there are no reliable statistics on the amount or flow of foreign investment. Costa Rica also does not require that foreign investment be registered.

Viewed from the perspective of its clientele, it is clear that ONI's primary function is to ease entry into the country for foreign investors. Ironically, this has not been a problem since foreign corporations have traditionally relied on the services of qualified and well-connected law firms. ONI has made life easier for the law firms, reducing efforts required by them to complete the administrative procedures, but has not appeared to have attracted much use from Salvadoran business people, especially small businesses. Major Salvadoran business or banking groups have their own resources to accomplish whatever administrative procedures may be needed. In sum, ONI works well but actually serves a limited clientele.

In terms of its investment law, El Salvador does have constitutional provisions which confuse the question of whether it truly offers "national treatment" to foreign investors. The provision restricting purchase by foreigners of rural land *(terrenos rusticos)* doesn't apply to Central Americans or to US citizens since Salvadorans have the right to buy rural land in the US. The restriction on foreign participation in small and medium enterprise also exempts Central Americans but there remains the question as to who defines "small and medium enterprise" and by what criteria. This consultant is unaware of any internationally accepted definition. A case can be made that El Salvador's constitution does not provide "national treatment" for foreign investors despite the nation's obligations to do so under terms of such treaties as its accession the GATT/WTO. Finally there is the issue of the government's ability to award concessions for public works which after 50 years revert to the state without compensation. Some contend that this is expropriation without compensation.

Further legislative efforts are required in the field of intellectual property rights. El Salvador became party to the Central American Convention on the Protection of Intellectual Property Rights in 1994. The provisions of the Convention reportedly do not meet the present standards established by the GATT/WTO agreement in its TRIPs section. El Salvador should have been in compliance by January 1, 2000. The principal point at issue is the use of unlicensed or pirated computer software, although other abuses of intellectual property occur as well. Initiatives to bring El Salvador's Intellectual Property protection in conformity with international standards are under consideration now in the National Assembly. Failure to resolve this issue could jeopardize El Salvador's access to the recently passed US law that expanded the benefits available previously under the Caribbean Economic Recovery Act, since access is contingent on a country's being in full compliance with international agreements. There seems to be wide spread belief in El Salvador that the principal miscreant in failure to pay royalties on software is the public sector and that for this reason the legislation in question has proceeded slowly.

One last area of public administration that affects business and investment and which has received universally poor marks in the course of this survey is that of environmental regulations. Reportedly the implementing regulations to the Environmental Protection laws passed some years ago have yet to be promulgated although legally required within 90 days of the original law's passage. Ministry officials charged with carrying out the law are not considered to have carried out their tasks reasonably or skillfully. This survey did not explore either the Ministry for the Environment nor the legal and regulatory framework so there can be no judgment made of how much of the problem comes from poor administration and how much from resistance to meeting the costs and operational changes of new environmental standards.

PRINCIPAL OBSTACLES TO INVESTMENT

The thrust of the foregoing sections has been that the legal and regulatory framework in El Salvador is not a significant barrier to investment or economic growth. There is still room for improvement, obviously, and the general burden of excessively bureaucratic procedures and poorly motivated public servants impacts negatively the life of most Salvadorans. But despite having improved the processes and lessened the barriers, El Salvador still has not attracted the level of foreign investment anticipated and needed. The principal obstacles lie more in the area of macroeconomic and general social conditions. Comments from the many individuals interviewed separate out the following as the major obstacles perceived to inhibit foreign investment.

1. ***Security:*** On top of everyone's list is the lack of personal security, or, in other words, the crime rate. There was also comment on lack of surety in legal or labor matters, i.e., changes in the "rules of the game" after a specific obligation had been undertaken. Anecdotes include

discussion of the import of armored vehicles, foreign managers only visiting the plants here and not moving their families to El Salvador, and other tales. The concern may be exaggerated in terms of reality, but it definitely affects El Salvador's image abroad and thus its attractiveness to investors. In Spanish the issues are: *inseguridad ciudadana, inseguridad juridica e inseguridad laboral.*

2. ***Cost Structure:*** Relative to its immediate Central American neighbors, El Salvador's costs appear substantially higher. Basic labor costs in apparel assembly plants in the Free Trade Zones are said to average 1,500 colones per month per employee. In Honduras the average is 1,500 Lempiras, or about 800 colones per month. Guatemalan wages are said to approximate those of Honduras. In a low margin business like apparel assembly you can't offer direct labor costs 70% higher than competitive locations and attract much investment, all other things being equal. Costa Rica and El Salvador both benefit to a degree from the distortion of the market derived from quantitative import quotas imposed by the US and other countries. For some items, relative labor costs are not as important as quota access. Compounding the labor cost problem, Salvadoran industry confronts higher than average costs for electrical power and for transport of manufactures. Most Salvadoran export manufactures – like assembled apparel – destined for markets outside the region go the eastern United States via the Atlantic. El Salvador has no Atlantic port and so most shipments go via Guatemala's Puerto de Santo Tomas de Castilla. Not only is there then a question of distance and road conditions but customs procedures at the border, even for goods with zero duty rates, often require as many as 20 hours to complete, essentially adding another day in time and costs to the shipping cycle each way.

3. ***Infrastructure:*** El Salvador lacks much in the way of physical infrastructure. The area most often mentioned is highways, most of which are considered to be in bad condition. Modernization of port facilities could perhaps divert export traffic away from the Atlantic to the Pacific. There are substantial needs in assuring the supply of potable water and waste disposal. The major requirement for solution of these problems is funding, which implies the Government's ability to structure projects in manner to attract private capital. Weak infrastructure adds to the costs of doing business and is another disincentive for investment.

4. ***Human Resource Skills:*** Salvadoran labor has a reputation for being motivated and productive, but the basic human resource base in terms of technically qualified people is weak. To address this problem, El Salvador like other countries in Central America imposes a one percent tax on industrial payrolls which funds technical training. In El Salvador an autonomous government agency, the *Instituto Salvadoreño para la Formacion Profesional*, is charged with this task. It offers training courses in a variety of technical skills at nominal costs and has the capacity to provide in plant training that matches a specific company's requirements. While autonomous, the Institute's agreements with private companies must be approved by the Ministry of Finance. Detailed and meticulous review by the Ministry may take between 6 and 12 months, too long in many cases for such an agreement to be of use to a start-up operation. The fact remains that the need for enhanced technical and vocational skills far exceeds the supply of these skills, reducing El Salvador's attractiveness for investment in such industries as electronics, pharmaceuticals or metal fabrication.

5. *Small National Market:* El Salvador's domestic market is very small in global terms. Few if any foreign investors can be expected to enter the country to serve the local market by establishing manufacturing facilities. Investment in such facilities can generally only be justified if directed principally at markets outside El Salvador, whether regional or farther afield. Investment, even survival, of Salvadoran industry has been discouraged through the impact of "globalization". Many of the local companies that served the domestic market were able to do so because it was a protected market replete with high tariffs and in cases quantitative import quotas. For lack of economies of scale or modern production facilities, these companies have lost much of their domestic market to imported manufactures that now enter the country under much reduced import tariff levels. This has led to considerable consumer benefit, but has not directly replaced the jobs lost in local industry nor justified additional investment by local industrialists. Economic theory states that the country should adjust to this situation by investment in areas of comparative advantage, seeking foreign markets. For reasons that this has yet to happen to the desired degree in El Salvador, refer to obstacles one through four above.

Recommendations for Future Activities

USAID/El Salvador has asked for recommendations of possible future activities that the Mission might consider, especially in connection with its Justice Reform Project. Assuming that the Project's objectives are defined broadly, there are a number of areas of legal and regulatory reform in which USAID interventions could prove useful in furthering economic growth in El Salvador. There are also other interventions apart from legal and regulatory reform that could promote economic growth. The various possibilities are discussed below.

Legal/Regulatory Reform in Economic Matters

- With respect to the Commercial Code, the area probably most lacking at present is providing the framework for electronic commerce. The US Embassy's economic section and a number of private chambers and associations are addressing this issue but qualified technical assistance offered to relevant committees of the National Assembly or to key public and private institutions could prove helpful. The problem can be solved without USAID intervention, but appropriate technical assistance could accelerate the process.

- More substantive changes in the Commercial Code covering the classification of enterprises, liquidation and bankruptcy and assuring conformance with related legislation would probably require a team of as many as three Salvadoran attorneys and two legal assistants together with technical assistance from outside El Salvador for a period of perhaps six months to review the existing codes and draft reform provisions. Whether there is sufficient interest politically from the private sector to push such reform through the legislature is not clear given other priorities demanding the Assembly's attention.

- There are no known initiatives at present in the area of reform of El Salvador's Labor Code. Problems of concern include not only the administration of the code, e.g. the registry of payroll data, etc., but also that lack of flexibility in the use of labor that inhibits acceptance on the part of industry of unionization. There are no provisions for reducing work hours in periods of low demand or increasing hours to meet higher, but temporary, demands. This inability to move workers from one facility to another or shift tasks and workloads is an important reason for resistance to unionization in the Free Trade Zones. Reform of the labor code might also look to update provisions for workplace safety, workers rights and health standards as well. In this latter area of workers rights and work place safety the US Department of Labor has begun to play a much more active role through both bilateral programs and through grants to the International Labor Organization. Possible USAID interventions should thus be coordinated with representatives of the Department of Labor to determine areas of complementarity.

- The National Assembly has under consideration significant reform of the Tax Code and in conjunction with that of Customs operations and regulations. Consistent with this could be efforts directed toward the reform of public administration in general, dealing specifically with the Civil Service Law and the Salary Law. It is widely recognized that public administration in El Salvador is generally burdensome and inefficient and that much of this stems from the government's inability to offer salaries adequate to attract skilled professionals. Level of effort in this area would be at least as high as that mentioned above for reform of the Commercial Code. Aside from effort, however, an assessment of likely political support within Salvadoran society for such reform would be required to determine the feasibility of undertaking this intervention.

- The Mission may want to consider revisiting the area of environmental standards and protection. An analysis of the problems could be a first step that could then lead to initiatives for legal or regulatory reform, public promotion of the value of environmental controls and mechanisms for easing the financial burden of compliance.

- There was concern expressed during the course of this survey over the perceived lack of effective competition or anti-monopoly legislation. USAID might want to review this legislative area to determining whether legislative reform would have a significant impact in strengthening competitiveness or whether the real problem is that of economic structure or ingrained business practices.

- The survey encountered comments about the weakness of El Salvador's stock exchange. This may be a reflection of the nature of corporate ownership in El Salvador rather than a problem of legal or regulatory framework inasmuch as the banking system has already been subject to substantial reform. Closely held family enterprises tend not to seek capital expansion through sale of equity nor to publicize their financial condition. What could be useful would be technical assistance in the development of financial instruments, such as medium or long term bonds, designed to capture local savings and emigrant remittances and that in turn could be traded in secondary capital markets.

Project Interventions Not Related to Legal/Regulatory Reform

- The survey encountered strong consensus in El Salvador of the weakness in technical training of the work force. As indicated above there are governmental and private institutions involved in providing vocational training but the impression is that these efforts fall short of the country's needs. Possible USAID interventions in this area include development of apprenticeship programs with the costs shared by government and industry. The objective would be to subsidize industrial development in the sense of reducing the costs of bringing labor productivity up to standard for new ventures or start-up companies and hopefully would be far more flexible in application than the present programs. Another intervention would be cooperative agreements with private sector or NGOs to strengthen technical training. These agreements would not be directed to microenterprise but to perceived technology deficits affecting Salvadoran industry as a whole.

- During the survey there was expressed great concern as to how to promote linkages between Salvadoran entrepreneurs and their counterparts overseas. The objective would be to develop opportunities for sales abroad as well as to attract interest in co-investment or other forms of assistance to local firms. The target beneficiaries on the Salvadoran side would be small and medium enterprises. The criteria, which should be flexible, might start with a general criterion of businesses with five or more employees. On the US side the target participants might be small and medium enterprises run by Salvadoran emigrants in the US. This type of business linkage program with trade missions, reverse trade missions and substantial technical assistance is well within the capacity of the US Small Business Administration to manage. What SBA does not have is authorization to use its operational budget for international activities. Thus it has been dependant on other agencies for such funding. For example, SBA has received funding from the US Commerce Department for this type of activity in Eastern Europe and last year was extended funds from USAID of $3.4 million for a two-year program to replicate the SBA in Egypt.

  USAID/El Salvador might well consider working with the SBA to design a program of small and medium business linkages between El Salvador and the US to be managed by the SBA but funded by the Mission.

ANNEX

LIST OF PERSONS INTERVIEWED

Associates

Dra. Ana Aracely Henriquez de Rodriguez
Ana R. Klenicki Director Democracy and Governance Program
Jorge Ernesto Peña Economic Growth Division
Todd M. Sorenson, Economic Growth Division

Interviewees

Lic. Jose Mauricio Roque Gerente Administrativo Textiles San Andres, S.A. de C.V.
Lic. Jose Mario Magaña Gerente, Division de Estudios Tecnicos, Camara Nacional de Comercio e Industria
Lic. Ana Ruth Hidalgo B. Division Estudios Tecnicos Camara Nacional de Comercio e Industria
Lic. Haydee de Trigueros Directora Ejecutiva Comision Nacional de la Micro y Pequeña Empresa (CONAMYPE)
Lic. Sylvia Bucher Asesora Tecnica CONAMYPE
Ing. Gloria Luz de Rivas, Asesora Tecnica, CONAMYPE
Lic. Jorge Arriaza, Director Ejecutivo, Asociacion Salvadoreña de Industriales(ASI)
Lic. Luis Roberto Chavez Quintanilla, Assesor Legal, ASI.
Ing. Waldo Jimenez, Gerente Tecnico, Asociacion Nacional de la Empresa Privada (ANEP)
Lic. Maura Rebeca Flor, Jefa Centro de Tramites de Exportacion (CENTREX)
Lic. Antonia Vasquez, Directora Ejecutiva, Asociacion de Medianos y Pequeños Empresarios Salvadoreños (AMPES)
Ing. Jorge Mariano Pinto, Presidente, AMPES
Dr. Felipe F. Umaña, Asesor, Fundacion Salvadoreña para el Desarrollo Economico y Social (FUSADES).
Lic. Emma Arauz M. Directora Programa de Promocion de Inversiones y Diversificaciones de Exportaciones.
Lic. Jeaneth de Herrera, Directora Oficina Nacional de Inversiones, Ministerio de Economia
Lic. Erminia Lozano Delegada del Registro de Comercio, ONI
Lic Ligia Arauz, ONI
Lic. Ena Gladis Torres Registro de Comercio
Lic. Ricardo Ramos, Delegado de la Oficina de Migracion.
Lic. Silvia M. Cuellar Sicilia Directora Ejecutiva Corporacion de Exportadores de El Salvador (COEXPORT).
Lic. Patricia Allwood Directora Ejecutiva Camara Americana de Comercio de El Salvador
Lic. Benjamin Valdez Iraheta Rusconi-Valdez & Asociados Abogado y Notario
Dr. Ricardo A. Cevallos Cortez Delgado & Cevallos Abogados y Notarios Asociados
Mr. Stanley Specht First Secretary for Economic Affairs, US Embassy
Lic. Eduardo Peña, Economic Affairs Office, US Embaasy
Dr. Jose Enrique Burgos Martinez, Secretario General, Universidad Technologico de El Salvador.

Lic. Juan Hector Vidal Director Ejecutivo, Camara Salvadoreña de la Industria de la Construccion.
Miembros de la Comision de Asuntos Finanzas y Presupuestarias de la Asamblea Nacional.
De los 10 assisiente cinco destacaron los siguentes:

Diputados Mauricio Quinteros, Vinicio Peñate, Juan Miguel Bolaños, Dagoberto Marroquin, y el secretario de la comision, Humberto Ceteño.