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# TRADE AND COMMERCIAL LAW ASSESSMENT – EL SALVADOR

FINAL REPORT



January 2005

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# UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT



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## Trade and Commercial Law Assessment El Salvador

### FINAL REPORT

December 2004

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**TABLE OF CONTENTS**

<b>I.</b>	<b>EXECUTIVE SUMMARY .....</b>	<b>I-1</b>
<b>II.</b>	<b>COMMERCIAL LEGAL AND INSTITUTIONAL REFORM AND TRADE IN EL SALVADOR: CROSS-CUTTING THEMES .....</b>	<b>II-1</b>
<b>III.</b>	<b>COMPANY LAW .....</b>	<b>III-1</b>
<b>IV.</b>	<b>CONTRACTS .....</b>	<b>IV-1</b>
<b>V.</b>	<b>REAL PROPERTY .....</b>	<b>V-1</b>
<b>VI.</b>	<b>COLLATERAL.....</b>	<b>VI-1</b>
<b>VII.</b>	<b>COMMERCIAL DISPUTE RESOLUTION .....</b>	<b>VII-1</b>
<b>VIII.</b>	<b>BANKRUPTCY .....</b>	<b>VIII-1</b>
<b>IX.</b>	<b>COMPETITION POLICY.....</b>	<b>IX-1</b>
<b>X.</b>	<b>INTERNATIONAL TRADE .....</b>	<b>X-1</b>
<b>XI.</b>	<b>FLOW OF GOODS AND SERVICES.....</b>	<b>XI-1</b>
<b>XII.</b>	<b>FLOW OF PEOPLE.....</b>	<b>XII-1</b>
<b>XIII.</b>	<b>FINANCIAL CRIMES.....</b>	<b>XIII-1</b>
<b>XIV.</b>	<b>FLOW OF MONEY .....</b>	<b>XIV-1</b>
<b>XV.</b>	<b>SUPPORTING INFRASTRUCTURE .....</b>	<b>XV-1</b>

**ATTACHMENT 1: COMPILATION OF RECOMMENDATIONS**

**ATTACHMENT 2: ROUNDTABLE CONFERENCE PACKAGE**

## I. EXECUTIVE SUMMARY

For many reasons, El Salvador is a role model for the Central American Free Trade Agreement (CAFTA) region. Since implementation of its Final Peace Agreement in January 1994, El Salvador has experienced numerous and far-reaching achievements in economic development and institutional capacity building. The team sponsored by the United States Agency for International Development (USAID) that visited El Salvador in June 2004 to conduct a trade and commercial legal and institutional reform (CLIR) assessment found a seriousness of purpose in reforming public institutions that has produced tangible results, including a highly functioning Company Registry and a similarly effective Real Property Registry; a Customs service that has made dramatic strides in efficiency and effectiveness; and improved managerial and automation practices in several other government agencies. Although the team also found systems that are significantly less effective—in particular, the courts, the bankruptcy system, and the institutions that educate, train, and support lawyers—there is a sense in El Salvador that real progress is being made toward economic development. Statistics bear out the anecdotal evidence. Over the past 3 years, although much of Latin America has experienced negative economic growth rates, El Salvador has maintained an average annual growth rate of approximately 2 percent.<sup>1</sup>

This report examines the legal foundations for economic activity in El Salvador, with an emphasis on how the CLIR and trade environments currently affect the country's commercial activity and economic growth. In addition, this report makes specific recommendations pertaining to CLIR and trade assistance in the future.

First, this report identifies certain overriding themes in El Salvador's CLIR and trade environment that should be incorporated into reform programs on a cross-cutting basis. These issues include the profound lack of public confidence in the judiciary, which results in virtual nullification of the effectiveness of a myriad of soundly drafted commercial laws; the lack of meaningful standards or oversight in certain vital professions, especially lawyers and notaries; and the importance of small and medium-sized enterprises (SMEs) in the further development of El Salvador's economy. A fourth issue that plays a part in formulating future reform efforts is that of El Salvador's recent and significant successes; that is, El Salvador has achieved notable competence and demonstrated important leadership in several areas that bode well for future reforms not only in the country but also in the region.

Second, the report examines 13 CLIR and trade-related areas designated for assessment by USAID—namely, company law, contracts, real property, collateral law, commercial dispute resolution, bankruptcy, competition policy, international trade, flow of goods and services, flow of people, flow of money, financial crimes, and supporting infrastructure. Each topic is analyzed from a four-part perspective: Framework Laws, Implementing Institutions, Supporting Institutions, and Social Dynamics. The four-part analysis not only allows for a multidimensional understanding of specific CLIR and trade-related challenges but also creates the basis for certain general themes to emerge.

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<sup>1</sup> <http://www.usaid.gov/policy/budget/cbj2005/lac/sv.html>.

## A. THE TRADE AND COMMERCIAL LAW ACTIVITY ASSESSMENT PROCESS

The assessment process was carried out through much of 2004 in each of the CAFTA countries by a team of expatriate specialists. In order to gain the highest quality information possible, the CLIR portion of the Trade and Commercial Law Activity (TCLA) also employed teams of local experts in each country, which included lawyers, judges, government officials and business leaders, to assist in the collection of data. The process began in March with a methodology seminar where local experts from the region were introduced to the CLIR methodology. Following this process, the local experts performed the base assessment for the CLIR portion of the analysis. With the completion of the base assessment, the expatriate team used this information as well as their own research to discern particular areas of focus prior to arrival in each country. The El Salvador mission was conducted in July 2004. The expatriate team members and their areas of specialization are presented in the following table:

NAME	ORGANIZATION	SUBJECT AREA FOCUS*
Aimee Carter, Team Leader	Booz Allen, International Development Specialist	CLIR
Andrew Mayock, Co-team Leader, TradeStream™	Booz Allen, Legal Reform Specialist	Flows of People and Money, TradeStream™
James Newton, Assessment Coordinator	Booz Allen, Legal Reform Specialist	Commercial Dispute Resolution (CDR), Financial Crimes, other CLIR areas
John Corley	Booz Allen Hamilton, Engineer	Infrastructure
John Baker	Louisiana State University, Commercial Law Specialist	CDR, Financial Crimes, Competition
JoAnne Cornelison	Independent Customs Consultant	Flows of Goods and Services
Maria Coppola	Federal Trade Commission, Legal Reform Specialist	Competition
Dale Furnish, Boris Kozolchyk, Maria Alejandra Rodriguez, Mariana Silveira	National Law Center for Interamerican Free Trade, Legal Reform Specialists	International Trade, Bankruptcy, Collateral
Omar Garcia	BG Consulting, Legal Reform Specialist	Property, Contracts, Company Law
Irina Swift	Independent Customs Consultant	Flow of Goods and Services

\* Given the extended nature of the assessment process, team members served as back-ups for each other as not all experts were able to participate in each country.

While in each country, the team interviewed numerous government officials, nongovernmental organizations, multilateral and bilateral donor agencies, judges, lawyers, notaries, investors, associations and chambers of numerous industries, trade and customs experts, and other domestic and international businesspeople to assess the trade and commercial legal environment of the each country.

### 1. Background of the Diagnostic Methodology Used

These assessments were the next in a series carried out since 1998 in a program that USAID created, and in which Booz Allen was retained to assist in the development of indicators and methodologies, for assessing the status of CLIR in a developing or transitioning country. In addition, more recently, the need for the development of a similar methodology was recognized

with respect to trade matters, which Booz Allen completed (TradeStream™) and which is applied here for the first time. While the CLIR and TradeStream™ diagnostics can be considered as two separate parts, together they make up a more complete picture of a nation's overall situation with respect to domestic and international business.

Both the CLIR and TradeStream™ methodologies have been subjected to field testing and peer review on a regular basis. Moreover, they have been adapted to the exigencies and realities of the area of the world in which they are to be applied; in the case of the TCLA for CAFTA countries, the CLIR methodology was adopted to better fit the Central American legal context, as opposed to that of Eastern Europe, for example, where the methodology was originally applied.

In addition, new areas of law continue to be added to the methodology. Along with the first application of TradeStream™, TCLA saw the further development and application of the newest CLIR section, Financial Crimes, which focuses primarily on those issues surrounding terrorist financing and money laundering, and have become more relevant in the wake of September 11, 2001.

## 2. Scope of the Methodology

The diagnostic assessment was designed to help USAID missions, the countries themselves, and other donors, achieve the following objectives:

- ◆ To provide a factual basis for characterizing the degree of development and the status of trade commercial law reforms in a country;
- ◆ To provide a methodologically consistent foundation for identifying and describing the root causes of the "implementation/enforcement" gap among the CAFTA countries; and
- ◆ To provide analytical and planning tools and metrics that will help USAID, the countries themselves, as well as other donors to design new approaches to sustainable, cost-effective interventions and reform programs.

While the subject matter areas have varied from country to country, for the purposes of these assessments, "commercial law" and CLIR is defined to include the following substantive legal areas:

- ◆ **Bankruptcy.** Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets, and rehabilitation of insolvent debtors.
- ◆ **Collateral.** Laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability, and simplicity in creating, identifying, and extinguishing security interests in assets.
- ◆ **Commercial Dispute Resolution.** Laws, procedures, and institutions relating to the settlement of commercial disputes, whether through courts or alternative dispute resolution mechanisms, and the enforcement of judgments and decrees.
- ◆ **Company Law.** Legal regimes for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.

- ♦ **Competition.** Rules, policies, and supporting institutions intended to help promote and protect open, fair, and economically efficient competition in the market, and for the market
- ♦ **Contract.** The legal regime and institutional framework for the creation, interpretation, and enforcement of commercial obligations between one or more parties.
- ♦ **Financial Crimes.** The legal regime, institutional infrastructure, and methods of international cooperation employed to prevent the financing of terrorist activities and laundering of criminal assets.
- ♦ **Real Property.** The laws, procedures, and institutions responsible for establishing, maintaining, and preserving rights in real property, including land, buildings, easements, liens, and other interests in real property
- ♦ **International Trade.** The laws, procedures, and institutions governing cross-border sale of goods and services.

With respect to the TradeStream™ diagnostic, the areas of inquiry are as follows:

- ♦ **Flows of Goods and Services.** Analyzes a nation's ability to move goods and services smoothly through ports of entry and throughout the country.
- ♦ **Flows of Money and Flows of People.** Similar to Goods and Services, these two sections look at a nation's ability to facilitate the entry and exit of financing and short and long term business persons, respectively.
- ♦ **Supporting Infrastructure.** Assesses the capacities of a country's physical infrastructure relevant to trade, including sea- and airports, roads, railways, communications, and postal services.

Within each of these substantive areas, four dimensions of CLIR were examined as a conceptual framework for comparison. These include the following:

- ♦ **Framework Laws.** Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Collateral, etc.).
- ♦ **Implementing Institutions.** Governmental, quasi-governmental, or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework laws is vested (e.g., bankruptcy court, collateral registry).
- ♦ **Supporting Institutions.** Governmental, quasi-governmental, or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework laws (e.g., bankruptcy trustees, notaries)
- ♦ **Social Dynamic/Market for reform.** The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

## **B. METHODOLOGY OF ASSESSMENT: A 360° REVIEW**

The methodology used to examine El Salvador's CLIR and trade environment provides a comprehensive yet flexible framework for analyzing a complex and dynamic development

challenge. Taking data from a broad spectrum of stakeholders, the assessment builds a 360° picture of the challenge, drawn from the following areas:

- ♦ **Legal Framework.** The assessment first examines the laws and regulations El Salvador has in place that serve as the structural basis for its ability to achieve market-based development. Often discovered through this review are opportunities to make relatively small changes that may result in significant openings for business development and expansion.
- ♦ **Implementing Institutions.** Next, the assessment examines the administrative bodies with primary responsibility for implementing and enforcing the legal framework and subsidiary laws, regulations, and policies governing one or more of the areas addressed in this report. For example, courts are usually a crucial institution in the examination of CLIR. Problems uncovered often relate to bureaucratic inefficiency, lack of resources and training, and, of paramount concern, real or perceived corruption. With respect to the flow of goods, services, and people, Customs and Immigration authorities are the chief implementing institutions.
- ♦ **Supporting Institutions.** The assessment then considers the environment of organizations, individuals, and activities without which the legal framework or policy agenda cannot be fully developed, implemented, or enforced. Examples include notaries, bailiffs, trustees, banks, consumer groups, business support organizations, professional associations, and other similar ancillary service providers. Of particular interest with respect to supporting institutions is whether they have any meaningful involvement in *what the law says*. Where there has been “buy-in” from affected constituencies, a law is more likely to be understood, to be used properly, and to achieve its purpose.
- ♦ **Social Dynamics.** Finally, studying social dynamics entails asking whether the affected constituencies of a law or policy perceive a need for change, and, if so, how they are demonstrating this need. Are they effectively lobbying those institutions that can make a change? Are the media seizing the issue as a topic of public concern? Are individuals speaking out? Or have social dynamics taken a less-positive approach—for example, is the “gray economy” growing as a response to overburdensome conditions for market entry? Analysis of social dynamics may affect how an assistance project ultimately is designed. Where outside participation is strong and public understanding high, a reform program may simply involve a relatively small number of government officials who are capable of meeting the demands. In contrast, where mistrust and misunderstanding are abundant, an approach that involves significant engagement of “end users” will likely be necessary.

## C. SUMMARY OF SUBJECT-SPECIFIC FINDINGS

Based on this multifaceted review process, reports for each area of law were prepared. It should be noted that some cross-cutting information, which affects more than one of the subject matter areas, such as the state of the judiciary, may also be repeated in the individual chapters. In general, however, the findings of the 13 subject-matter areas addressed in this report are summarized as follows:



- ♦ **Company Law.** Like much of the legal environment in El Salvador, the legal processes pertaining to the establishment, financing, and growth of companies are highly formalistic, with many rules existing at the expense of development-oriented results. Incorporation is used for both constructive and destructive purposes—that is, to develop legitimate entrepreneurial ideas but also to dodge legal responsibility for self-dealing in corporate matters. Public companies do not exist; protection for minority shareholders is weak; and the judicial system, as detailed throughout this report, is ineffective. Both formal and informal SMEs are a driving force of the economy, although they lack access to customized financing mechanisms. Significantly, the Commercial Registry has made truly impressive improvements in recent years. Through the benefits of a strong will to reform and progressive management techniques, the registry is now highly automated, has well-trained officers, and is readily accessible. Companies seeking to enter the formal sector receive a certificate of registration typically within 72 hours, and registry personnel appear motivated and enjoy their access to modern equipment. Finally, the entrepreneurial culture of Salvadorans is reflected in a strong private sector that has succeeded in international markets; there are many lessons to be learned both locally and regionally from recent success stories.
- ♦ **Contracts.** Although contracts can be easily formed in El Salvador, the institutions that support the drafting, notarizing, and enforcing of contracts are weak. Many lawyers have dubious qualifications—whether a significant portion of them graduated from law school is in doubt—and, even when they satisfy formal qualifications, the quality of their training is inadequate to meet the demands of a trade-oriented economy. Notaries hold significant authority with respect to executing contracts; however, there is virtually no meaningful oversight of their work. Specifically, although notaries are perceived to routinely engage in fraud, there is no threat of significant discipline for malfeasance. In addition, judges typically lack understanding of the contractual concepts used by modern international business and are slow and ineffective in their treatment of legal actions to enforce contracts.
- ♦ **Real Property.** The real property system of El Salvador has benefited from significant improvements in recent years, chiefly through administrative and automation changes that have improved the effectiveness of the Real Property Registry. The full power of property rights, however, is constrained by the inefficiencies of the cadastre system, which create risks of double title and uncertainty in ownership. Moreover, the ineffectiveness of El Salvador’s judicial system discourages investments in real estate and makes execution of real estate guarantees difficult. The real property lease law provides extensive protection to tenants, but landowners’ interests often go unprotected. Securitization of real estate guarantees or titles is legally permissible but does not occur because of a lack of economic incentives. A bill on asset securitization is currently pending in the Legislative Assembly. Finally, El Salvador desperately needs a law on territory order or zoning.
- ♦ **Collateral Law (Secured Transactions).** Although legal mechanisms capable of creating security interests exist in El Salvador, anachronistic procedural laws require unnecessary supervision of enforcement measures by the overburdened, inefficient, and unreliable court system. Relatively efficient substantive rights thus flounder against the procedural dysfunction, and creditors’ risks inherent in a collateralized loan remain

nearly as high as they would be if the substantive mechanisms did *not* exist and loans had *no* guarantee. In the Salvadoran legal system, there is no way to turn movable collateral into an effective guarantee should the debtor fail to pay. As El Salvador considers new additions to its legal framework that could reform the enforcement of collateral interests for guaranteed loans, lawmakers should endeavor to harmonize new laws with analogous statutes in the region. They should base their reforms specifically on model laws such as the Organization of American States Model Law of Secured Transactions (2002), the Model Inter-American Rules for Electronic Documents and Signatures (2002), and other uniform laws from the United Nations Commission on International Trade Law and the United Nations International Institute for the Unification of Private Law. The opportunity to incorporate these existing initiatives into the Salvadoran national scheme should not be missed; it represents an important opportunity to serve as a leader in regional harmonization in commercial law.

- ◆ **Commercial Dispute Resolution.** The state of El Salvador's judicial system is no less than dire: the system suffers from untenable delays, inadequate training of both professional and administrative staff, a lack of judicial independence, and otherwise unqualified personnel who hold important positions, including judges. There is an absence of public confidence in the system that is charged with supporting meaningful implementation of a commercial law structure. As one way of coping with the failures of the traditional system of dispute resolution, El Salvador enacted a Law on Mediation, Conciliation, and Arbitration in August 2002. The new law represents an important step toward more efficient resolution of commercial disputes; however, neither the legal community nor the public at large particularly understands, trusts, or thinks of alternative dispute resolution (ADR) as a viable substitute for the courts. Enormous support efforts are needed both to reform the court system and to develop ADR as a practical alternative for resolving commercial disputes.
- ◆ **Bankruptcy.** The absence of a functioning bankruptcy system in El Salvador represents a missed opportunity of potentially enormous economic significance. Although the Codes of Commerce and Civil Procedure and the Law of Mercantile Procedures nominally provide for voluntary liquidation by the debtor, they are almost never used *and* they do not allow creditors to place a failing company into the hands of a bankruptcy administrator under the supervision of a court. Without a meaningful bankruptcy law, creditors can neither foreclose those debts guaranteed against movable collateral nor assert unsecured claims with any hope of payment in a realistic time frame. This gap in the law increases the risks for lenders, thus reducing the supply of credit offered to potential borrowers. Moreover, debtors almost never exercise their rights when they are insolvent, because they find sufficient protection in the typically long delays attendant to creditors' attempts to collect debts and enforce guaranties through normal court processes. Finally, El Salvador's insolvency laws do not provide debtors with a full and final discharge of their debts. Although the statutes refer to *rehabilitaci3n* for debtors, they do not require all creditors to participate by binding their claims to discharges granted within the insolvency.
- ◆ **Competition Law and Policy.** Recognizing the benefits of a legal regime that maintains and improves efficiency in markets, promotes competitive pricing practices, and restrains price rises in markets affected by anticompetitive business practices, the Government of

El Salvador adopted a competition law in November 2004. This action took 10 years to happen—before the law’s passage, seven initiatives were submitted to the Legislative Assembly without enactment. Past resistance appears prompted by the power of select special interest groups and weak or little understanding of competition law among assembly members. Now, the challenge before El Salvador is to create and support an effective implementing institution and apprise businesses and individuals about their rights under the new law. Significant training and public education efforts are in order at this time.

- ♦ **International Trade.** El Salvador has the basic international trade conventions in place, plus a regional integration commitment and several free trade agreements. It has been a member of the Central American Common Market (CACM) since the CACM was founded in 1962, and in recent years it has been one of the CACM’s most enthusiastic supporters. El Salvador became a member of the World Trade Organization (WTO) in 1995. It has free trade agreements with Mexico, Chile, and the Dominican Republic. Most of its exports enter the United States, Europe, and Japan duty-free under generalized systems of preferences unilaterally established by those destination markets. The country’s significant level of dependence on manufactured goods, as compared to agricultural goods, helps to explain in part the nation’s consistent support for Central American economic integration, CAFTA, and various free trade agreements with other nations. Salvadoran international trade legislation is not highly developed, nor is it an area of the law that gives rise to frequent disputes before Salvadoran authorities. By and large, the country is content to allow international treaties like the WTO and the CACM, which become national law upon their ratification, to fill up the substantive rules that govern international trade. There is a concern that laws in this area need to be fleshed out, and they will continue to be reformed gradually.
- ♦ **Flow of Goods and Services.** El Salvador has made great strides facilitating trade in recent years and is a leader in the region with respect to trade facilitation. Strong improvements have taken place recently, as indicated by the development of a stronger Customs agency; the development of open markets nationally, regionally, and internationally; good working relationships between the public and private sector; increases in the security environment; and upgrades in infrastructure. However, trade-related institutions continue to burden traders with unnecessary transaction costs through delays and administrative encumbrances. By eliminating unwarranted and onerous constraints embodied in laws, regulations, and procedures, El Salvador can capture greater savings and efficiencies. Major areas demanding continued reform include further development of the capacity of the Customs agency, especially through risk management; better integration and simplification of processes among border agencies; continued improvements to the security environment; and establishment of a national priority to develop a regional distribution and logistics hub.
- ♦ **Flow of People.** Salvadoran laws, along with public and private institutions, generally support flows of people for trade purposes. The country could do more, however, to modernize its management of highly skilled visitors seeking longer-term stays, and to address illegitimate flows. The issue of flows of illegal people remains a significant problem. El Salvador’s borders with Guatemala and Honduras are long and porous, and

El Salvador serves as a key origin and transit country for illegal immigration to the United States. There is a moderate risk of kidnapping, but it rarely affects foreigners.

- ◆ **Financial Crimes.** El Salvador has the basic legal framework, institutions, and public will to combat financial crimes. Certain improvements are needed, however, and the country must remain vigilant. Adoption of the U.S. dollar as legal currency in 2001 has made the country more attractive to money launderers, and much has changed since El Salvador first passed its laws regarding money laundering in 1998. Specifically, a law on terrorist financing, currently being developed, must be passed. In addition, the problems faced by the judiciary, as discussed in greater detail in other sections, also have a deleterious effect in this area. Nonetheless, the changes needed in El Salvador with respect to combating money laundering in particular, and other financial crimes in general, are ones primarily of updating and fine-tuning as opposed wholesale revision and reform.
- ◆ **Flow of Money.** Cross-border goods and services transactions reflect a relatively small, yet still significant, amount of monetary exchange that pays for those goods and services traded—approximately \$8.9 billion in goods and \$1.8 billion in services traded annually in 2003.<sup>2</sup> In addition, in 2003, an estimated \$2.1 billion dollars poured into El Salvador through remittances of El Salvadoran workers and families abroad. These remittances were equivalent to approximately 14 percent of gross domestic product.<sup>3</sup> El Salvador is the second-most remittance-dependent country in Latin America on a per capita basis. Overall, El Salvador's laws and institutions support these trade-related money flows. Trade finance products are available to all traders. The economy is fully dollarized and other foreign currency exchange is widely available and easily exchanged for all traders. Credits for export are very difficult to gain because of serious structural issues, such as high collateral requirements and a poorly functioning judicial system. As with other CAFTA members, El Salvador is challenged by illegal money flows.
- ◆ **Supporting Infrastructure for Trade.** In general, El Salvador's stock of trade infrastructure meets the existing demands of the marketplace. Individual infrastructure components are generally well maintained and in reasonably good condition. Recently implemented improvements and contemplated transportation projects employ industry best practices in design and construction. However, broad differences in capabilities and service levels exist between the various infrastructure components. Targeted initiatives to create a seamless infrastructure environment are required. Specifically, El Salvador should focus its efforts on the following areas: roadways, seaports, airports, railroads, border crossings, electricity, and telecommunications.

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<sup>2</sup> See <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=SV>.

<sup>3</sup> See Economic Intelligence Unit (EIU) Country Profile – El Salvador, 2004-2005.

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## **II. COMMERCIAL LEGAL AND INSTITUTIONAL REFORM AND TRADE IN EL SALVADOR: CROSS-CUTTING THEMES**

Along with the specific findings in 13 subject matter areas detailed in Sections III–XV, certain cross-cutting themes emerged with respect to commercial legal and institutional reform (CLIR) and trade in El Salvador. It is important to consider and incorporate these themes but not necessarily through stand-alone initiatives. Rather, it would be prudent to address these themes within the context of any reforms undertaken, as further detailed below.

### **A. THE URGENCY OF JUDICIAL REFORM**

In virtually every section of this report—contracts, collateral, real property, bankruptcy, flow of money, and others—the inability of El Salvador’s court system to facilitate the prompt resolution of commercial disputes and the enforcement of their own judgments is identified as a fundamental problem. The many aspects of this issue include a lack of public confidence in judges (because of their perceived lack of competence and, in many instances, suspect credentials, along with an unduly formalistic approach to the law), the overall inefficiency and sluggishness of court processes, a lack of significant automation in the courts, the virtual impossibility of enforcing court decisions in a timely fashion, and so forth.

This absence of confidence in the courts represents more than a stumbling block on the path of economic development—it is a mile-high wall that will serve as a barrier to growth for years to come. Prompt, nonbureaucratic, and effective court action, based on reliable information garnered from the country’s formal registries, is not yet a reality in El Salvador. As a significant consequence, the use of collateral is so restricted that even the best-laid plans for business development typically are thwarted by a lack of access to capital. Notwithstanding laws that permit pledges on movable property, entrepreneurs who do not own real property have little chance of obtaining a loan at the start-up phase. Loans typically are made on the basis of movable collateral *only* when the business is well established and immovable property has already been secured. In addition, loan guarantees against movable collateral typically require high overcollateralization; that is, the lender may loan as little as 20 percent or less of the collateral’s value.

Until the commercial community in El Salvador trusts that the courts are capable of affording remedies in the event of defaults on loans and breaches of contracts, there will, quite simply, be fewer loans and fewer contracts than the economy could otherwise support. In short, the great risks involved with extending credit or engaging in an arms-length transaction will result in less economic activity and less growth. Even the development of alternative dispute resolution (ADR) mechanisms will not overcome the restraints El Salvador’s underfunctioning court system places on the economy—that is, there will be no confidence in ADR in the long run if the courts cannot be trusted to enforce ADR agreements and awards.

It is well known that the courts in El Salvador require reforms to meet adequately current demands and internationally accepted norms. In this regard, various projects aimed at strengthening the courts are under way, including an \$18.2 million loan/credit from the World

Bank, approved in 2002,<sup>4</sup> and, in fiscal year 2005, more than \$5 million from the United States Agency for International Development (USAID) dedicated to increasing access to justice and improving court case preparation; improving the transparency, efficiency, and promptness of the court system; promoting ADR; and combating corruption throughout Government.<sup>5</sup>

That said, there does not yet seem to be a comprehensive vision held between the donor community and the Government that focuses on the bright line that crosses from the desire of an individual to launch a business to the ability of that person to access capital and to the ability of a business, once established, to collect on its debts. Until the commercial capabilities of the courts change, little can be done to release constraints on access to capital and economic growth. Thus, all future programs in CLIR should incorporate the judicial component of the issue. This would include leveraging the resources of existing court reform programs to emphasize the relationship between court reform and economic growth and, where gaps remain, formulating technical assistance efforts that do the following:

- ◆ Improve the commercial capacity of courts through administrative and automation processes that make the process of dispute resolution faster, more predictable, and more transparent.
- ◆ Train judges in areas pertaining to commercial activity, particularly with respect to modern types of commerce and newer laws, such as the new competition law, potential laws pertaining to modern contracts or electronic commerce, and laws concerning money laundering.
- ◆ Attempt, through training and statutory reform, to address the overly formalistic, anti-growth aspects of the law and the judiciary.
- ◆ Through public outreach, persuade businessmen that the courts in El Salvador are to be trusted to uphold their commercial agreements.

## **B. PROFESSIONAL COMPETENCIES, WITH AN EMPHASIS ON LEGAL EDUCATION**

Throughout this report, weaknesses in legal and trade-related institutions are observed to be significantly grounded in inadequate professional capabilities, not only among judges but also with respect to lawyers, notaries, government officials, private actors, and others. For example—

- ◆ There are roughly 3,000 lawyers for whom the validity of legal degrees is dubious. Certain universities, which no longer exist, were known to sell law degrees.<sup>6</sup>

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<sup>4</sup> See Legal Vice Presidency of the World Bank, *Initiatives in Legal and Judicial Reform* (2004 Edition) at 58 ([http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2004/03/01/000012009\\_20040301142827/Rendered/PDF/250820040Edition.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2004/03/01/000012009_20040301142827/Rendered/PDF/250820040Edition.pdf)); see also World Bank, Judicial Modernization Project/El Salvador (<http://web.worldbank.org/external/projects/main?pagePK=104231&piPK=73230&theSitePK=40941&menuPK=228424&Projectid=P064919>).

<sup>5</sup> See USAID, Congressional Budget Justification 2005—El Salvador (<http://www.usaid.gov/policy/budget/cbj2005/lac/sv.html>).

<sup>6</sup> This information was gathered from interviews conducted as part of the assessment, *See, e.g. infra*, chapters on Commercial Dispute Resolution, Company, Real Property, Contracts and Collateral for further discussion.

- ◆ The lack of an independent bar association or a similar body for notaries means that lawyers (most of whom are notaries as well) are not well-regulated, are not held to particular ethical standards, and are not required to engage in any sort of continuing legal education.
- ◆ To various degrees, the police academy, the *Consejo Nacional de la Juridicatura* (CNJ, or National Judicial Council, which is, among other roles, one of the primary training institutions for judges), and schools responsible for training professionals, such as law and accounting schools, all fail in providing sufficient opportunity for individuals to develop a skill set for combating financial crimes before being assigned the role in a professional setting.
- ◆ In the private sector, technical skills are often weak, with inadequate skills in marketing, accounting, operations, and—particularly with respect to SMEs—information technology skills.
- ◆ Within the courts of first instance, judges must not only be legal practitioners but also administrators as there are very few court administration or management professionals.
- ◆ In the courts, judges tend to overemphasize formal, process-oriented decision making, perhaps to obscure a very weak grasp of the substance of the commercial laws they are asked to interpret. They do not typically search for the reality of corporate matters, it is said, but rather seek to comply with the formalities.

These and other often-cited weaknesses in the performance of professionals who work in the commercial law or trade arena warrant cross-cutting consideration. Even in the context of low salaries, poor physical facilities, and other negative circumstances, the opportunity to *learn more* and *do better* will likely find an audience in the various institutions this report surveys. Reform programs can confront and address poor command of subject matter, poor management and problem-solving techniques, and lack of institutional consistency in a number of ways. These include the following:

- ◆ Strengthened professional organizations that serve their constituencies through common guidelines, standards, resources, and means of professional oversight.
- ◆ Improved access to and quality of continuing education for virtually all commercial and trade-related professions.
- ◆ Collective development of codes of conduct and increased public understanding of what they are entitled to expect from public officials engaged in commercial and trade-related work.
- ◆ In the private sector, better accounting practices, more efforts at transparency, and stronger adherence to principles of sound management.

As a matter of particular urgency, the system of educating lawyers needs reform. As detailed in the commercial dispute resolution section of this report, approximately 20 universities in El Salvador have a law faculty, but according to interviewees, only 1 or 2 of these schools reportedly produce lawyers who are adequately prepared for the actual practice of law. Law

schools face delays and other obstacles in changing their curricula, as any such adjustments must be approved by the Ministry of Education. A handful of educators and practitioners try to keep up with the constantly advancing field of international commercial practice, but they are sometimes stymied by a lack of interest. For example, one knowledgeable practitioner interviewed for the assessment offered to give classes on the use of arbitration at approximately 40 schools and associations; only two expressed interest in taking advantage of this offer.

USAID is positioned to serve as a leader among donors in forging and supporting a coordinated effort to improve commercial legal education. In addition to providing key funding support, USAID could bring together donors and local stakeholders to develop a strategic, coordinated, approach to commercial legal education in El Salvador. USAID could specifically provide leadership with respect to sharing lessons learned and consulting on curriculum development. To establish a baseline for reform, the following questions need clear answers:

- ♦ What commercial law courses are currently available in the standard law school curriculum? Who is the faculty assigned to teach these courses, and to what extent are these faculty members familiar with recent evolution in the law?
- ♦ What is the universe of local and donor activity specifically targeted at the law schools? Of this activity, which specifically pertains to commercial law? What is the current level of donor coordination with respect to commercial law-related assistance to the law schools?
- ♦ What long-term reforms are necessary to allow the law schools to provide a comprehensive and meaningful curriculum in commercial law? How can these reforms be prioritized? What existing structures are in place within the legal education community to oversee and guide a long-term reform process, and what new structures might be necessary?
- ♦ What short-term methods could be used to get much-needed information and assistance to students now? How could donor and local resources be leveraged to most effectively implement these methods?

In reality, reforms to the legal education system in El Salvador will likely take a generation. Through a shared vision of long-term reform, combined with thoughtful and well executed short-term initiatives, a shift in the learning dynamic and the quality of commercial legal education may finally take place in a sustained and meaningful fashion.

### **C. SMALL AND MEDIUM-SIZED ENTERPRISES AND THE GROWING ECONOMY**

Small and medium-sized enterprises (SMEs) employ two-thirds of the workforce of the European Union<sup>7</sup> and about 50 percent in the United States.<sup>8</sup> They also play a vital role in El Salvador, where nearly 500,000 micro, small, and medium-sized businesses were said to be in place at the close of the 1990s.<sup>9</sup> The CLIR and trade assessment team found that SMEs are

<sup>7</sup> See [www.europa.eu.int/scadplus/leg/en/lvb/n26013.htm](http://www.europa.eu.int/scadplus/leg/en/lvb/n26013.htm).

<sup>8</sup> See [www.sba.gov/advo/press/04-06.html](http://www.sba.gov/advo/press/04-06.html).

<sup>9</sup> See Fundes International, Business Enabling Environment Program, Presentation on SMEs ([http://home.fundes.org/doc/FUNDES\\_INDICATORS\\_2\\_STATISTICS.pdf](http://home.fundes.org/doc/FUNDES_INDICATORS_2_STATISTICS.pdf)).



indeed a driving force in the economy but also found that they face various obstacles in their establishment and growth. The team observed the following:

- ♦ Many of the SMEs in El Salvador are informal. It is thought that about 40 percent of the Salvadoran economy operates outside the formal commercial sector.<sup>10</sup> Some micro businesses have expressed that they do not formally incorporate because of excessive regulatory steps. When SMEs do not enter the formal sector, they are unable to take advantage of laws and programs that support their continued growth. In turn, the state is deprived of tax revenues that are used to support a legal and physical infrastructure that sustains economic growth.
- ♦ Financing for SMEs (especially informal ones) is not easily available. Some programs have been implemented to assist SMEs in the exportation of goods. Those programs often lack funding, however, and are not sufficiently coordinated. Marginal candidates for credit, including virtually all SMEs, cannot gain access to credit from conventional lenders.
- ♦ The technical needs of the SME sector are great. Currently, according to interviewees, only 5 to 8 percent of its members have information technology capability.

In general, SMEs are at a disadvantage in El Salvador's economy, which—notwithstanding significant recent progress—suffers from weaknesses in certain crucial institutions. Costs and risks associated with doing business are all the greater for smaller businesses. Indeed, the costs of start-up and operation can be crushing to a new business that has virtually no access to capital. SMEs must bear significant expenses at every point in their life cycle. Some of the most burdensome costs include taxes; start-up costs, regulatory burdens, and inspections; labor; security; and high collateral requirements for loans.

In addition, there are major risks involved with launching and growing a business in El Salvador. These risks include the difficulty in enforcing contracts because of the problems in the judicial system and lack of meaningful alternatives in dispute resolution (although the latter is changing); a lack of availability of affordable funding to meet the ongoing needs of a business, especially in a crisis or new opportunity; and, although improvements have been made, the security of domestic, regional, and international trade.

Throughout this report, suggestions for legal and institutional reforms aim ultimately to reduce the cost and risk of doing business. Although many of the recommendations apply generally to both large and small businesses, the vital role of SMEs in the Salvadoran economy warrants special consideration of their particular needs on a cross-cutting basis.

#### **D. THE LESSONS OF SUCCESS**

The World Bank recently summarized the highly promising—if far from perfect—state of economic development in El Salvador:

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<sup>10</sup> <http://rru.worldbank.org/DoingBusiness/ExploreEconomies/BusinessClimateSnapshot.aspx?economyid=62>.

El Salvador has made remarkable progress in the economic, social, and political fronts since it emerged from a 12-year civil war in 1991, but the earthquakes of 2001 have brought new challenges. During the 1990s, growth and stable prices replaced economic decline and inflation. Trade liberalization, financial sector and pension reforms, privatization of state-owned enterprises, and the decision to move to a bi-monetarist regime in 2001 have all contributed to a strengthened economy.

Nowadays, El Salvador has a more deregulated and diversified economy than in the past, is less dependent on agriculture and is developing strong service and manufacturing sectors. As a consequence, standards of living improved and poverty declined markedly during the last decade. Net enrollment in primary education increased by close to ten percentage points, infant mortality declined by 40 percent, population without access to safe water was halved and extreme poverty was reduced by half. By 2000, El Salvador was well positioned to meet most of the 2015 Millennium Development Goals ahead of schedule.<sup>11</sup>

Consistent with the World Bank's overview, the assessment team observed many specific examples of improved laws, institutional capacities, and practices in El Salvador, including the following:

- ♦ The Salvadoran Customs Service is a vigorous, effective agency that facilitates the movement of goods in and out of the country. Already very competent, it is striving to become more so.
- ♦ Private-sector users of the agencies that administer international trade matters in El Salvador seem quite satisfied with current practices. They indicate that, across the board, procedures are handled quickly, in a transparent manner, and with virtually no corruption.<sup>12</sup> They believe that the Government, from the president down, gives great importance to international trade and generally supports it in every way it can.
- ♦ In the past, El Salvador's commercial registry lacked the capacity to handle the large quantity of requests it received, but over the past year the registry has made important improvements in its capabilities. As was learned during the assessment process, it currently takes a company about 72 hours to receive a certificate of registration. The Salvadoran Commercial Registry is the only registry in Latin America to have received an ISO-9000 quality certificate. The registry is highly automated, has well-trained officers, and provides good accessibility. On a visit to the Commercial Registry, it was noted that personnel are well motivated and have access to modern equipment.
- ♦ By enacting a Competition Law in 2004, El Salvador became the second of only two Central American Free Trade Agreement (CAFTA) countries—the other being Costa Rica—to have such a law in place.<sup>13</sup>

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<sup>11</sup> World Bank, El Salvador Country Brief (<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/ELSALVADOREXTN/0,,menuPK:295253~pagePK:141132~piPK:141107~theSitePK:295244,00.html>).

<sup>12</sup> See Chapters on International Trade and Flows of Goods and Services for further discussion.

<sup>13</sup> *Ley de Competencia*, November 26, 2005, Decree No. 528.

- ♦ El Salvador is one of only nine countries to fully adopt the U.N. Convention against Corruption.<sup>14</sup>

These are just a few examples of improvements made in El Salvador in recent years through a commitment of political will, hard work, and forward-looking practices. Its own experience with implementing change bodes well for those institutions that need changing. In addition, El Salvador serves as a model for the region. As noted at various points in this report, there is a strong need at this juncture for the emergence of Central America as a united trade base for increased harmonization and regionalization of laws and practices. El Salvador can serve as a leader in this regard, using regional and international models for guidance as it updates its legal framework, as encouraged at several junctures in this report.

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<sup>14</sup> See, United Nations Convention Against Corruption, Doc A/58/422, [http://www.unodc.org/unodc/en/crime\\_signatures\\_corruption.htm](http://www.unodc.org/unodc/en/crime_signatures_corruption.htm).

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### III. COMPANY LAW

#### A. INTRODUCTION

El Salvador has a very formalistic legal system. The legal processes regarding company law are no exception. Incorporation is used for both constructive and destructive purposes: to develop a legitimate entrepreneurial idea and to dodge the application of the law. Public companies do not exist and protection for minority shareholders is weak. In addition, the judicial system is unreliable.

However, the Commercial Registry is very efficient and the entrepreneurial culture of Salvadorans is reflected in a strong private sector that has succeeded in international markets. TACA, perhaps the second-largest privately owned Latin American airline was formed in El Salvador and the largest Central American bank, Banco Agrícola, originated in that country.

Both formal and informal SMEs are a driving force of the economy, although they lack access to customized financing mechanisms.

#### B. LEGAL FRAMEWORK

The legal framework of company law is found in the Commercial Code of El Salvador. In general, the Commercial Code is legally sound.

The Commercial Code provides for the creation of various business structures. The most commonly used structure is a limited liability company, called a *sociedad anónima*. A *sociedad anónima* is easy to incorporate by officially registering the articles of incorporation and bylaws and paying a contribution to the company's capital.

According to the Commercial Code of El Salvador, a *sociedad anónima* cannot be registered without initial capital of \$11,500. However, of the minimum capital requirement, only 25 percent needs to be paid during incorporation. Initial capital payments can be made in cash or in kind.<sup>15</sup>

Companies that do not register with the Commercial Registry make shareholders liable to third parties. Thus, both company's and shareholder's assets for non-registered companies are subject to seizure by creditors.

Publicly held companies do not exist. Legally, companies can issue shares to the public, but this has not happened. Thus, most shares are traded privately. However, companies have access to the stock market for public financing through the issuance of bonds. To publicly issue bonds, companies need to receive authorization from the Stock Superintendency and comply with the provisions of the Stock Market Law and the internal regulations of the *Bolsa de Valores*.

*Sociedades Anónimas de capital abierto* are another common business structure. These companies have fixed and variable capital. They are allowed to increase capital in a flexible way without announcing the increase or calling a shareholder meeting to modify the company's

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<sup>15</sup> Commercial Code of El Salvador (Commercial Code), Article 192.

bylaws. This business structure requires that fixed capital remain unchanged and that a record is kept of changes in the variable capital.

Companies are subject to both internal and external control mechanisms. Internally, shareholders are entitled to supervise the actions of the firm's administrative body. Externally, the law requires that shareholders appoint an auditor who would be liable for failure to comply with his/her duties vis-à-vis third parties including shareholders. Auditors' functions range from confirming company incorporation and granting guarantees to corporate administrators to reviewing balance sheets. Auditors also advise shareholders of misdeeds by the firm's administrative body. Bylaws may require that other auditors be appointed for other functions. In all cases, the auditor needs to be a certified public accountant.

A company is required to have a minimum of two shareholders at any point in time. If the company has a sole shareholder, it is considered an irregular company for which the shareholder will have joint and unlimited liability to creditors.

Protection for minority shareholders is weak. If a minority shareholder does not agree with decisions of the majority he/she can leave the company, but whether shares will be bought back at market value is ambiguous. Most frequently, shares are bought back at book value.

Likewise, if a minority shareholder were to notice any wrongdoing by the administrators, he/she could call a shareholders' meeting assuming he/she owns at least five percent of the company's shares.<sup>16</sup> The law provides that, in cases of capital increase by dividend capitalization, when a shareholder does not want to take part in the capitalization, he/she can demand payment of dividends.<sup>17</sup>

Unless bylaws state otherwise, shareholders who own 33 percent of shares can appoint one-third of the directors. For most relevant company changes, approval from 66 or 75 percent of shareholders is required.<sup>18</sup>

Administrators are not personally liable for actions of a *sociedad anónima*. However, administrators can be held accountable to shareholders if they fail to comply with stated duties. In cases of fraud and other misdeeds, it is not possible to lift the corporate veil or disregard the legal personality of the parent company of a subsidiary because of a lack of legislative provisions in this matter. In those cases, only criminal charges can be made against the administrators.

The Commercial Code establishes a very important difference between a company and an enterprise, with the latter defined as commercial activity. For this reason, a business license is required to undertake commercial activities. Licenses are issued by the Commercial Registry and need to be renewed every year. Once a license has been requested from the registry, the registry issues a temporary license, which allows the firm to do business while it awaits an official license. Official licenses typically are issued in about three months. In addition, and as a consequence of the above difference between company and commercial activity, a company can grant a mortgage on the commercial activity (i.e., inventory, goodwill).

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<sup>16</sup> Commercial Code, Article 231.

<sup>17</sup> Commercial Code, Article 276.

<sup>18</sup> Commercial Code, section C.

Corporate books and accounting systems need to be legalized by accountants as per a new law on accounting. According to interviewees, it takes approximately 20 days for accountants to legalize these processes, and it has been reported that accountants' fees for this task are high. However, the company can operate while it awaits legalization of its accounting processes.

Other documents also need to be filed at the Commercial Registry, such as guarantees given on the bulk business or enterprise (i.e., inventory, goodwill, commercial rights, and financial leasing contracts).

### **C. IMPLEMENTING INSTITUTIONS**

In El Salvador, companies need to register with the Commercial Registry to be valid vis-à-vis third parties.

As was learned during the assessment process, in the past the registry lacked the capacity to handle the large quantity of requests it received, but over the past year the registry has made important improvements in its capabilities. As mentioned previously it takes a company about 72 hours to receive a certificate of registration. The Salvadoran Commercial Registry is the only registry in Latin America to have received an ISO-9000 quality certificate. The registry is highly automated, has well-trained officers, and provides good accessibility. On a visit to the Commercial Registry, it was noted that personnel are well motivated and have access to modern equipment.

Registration fees are not high. In the case of incorporation, fees are determined by the capital of the registering company and cannot exceed \$5,700. To incorporate a company with capital ranging between \$11,428.57 and \$57,142.86, registration fees would be \$91.43.<sup>19</sup> These revenues are devoted to finance operations, as the registry does not receive funds from the central Government.

Currently, the Commercial Registry is centralized. Some regional offices exist, but these offices can only receive documents. However, given the size of El Salvador, centralization does not seem to be a major problem and plans for increasing the capacity of regional offices are under way. Currently, it is not possible to register a company online, but plans have been drafted to allow incorporation via the Internet and to create a network between government offices. Once this network has been completed, it is expected that all business registrations can be conducted electronically at a virtual one-stop shop.

Problems at the Commercial Registry typically are associated with errors made by submitting parties. In most cases, these parties are notaries. Examples of these errors include the presentation of prohibited documents, the delay in correcting mistakes on documents, and the withdrawal of the documents issued by the registry.

Another relevant implementing institution is the Superintendency of Commercial Obligations, formerly the Superintendency of Commercial Companies. This agency is in charge of supervising and controlling the operations of companies. The Superintendency can impose fines if companies fail to comply with duties, such as failing to have the minimum number of

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<sup>19</sup> Centro Nacional de Registros de El Salvador. <http://www.cnr.gob.sv/>

shareholders or failing to file annual profit-and-loss statements or balance sheets. The Superintendency can be called on to attend shareholders' meetings to verify that companies comply with Company Law. However, the supervision function of the Superintendency of Commercial Obligations is not perceived as effective.

Courts also play an important role in Company Law implementation. Courts handle cases involving companies, including suits against administrators, suits by and against companies, and regarding general enforcement of shareholders' decisions or administrators' resolutions.

A chaotic judicial system was repeatedly mentioned as the primary problem for Company Law in El Salvador. The judicial system is slow and unreliable and generally lacks professionalism. It has been reported that some judges have not, in fact, earned their law degrees. In addition, the judicial system is not automated. The Supreme Court is similarly poor. The few people who defend the overall state of the judicial system agree that the Supreme Court is in a deleterious state.

There is little awareness of alternative dispute-resolution mechanisms such as arbitration. An arbitration center was recently formed in El Salvador, but the center has not yet been widely utilized. Thus, despite passage of new laws on arbitration, ADR mechanisms cannot be said to be available for businesses seeking to avoid the inefficiencies of the traditional judicial sector.

#### **D. SUPPORTING INSTITUTIONS**

In El Salvador, interviewees stated that notaries are required to be lawyers and to pass a special exam to obtain a notary license; there are around 8,000 lawyers and 6,000 notaries. Of the 8,000 lawyers, there are strong indications that 3,000 have fraudulent law degrees.

The function of notaries is to grant verity of the documents they witness. The power to verify extends to certifying the identity of parties and the content of documents. Although not mandatory, it is common practice for firms to ask notaries to draft and authenticate articles of incorporation and have notaries file the documents with the Commercial Registry.

Notary fees can be negotiated, but, nonetheless, they are generally considered to be the highest cost associated with starting a business.

A stock exchange market exists in which companies primarily trade bonds and other debt instruments. Reportedly, according to practitioners and businessmen in this area, an average of \$30 million in these securities are traded daily. Although the market seems to be modern, Salvadorans have little knowledge of the benefits of investing in stocks.

#### **E. SOCIAL DYNAMICS**

Corporate governance principles are not widely known by Salvadorans. The auditing principles of the Sarbanes-Oxley Act, which are relevant to Salvadoran companies doing business in and with the United States, are not widely known. Among some civil society groups, there is demand for stricter rules on corporate governance, mainly when it comes to the financial sector. There are no pending government initiatives in the area of corporate governance.

Likewise, there is a demand to increase protection for minority shareholders through legal reform. Again, no plans for reform have been announced in this area.

Integration of the Commercial Registry with all the other National Registries is currently taking place. A plan financed by the Canadian International Development Agency (CIDA) has already started this process.

The judicial system is in need of radical reforms. Procedures need to be expedited and the quality of the judges needs to be enhanced. There have been several timid reform efforts and a law has been drafted that would convert some judicial procedures into oral ones. Nevertheless, judicial reform efforts remain scarce. The Government professes to be doing its best considering the budgetary and institutional restrictions it faces.

According to information gathered during the assessment, roughly 500,000 micro enterprises and SMEs have been reported to exist in El Salvador. Many of the SMEs are informal. It is thought that 40 percent of the Salvadoran economy operates outside the formal commercial sector. Some micro businesses have stated that they do not formally incorporate because of excessive regulatory steps. As a result, these firms operate outside the legal framework with few opportunities to grow. Financing for SMEs (especially informal ones) is not easily available. Some programs have been implemented to assist SMEs in the exportation of goods. However, those programs often lack funding and are not coordinated among each other.

## **F. RECOMMENDATIONS**

- ◆ There is a general need for increased knowledge of corporate governance principles. A training program for business people, lawyers, judges, and government officials in the area of corporate governance could ameliorate some of these issues.
- ◆ The legal profession needs to be reformed. Many of the problems associated with the poor judicial system are due to the lack of ethical and professional standards for legal professionals. Admissibility requirements need to be imposed for lawyers and notaries, such as sophisticated knowledge exams. Continuing legal education for admitted lawyers should be mandatory.
- ◆ Legal education needs to be modernized. International business transactions and international and comparative law should be included as part of the curricula for legal education. Judges should be trained in these areas, with additional training in substance over form and tools such as economic analysis of law. Teaching methods should be modernized and the Socratic method, with its emphasis on case solving, should be used.
- ◆ Legal reform is needed in the areas of corporate governance, protection of minority shareholders, and treatment of exceptional cases, when the legal personality of a company can be disregarded.
- ◆ The CIDA project to integrate the Commercial Registry with other registries and the evolution into a virtual one-stop shop should be monitored and supported when needed.
- ◆ A thorough assessment of the status of the SMEs and the size of the informal sector is needed. The assessment should identify obstacles that hinder SME growth and provide a



strategy for their removal. Consideration should be given to issuance of special certificates to SMEs, similar to the 8a certificates issued by the U.S. Small Business Administration granting certified SMEs advantages in terms of operation, flexibility on certain regulatory burdens, and tax incentives. Likewise, cooperation between programs that support SMEs would increase their effectiveness. An initiative to train, promote and strengthen SME clusters could address some of the issues these important commercial players face.

## **IV. CONTRACTS**

### **A. INTRODUCTION**

Contracts can be easily formed in El Salvador. The only restriction parties face is that they cannot enter into contracts that violate laws or that are contrary to public order.

Enforcement of contracts, on the other hand, is a different issue because of the critical condition of the judicial system and a lack of alternative dispute-resolution mechanisms. Both the time necessary to enforce a contract and the outcome of decisions are unpredictable. It can take years to reach decisions, and in some cases the judges have issued decisions that are completely contrary to the law. In general, judges are poorly trained and some of them even lack a legitimate law degree. The Supreme Court has problems similar to those observed in lower courts.

### **B. LEGAL FRAMEWORK**

Commercial contracts are first subject to the Commercial Code and then, secondarily, to the Civil Code. If the Commercial Code does not provide coverage for a specific contract where a business person or company is involved, the Civil Code applies.

No special legal formalities exist to ensure the validity of commercial contracts. Notarization is not required in most contracts. However, parties often prefer to have the contracts authenticated by notaries to expedite the enforcement process.

Leasing contracts are becoming popular. For example, most cars are offered through leasing arrangements. A special law on leasing has been passed and is regularly implemented.

*Factoreo* or discount of accounts payable is regulated not by law but rather by the agreement made by the signing parties. Businesses of all sizes sell, at a discount, an informal commercial instrument called *quedan* in which a statement is made about merchandise not yet delivered or accounts payable pending payment. Businesses use this mechanism as a means to finance operations and in some cases to guarantee formal loans.

Electronic contracts are not regulated, nor is there a law that covers electronic signatures. However, in use of the freedom to contract, parties enter into different kinds of electronic transactions provided they are not contrary to an existing law.

Contracts are generally of a written nature. In theory, oral contracts are allowed; however, enforcement of an oral contract is difficult.

Distribution and agency contracts are regulated. Disproportionate protection is granted to the local distributor or agent. In cases in which distribution or agency contracts provide a choice of foreign law or foreign jurisdiction, local courts are bound to the provisions of the Commercial Code whereby disputes for distribution contracts are decided by the court of the domicile of the distributor or agent.

El Salvador is a signatory of the Interamerican Convention on Legal Regime of Powers to be used abroad. Thus, powers of attorney granted in a signatory country are easily used in El

Salvador without formalities apart from the apostil written by the relevant officer in the country of origin.

### C. IMPLEMENTING INSTITUTIONS

Certain commercial contracts need to be notarized to be valid. This is the case with powers of attorney for commercial matters or to or from a company. Notarization is also required for contracts for the sale of goods and real property.

As was learned through interviews conducted as part of the assessment, notaries must be lawyers. There are roughly 8,000 lawyers in El Salvador, of which 6,000 are notaries. Requirements to become a notary are lax. Recent changes in the process of becoming a registered notary require lawyers to pass an exam. It was reported that the first time the exam was given only 2 of 1,000 testing lawyers passed. In the most recent exam, 6 of 800 passed initially and an additional 6 passed after appealing. It was reported that because of the nature of the exam, which was said to be unclearly worded, luck rather than knowledge of the law determined passage. It was also reported that some notaries have been conspirators in fraud. In one case, a notary tried to file a document for the sale of a company's real property with a forged signature of the company's president. In another case, a notary falsified the signature of a judge.

Notaries are regulated by special laws and supervised by the Supreme Court. The Supreme Court grants licenses to notaries and can abjure notary privileges. The Supreme Court has not taken disciplinary action against any notary.

Notaries base their fees on the value of the transaction; they charge a percentage of the transaction's value. These fees can be prohibitively high for small entrepreneurs.

If a party fails to comply with the terms of a contract, the other party can try to obtain compliance by suing in the appropriate court. In the case of contract enforcement, the Salvadoran court system has proved inadequate.

El Salvador has three levels of courts: trial, appellate, and Supreme. Cases are often delayed, leaving contract parties uncertain about when their case will be heard. As was reported during the assessment, one is said to be fortunate if one's case reaches a decision within two years at trial courts. Decisions take roughly the same amount of time in appellate courts and can take from two to five years in the Supreme Court. Once a case reaches the Supreme Court, there is still a possibility that *amparo*, a special action for violation to the Constitution, could be filed before the constitutional chamber of the Supreme Court.

Judges are typically rigid in making decisions, applying the law as written. This is to say that judges tend to be formalistic and they tend to ignore broader interpretations of facts, focusing instead on whether compliance with legal forms has been met. Rarely does a judge refer to foreign jurisprudence, foreign doctrine, or international law, including international laws to which El Salvador is party.

According to interviewees, there are roughly 3,000 lawyers for whom the validity of their legal degrees is dubious. Certain universities, which no longer exist, were known to sell law degrees. An investigation conducted by the Attorney General's office, found 169 law degrees to be false.

During the investigation it was found that law degrees were sometimes sold for as little as \$500. The Attorney General's office initiated legal action against 13 of the alleged false law degree holders. Of the 13 cases, 8 were declared innocent due to technicalities, 5 of the cases are still pending ruling, and 3 were sentenced to "return to university."

In a similar investigation regarding judges, the Supreme Court also initiated an investigation in which it was determined that at least 50 judges had false law degrees. Reportedly, only 18 of the judges found to have no legal degree were dismissed. The investigation is still pending, but interest in the issue seems to have waned. One Supreme Court justice, who was openly opposed to the investigation, proposed that the degrees be validated retroactively.

The Supreme Court is constantly mentioned as the origin of problems with the judicial system. The Supreme Court is composed of 15 justices appointed for a nine-year term by the Legislative Assembly. Because of political polarization between a strong leftist coalition group and the center-right group, the appointment process is a function of politics rather than merit. Consequently, the best lawyers are often passed over for justice appointments due to contrary or lack of political affiliation. In addition, the Supreme Court appoints the judges downstream. It has been reported that each political group has control over a portion of the judiciary.

The Supreme Court has many administrative functions, such as supervising lawyers, notaries, and judges of lesser courts. These responsibilities distract the Supreme Court judges from their duties in deciding actual legal cases. It has been reported that justices devote more time to administrative and social matters than to case duties. At the Supreme Court level, cases often take years to come to hearing.

An independent body, the CNJ, is responsible for many of the administrative duties such as selecting, evaluating, and training judges. It has reform plans and international assistance to undertake its job. However, the Supreme Court intervenes in most of the CNJ's activities.

According to knowledgeable practitioners, the cost of a court trial, assuming a staff of 18 plus a judge, ranges between \$15,000 and \$20,000 monthly. There are no budgeted monies for new courtrooms or increasing case capacity. Six percent of the national budget is mandatorily devoted to the judicial system, but this quantity remains insufficient to manage caseloads.

Courts also lack managerial acumen. In a typical court trial, most resources are devoted to handling administrative matters. One court reported that during one month, there were 3,000 cases for which the court took some type of action. The same court reported that on average they took 1,000 decisions per month that were of a purely administrative nature and issued 300 notification notices. That court reached final merit-based decisions on only 37 cases during the month in question.

Corruption and political influence are commonly mentioned as the driving force behind a prompt and favorable decision. Clerks and judicial assistants were repeatedly cited as poorly trained and corrupt. In addition, it is difficult to remove a corrupt or underperforming judicial officer.

One clerk reported handling cases from as far back as 1994. The clerk also mentioned the disparity in case priorities by citing a case involving a foreign soft drink company that was decided in one year because of political and media attention.

### Enforcing Contracts (2003)

The ease or difficulty of enforcing commercial contracts in El Salvador is measured below, using three indicators: the number of procedures counted from the moment the plaintiff files a lawsuit until actual payment, the associated time, and the cost (in court and attorney fees). An overall index of the procedural complexity of contract enforcement is calculated by averaging four subindices related to dispute resolution. The index varies from 0 to 100, with higher values indicating more complexity in enforcing a contract. The procedural complexity index for El Salvador is 81, compared with the regional average of 70 and the Organization for Economic Cooperation and Development (OECD) average of 49.

Indicator	El Salvador	Regional Average	OECD Average
Number of procedures	42	33	18
Duration (days)	240	363	213
Cost (% GNI per capita)	7.3	38.0	7.1
Procedural Complexity Index <sup>20</sup>	81	70	49

Source: World Bank.

Notes: Subindex components are scored between zero and one, with one representing the highest level of complexity. The procedural complexity index is constructed by averaging the six subindices and multiplying by 100. It varies between zero and 100.

#### D. SUPPORTING INSTITUTIONS

Arbitration is an alternative to the court system. Whereas in the past ad hoc arbitration was possible, it was only recently that an ADR law was formally passed. On the basis of the new law, the Chamber of Commerce and Industry created an arbitration center. The center is meant to handle commercial disputes. However, to date the center has received only eight cases, of which only one has been decided. Lack of knowledge about alternative means for settlement and the costs associated with arbitration are mentioned as the main reasons for the center's small caseload.

In the absence of a reliable court system and experienced arbitration centers, foreign investors take disputes abroad when possible. In a case between a Spanish investor and the Salvadoran state, the investor filed an arbitration claim against the state before the International Center for Settlement of Investment Dispute (ICSID) in Washington, DC.<sup>21</sup>

It has been reported, in the case of ad hoc arbitrations, that the state does not usually comply with arbitration awards or delays payment because of lack of financial resources. However, in cases of ICSID arbitration, the state does not have the option to ignore rulings. Failure to comply with an ICSID ruling could result in El Salvador's exclusion from the international legal system.

A federation of chambers of commerce called the *Asociación Nacional de la Empresa Privada* (National Association of Small Enterprise, El Salvador, or ANEP) also plays a role in contract

<sup>20</sup> The procedural complexity index is constructed by averaging the six subindices used in the World Bank Doing Business research on contract enforcements. It varies between 0 and 100.

<sup>21</sup> See, <http://www.worldbank.org/icsid>.

law. ANEP is proactive in advancing changes to the legal and judicial system. The organization's suggestions, seemingly sound, well founded, and well intended, are directed to the central Government.

FUSADES (*Fundación Salvadoreña de Desarrollo Económico y Social*, or the Salvadoran Foundation for Economic and Social Development), a reputable think tank, was created 20 years ago with funding from USAID. FUSADES conducts legal research, publishes papers, and generally tries to shape policy regarding economic and social development. Specifically, the group has identified a need to strengthen government institutions, including the judiciary. FUSADES also has a legal division, which is very active in the law-making process.

There is no Bar Association in El Salvador. The *Centro Estudios Juridicos* is the association that most resembles a Bar Association. *Centro Estudios Juridicos* is the largest professional organization of lawyers. According to interviewees, approximately 250 lawyers are active members. The organization has been active for 40 years and makes recommendations for legal and judicial reform.

## **E. SOCIAL DYNAMICS**

As is well known, twelve years ago, El Salvador ended a civil war in which around 70,000 Salvadorans were killed. It has been said that, in the face of impunity, peace is unsustainable. Impunity exists when the judicial system fails in its intended role. As adequate means for dispute resolution are absent, society is in the dangerous position of being unprotected and weary of its own judicial system.

It is critical that El Salvador avoid the possible strife that could stem from estranged citizens and make a strong push to reform the judicial system.

The World Bank is sponsoring a judicial reform program. The program is meant to reform the processes of judges' appointments and court management and to increase transparency in judicial procedures.

Adding to the dilatory nature of the judicial system is the requirement of written processes. A bill pending congressional approval would convert many written judicial procedures into ones that could be conducted orally. It had been widely reported that the law is a national priority.

There is a need for more arbitration centers. Promotion of the advantages of alternative dispute-resolution mechanisms is constantly mentioned by the business community as a critical component of overall reform of the judicial system. Lack of popular legal education and knowledge about the arbitration process could lead to social problems if a foreign arbitral award were to be issued against El Salvador.

Notaries are mentioned as a main cause of disturbance for many business transactions. Stronger regulations, admissibility requirements, supervision, and a specialized disciplinary body were repeatedly requested by the private sector.

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## F. RECOMMENDATIONS

- ◆ Government institutions in El Salvador are in a critical state. The result of poorly run institutions is a weak rule of law. There is a lack of communication between the Government and the private sector on this issue. Both parties need to understand the importance of the issue and their respective responsibilities for driving change. The Government needs to promote institutional changes by passing legislation aimed at institutional strengthening and integration. The Government also needs to make efforts to eliminate politics from the judicial system. The private sector needs to change behaviors such as the “shortcut” tradition in which individuals bypass legal processes by using informal processes. The roles of the public and private sectors should be understood by both Government and business. For this reason, consensus needs to be built in the area of rule of law through public-private sector workshops and working groups.
- ◆ The legal profession needs reform. Admissibility requirements for lawyers and notaries should be stiffened and rigorously enforced. Consideration should be given to international practices, such as required admission or a bar exam and continuing legal education for lawyers. Likewise, law schools should be subject to strong control and supervision.
- ◆ Legal education should be reformed and modernized. Law schools should have a required core curriculum and should be allowed to implement modern legal themes into their programs. Law schools should promote student specialization during the final portion of programs by providing elective courses. Existing lawyers and judges should be trained in the importance of the rule of law, basic legal principles, international law, international business law, foreign jurisprudence and doctrines such as “substance over form,” and economic analysis of the law. Courses on European law, already taken by many Salvadoran lawyers, at the Universidad de Salamanca in Spain, are beneficial in broadening legal interpretations, but a similar program is needed for U.S. law. Using a case methodology to teach lawyers and judges allows for greater flexibility in interpretation of the law and should be encouraged. There are currently judicial training programs sponsored by USAID and the United Nations Program for Development. These programs should be complemented by further training. Overall legal education reform should include training of basic legal principles for common citizens to provide civil society with means for monitoring the rule of law and shaping the greater legal climate.
- ◆ More arbitration centers should be created. Specialized arbitration centers devoted to settling disputes of SMEs should be created to handle the specific needs of this important economic sector. Likewise, a promotional campaign on the use of alternative dispute mechanisms could increase the use of these valuable alternatives to traditional means for legal settlement. In addition, the use of *amparo* should be restricted to exceptional cases in arbitration clauses and awards by legal reform and judge training.
- ◆ Efforts should be taken to work cooperatively with and support the World Bank project on judicial reform. A method for electing justices in which the Legislative Assembly approves public guidelines to gauge the merits of the candidates and civil society monitors compliance would improve the current judicial selection process. In addition, judicial administrative duties should be passed to the CNJ. In the case of administrative

duties that cannot be easily relinquished by the Supreme Court, coordination between the Supreme Court and the CNJ should be strengthened and strategic management techniques should be provided to allow the Supreme Court to focus more on its paramount duty of deciding cases.

- ♦ The pending approval of the new civil and commercial procedure code should be monitored. The new code should allow official communications to occur electronically and by fax and certified mail to expedite processes. If there is lack of political motivation for the timely approval of the new civil and commercial procedure code, consensus should be built between the public and the private sectors through working groups and workshops that motivate and coordinate a campaign for the code's approval. Judges and lawyers should be trained in how to handle oral procedures to maximize the efficiency gains sought by the new procedural code.
- ♦ The draft law on electronic contracts should be made a political priority. Changes should be made to the Commercial Code to allow distribution agreements to be subject to foreign law and jurisdiction.



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## **V. REAL PROPERTY**

### **A. INTRODUCTION**

Huge improvements have been made in the real property system of El Salvador. However, some problems remain, mainly from inefficiencies of the cadastre system. That creates situations such as risk of double title.

A law on territory order or zoning is needed. The lack of a reliable judicial system creates uncertainty. Long judicial procedures discourage investments in real estate and make it difficult to execute real estate guarantees.

The real property lease law provides extensive protection to tenants, whereas landowners' interests are often unprotected.

Securitization of real estate guarantees or titles is legally permissible but does not occur because of a lack of economic incentives. A bill on asset securitization is currently pending in the Legislative Assembly.

### **B. LEGAL FRAMEWORK**

The right to own, acquire, donate, use, rent, mortgage, or impose any lien on real estate is guaranteed to both Salvadorans and foreigners. The Civil Code is the paramount legal instrument pertaining to real property.

Real property can be transferred by consent of the owner without government authorization. However, for title transfer to be valid vis-à-vis third parties it needs to be registered. No person in El Salvador can own more than 245 hectares of land.<sup>22</sup>

Salvadoran real estate lease law tends to heavily protect the interests of tenants. For example, the law allows tenants to remain on property after their lease expires provided they continue to pay rent. Likewise, the law limits the amount of rent that can be charged and makes eviction processes extremely difficult. Parties are not free to include any provision to the lease that violates the real estate lease law. If such provisions are present, they are considered nonvalid.

Real property can be mortgaged in two ways: open and closed. In the case of an open mortgage, a maximum amount for which the guarantee is given is indicated. A period of duration and a list of assets to be mortgaged need to be stated in the filed documents. The open mortgage works well with lines of credit. The mortgage can be renewed under the same terms or terms can be modified upon renewal. The closed mortgage is a guarantee for a fixed amount.

Squatters can possess property in good faith without owning a title to the property. If the owner of the property is unknown, squatters can acquire title after 20 years of good faith possession through a judicial procedure; if the owner is known, squatters can acquire title after 30 years.<sup>23</sup> The right to possess and the period of possession of a squatter can be transferred and usually is.

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<sup>22</sup> Constitution of El Salvador, Article 245.

<sup>23</sup> Civil Code of El Salvador, Article 2250.

Transfer occurs by means of private contract. In some cases, notaries are used to authenticate the signature of the parties. However, these contracts cannot be registered with the Real Property Registry. In cases in which squatters possess, in good faith, land that is state-owned they do not have the right to obtain title. In cases in which a squatter occupies land owned by a municipality, the municipality usually grants the right of use to the squatter.

There is no law on territory order. Zoning is regulated by municipal rules. Lack of a zoning map creates uncertainty in land usage. Municipalities have complete discretion concerning use of properties within their borders. In addition, municipal maps that designate land use are not available to the public.

According to knowledgeable practitioners, real property transfer is subject to a tax of three percent of the property's value in excess of \$28,600.00. In addition to the ad valorem tax, registry fees must be paid for the land transfer. Municipalities are not entitled to levy tax on property use. However, municipalities have tried to disguise usage taxes by charging fees for use of the municipality's lands, such as public parks. This practice has been deemed unconstitutional.

Nonliquid rights on real property could be secured and converted into tradable instruments. For example, banks can use their portfolio of mortgage credits to secure commercial instruments. However, because of the unsophisticated stock market, lack of general knowledge about financial matters and regulations on the type of entities allowed to securitize, and tax hurdles that increase the cost of the instruments, securitization of real property rights and issuance of bonds secured with mortgage portfolio have not been offered.

### **C. IMPLEMENTING INSTITUTIONS**

The Real Property Registry (RPR) within the National Registry Center is the government entity with authority to register transactions related to real property, such as real property transfer, mortgages, and powers of attorney related to real property. Creditors guaranteed by open mortgage can ask the RPR to preventively take notes on properties that are part of the mortgage and freeze transactions related to those assets.

The RPR is decentralized and automated. It also has document reception offices in different parts of the country.

Once a document is presented for registration it is given priority within the RPR. Once final registration is granted, rights are extended retroactively. According to interviews, completing a registration can take as long as six months; typically, however, the process takes eight days.

Information on real property is maintained in three different systems: per person, per property, and electronically. Some properties are registered in one system and not in the other. Eventually, the registry intends to have all Salvadoran property registered electronically. However, there are still many properties that are registered only in the old per-person system. This fragmentation creates uncertainty and can lead to delay and mistakes. It has been reported that incorrect information about properties has resulted from errors in transferring information into the new electronic system.

Registration fees are clearly established. Fees have been reported as high. Practitioners informed the assessment team that a property sold for \$200,000 would cost another \$12,600, in addition to any notarial fees.

Expedited payment has been legalized. Expedited payment allows a registrant to prioritize an application by paying an additional fee. Likewise, notaries who process a high volume of transactions at the RPR can enter into agreements with it to accelerate the procedures upon payment for the extra time of the registry's officers.

A national cadastre map is currently being created. Until recently, information from the RPR and the cadastre office was inconsistent. Interviewees knowledgeable of these matters reported that 40 percent of the country's land has been measured and included in the national cadastre database. A plan to fully integrate information from the cadastre office and the RPR is under way. In addition, the RPR has requested that real property sale documents be presented along with cadastre information. In cases of property sale, interested parties present information gathered by an independent expert regarding the dimensions of the land, and the RPR appoints another expert to confirm the information. Once confirmed, the information is included in the integrated information system of the RPR and cadastre.

Inaccurate cadastre information causes problems such as double title. If two titles exist on a portion of property because of errors in measurement, an official procedure exists to determine the actual boundaries of each claim. If one of the titles of a double claim is fraudulent, an interested party can request the annulment of that title in court.

The RPR has a Web page with information about costs and a password-accessible service where title information is provided. However, in five attempts on different days that service was not available. Officers at RPR conceded that the online tool is still in the experimental stage. Nevertheless, that information can easily be obtained at the main RPR office.

Real property disputes are handled through the court system. However, most Salvadorans perceive the courts as slow, corrupt, and unreliable. The Heritage Foundation gave El Salvador's real property system a score of three out of five, with a score of five being the worst. The U.S. Department of State has expressed similar concern for the state of property rights, "the Constitution provides for an independent judiciary and the Government respects this provision in practice. However, the judiciary suffers from inefficiency and corruption." The Department of State added, "A purge of the judicial system is getting underway and some corrupt judges and administrators have been removed from their posts. However, investors must be aware that the legal and regulatory system can act arbitrarily, and should take all due precautions to protect their property and investments." According to the Economist Intelligence Unit, two of the "main constraints on growth in foreign investment are high crime levels [and] an inefficient judiciary...."<sup>24</sup>

Alternative dispute resolution (ADR) mechanisms are an option for settling property claims, but both parties must agree to arbitration. Arbitration is not a popular settlement mechanism for local disputes and often is too expensive for local cases.

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<sup>24</sup> Heritage Foundation, Economic Freedom Index for 2004.  
<http://www.heritage.org/research/features/index/countries.html>

#### **D. SUPPORTING INSTITUTIONS**

Sale of real property, mortgages, and powers of attorney for real property transactions are required to be public documents. For a document to be public, a notary needs to authenticate the content. Notary costs are reported to be expensive. The registry attributes part of its problem in information management to a lack of control over notaries, who have been reported to present false documents for which the RPR has no authority or capacity to verify. It has been reported that some delays with registration occur as a result of notaries' delays in correcting errors discovered after their initial filings.

A real estate construction chamber of commerce is very active in suggesting legal and institutional changes with regard to the real property framework. The chamber holds regular conferences on issues related to property laws. Likewise, public documents are regularly produced in different areas. The chamber has expressed interest in developing a mortgage market in El Salvador through securitization, to provide a financing mechanism to the industry.

#### **E. SOCIAL DYNAMICS**

As was reported during the assessment, there are various on-going reform projects. The World Bank is financing a project at the RPR supporting integration of real property information and the creation of the cadastre map. The project is meant to finish by 2010. CIDA is also supporting the National Registry in integration efforts and providing assistance to simplify registration procedures. The CIDA program intends to create a portal where information on all possible investments in El Salvador, in both real property and the stock market, is made publicly available. The RPR expressed interest in making the information portal an instrument for allowing Salvadorans living abroad to invest remittances in assets based in their home country.

A recently passed law to simplify and harmonize procedures at the National Registry came into force on August 10, 2004. This law is perceived to be evidence that the Government is moving in the right direction concerning institutional strengthening. Is it still too early to know of the law's effectiveness.

Other areas related to property transactions are under public scrutiny. For example, there is a constant demand to impose higher standards on notaries. There is a growing concern that some notaries commit fraud in performing their duties. Their costs are also referred to as very high. Notaries must pass an exam to be allowed to undertake their functions. However, the exam contains ambiguous and tricky questions, and passing it depends much more on luck than on knowledge of the law. Once a notary is licensed, there is little supervision.

The construction community demands reform of the judicial system. Approval of the new code on civil and commercial procedures is constantly mentioned as a "must." Likewise, there is a bill pending approval of the Legislative Assembly in the area of securitization. It will remove the obstacles that currently make securitization very difficult to achieve while certainty is provided and the right incentives are created.

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## F. RECOMMENDATIONS

- ◆ There is a need to build private-public consensus around the issue of real property. Seminars and working groups on topics such as integration of the Real Property Registry and the cadastre and on regulation of notaries will help spur change in these areas. It is important that society at large understands the nature of changes in the registry and that a mechanism for managing complaints be created. Likewise, it is important that the civil society understands that a “shortcut” culture of avoiding official procedures is harmful to everyone. Government must create processes for which compliance is made easier than noncompliance. As was the case in legalization of the expedited registration, communication between the RPR and the private sector can provide Government with information about where “shortcut” methods can be formalized to increase efficiency.
- ◆ There is a need to increase standards for notaries. Admissibility requirements for notaries should be strengthened and enforced. Notary certification exams need to be developed professionally, transparently, and independently. An independent body should supervise notaries. Continuous legal education requirements also should be imposed on notaries after they obtain certification.
- ◆ Currently, zoning regulation is chaotic. A law on territory order should be passed and the proper institutions should be empowered to enforce the law. Strategic planning techniques should be introduced to the public officers relevant to the territory plan and zoning. Civil society’s involvement in the zoning process is crucial.
- ◆ Legislation pertaining to real property reform pending congressional approval should be prioritized. Passage of pending legislation on asset securitization is necessary for the development of financing mechanism for construction projects. The law to reform civil and commercial procedures should be updated to allow service of process by specialized companies, e-mail, fax, and certified courier. Finally, the Law on Real Estate Lease should be reformed to provide better balance between tenant and landowner interests.
- ◆ Efforts should be made to support the World Bank project regarding RPR and cadastre integration, and collaboration with other donors should occur when possible. More specifically, a follow-up law, for which owners are given a deadline to file complaints about property specifications after integration is complete, could assist the rationalization of information. Once the deadline is reached, information from the cadastre would be officially transferred to the RPR. Similarly, the CIDA general registry-government integration project should be monitored.
- ◆ Technological support should be provided to the National Registry, banks, and the stock market to establish a system whereby money remitted from Salvadorans living abroad can be invested directly into real estate or other Salvadoran assets. According to interviewees, last year Salvadorans living abroad sent approximately \$2 billion in remittances. These monies could be invested directly into real estate via communications technologies. Three things are necessary to make such a system a reality: provision of technological support to all parties involved, an educational campaign to Salvadorans in El Salvador and abroad about the opportunities available through the real estate electronic

investment mechanism, and institutional strengthening for the entities involved provided through management, information technology, and financial training.

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## VI. COLLATERAL

### A. INTRODUCTION

To a far higher degree than most countries, El Salvador has in place legal mechanisms capable of creating security interests in the variety of movable goods that provide the bulk of the world's wealth today. Unfortunately, however, anachronistic procedural laws require unnecessary supervision of enforcement measures by an overburdened, inefficient, and unreliable court system. The relatively efficient substantive rights created by the Salvadoran legal system thus flounder against the dysfunction between substance and procedure, and the creditor's risk inherent in a collateralized loan remains virtually as high as it would be if the substantive mechanisms did not exist and all loans had no guarantee. In the Salvadoran legal system, there is no way to turn movable collateral into an effective guarantee should the debtor fail to pay.

Financing in El Salvador relies today, as it did centuries ago, on mortgage-based loans or loans guaranteed by individuals with immovable collateral to back up their guarantee. Loan guarantees against movable collateral typically require high overcollateralization: the lender may loan as little as 20 percent or less of the collateral's value. In El Salvador's environment of high credit risk, the supply of credit offered by lenders remains relatively small. Marginal candidates for credit, including, by definition, virtually all SMEs, cannot gain access to credit from conventional lenders. However, it should be noted that, for borrowers who do gain access to credit, terms are excellent. According to interviews performed during the assessment, interest rates are reasonable in the extreme, well below 10 percent as of July 2004.

Ample and accessible special programs provide public and other alternative sources of credit that mitigate some of the reductions in credit supply imposed by the inefficient legal system and the high risks with which it saddles the market. Unfortunately, such sources of credit are seldom permanent or even long term, because they depend on international funding agencies whose programs often consist of seed money. Should such non-market sources of funds dry up, as they surely must, the shortfall in credit supply will be exposed, to the detriment of Salvadoran export capacity, business production, and general economic activity. The only measures that can forestall that result consist of reforms to the legal system that significantly reduce the risk to lenders by assuring them of efficient and effective guarantees against borrowers' collateral.

El Salvador has the capacity to meaningfully participate in reform and harmonization in this area. Its commercial registry has undergone significant modernization—reflecting an attitude and environment for business that is palpably positive. Think tanks like *Fundación Salvadoreña para el Desarrollo Económico y Social* (Salvadoran Foundation for Economic and Social Development, FUSADES) have proved themselves effective, public-spirited sources of policy and conscience for the country. El Salvador manifests openness—even anxiety—to change and reform that many countries cannot approach.

Many laws are pending that could provide needed reform with respect to creating and, particularly, enforcing collateral interests for guaranteed loans and significantly reduce the risks for lenders of credit. These laws should be passed but not in their current form. Above all, El Salvador should take careful account of model laws like the Organization of American States (OAS) Model Law of Secured Transactions (2002), the Model Inter-American Rules for

Electronic Documents and Signatures (2002), and other uniform laws from the United Nations Commission on International Trade Law (UNCITRAL) and the United Nations International Institute for the Unification of Private Law (UNIDROIT) that may harmonize the laws of the region and even the hemisphere and thereby greatly simplify credit and trade on a regional, hemispheric, and global basis. The opportunity to incorporate these existing initiatives into the Salvadoran national scheme should not be missed. If El Salvador passes non-uniform laws now, it may lack the political will and cost necessary to revisit those laws and conform them to uniform provisions later on.

## **B. LEGAL FRAMEWORK**

No national economy can compete in the global economy without a credit market that collateralizes its wealth by guarantees against the constantly growing universe of movable collateral. In a credit market that must rely on the much smaller and relatively static pool of immovable assets (real estate) to guarantee its loans, merchants do not enjoy many business opportunities available to debtors in competing national systems. An effective system of secured transactions in the 21st century can exist only where there are the following:

- ◆ Up-to-date substantive laws, harmonized with international model laws and conventions such as those generally provided by OAS's Inter-American Specialize Conference on Private International Law (CIDIP) process and UNCITRAL but especially with the OAS Model Law of Secured Transactions adopted in 2002.
- ◆ A registry maintaining current records of all security interests against movable and immovable collateral and providing convenient public access by debtor's name.
- ◆ Enforcement of guarantees against collateral by extrajudicial processes, backed up by the speediest of judicial processes where the courts do take part in executing guarantees.
- ◆ A sound central banking system and/or regulatory policies that monitor lenders' practices and portfolios and reward prudent lenders with increased access to liquidity at better rates of interest.

Salvadoran law is quite advanced in its substantive provisions for secured transactions in movable property—generically known in the law as *garantías reales mobiliarias*—although it has no single set of provisions that covers the generic concept. Instead, the practitioner needs to work his/her way through fundamental sources such as the Civil Code and the Code of Commerce as well as more specialized laws such as the leasing law (*Ley de Arrendamiento Financiero*) and the *Ley de Garantías Recíprocas*, which provides for guarantees by entities created expressly for that purpose. Notably, the current laws do include intellectual property among movable assets that may serve as collateral.

### **1. Civil Code**

The Civil Code (*Código Civil*) recognizes the pledge (*prenda*) and the mortgage (*hipoteca*). The Civil Code specifies that both the pledge and the mortgage must be created by contract and further specifies the necessary elements that make up a valid contract for those purposes and all the rights and duties created thereby. The Civil Code recognizes as a proper pledge only that in



which the debtor surrenders possession of the collateral to the creditor. The Civil Code also recognizes the right of setoff wherever the debtor agrees or the law provides. This possibility gives banks a right against their debtor's accounts (*retención bancaria*), for example, but requires judicial approval. This, in fact, is an example of the extreme application of the due process constitutional guarantee, which in fact has the effect of holding up the collection of debts and, ultimately, discouraging lending (domestic, regional, and international).

## 2. Commercial Code

While the Civil Code contains concepts that have changed little since Roman times, the Commercial Code (*Código de Comercio*) introduces a variety of forms, many of which are quite modern in their possibilities and effects. The Commercial Code applies to all commercial acts—generally, those involving a merchant—whereas the Civil Code's provisions apply to acts involving only consumers.

## 3. General Framework

The Commercial Code also provides for a pledge over negotiable documents, such as promissory notes and papers conveying title to goods. The same effect may be achieved by an endorsement (*endoso*), usually accompanied by physical transfer of the documents to the secured creditor.

The Civil Code by definition limits the mortgage to immovable goods, but the Commercial Code goes beyond that, providing that a commercial mortgage (*hipoteca*) may reach any goods held by a merchant, movable and immovable. In El Salvador, the commercial mortgage often takes the form of a so-called “open mortgage,” or *hipoteca abierta*. Such a mortgage must operate in favor of a financial institution licensed to carry out such loans and must state a maximum amount of credit to be guaranteed and a term for the guarantee. In another departure from laws common throughout most of Latin America, the *hipoteca abierta* permits a fluctuating loan amount and even the possibility that, at given times in the life of the guarantee, the debtor may owe nothing to the creditor. Typically, the more astute creditors include a “dragnet clause” in the open mortgages that their debtors sign, which lists virtually every type of movable asset imaginable as the collateral contemplated under the guarantee. The *hipoteca abierta*, which—like all the guarantees against movable goods—must be inscribed in the *Registro Comercial* to create effects against third parties, may be amended to extend the time for which it is valid and/or to increase the maximum loan amount it may guarantee, so long as such modifications are entered in the registry too.

Outside the Civil and Commercial Codes, special laws have been added to recognize a financing lease as a form of guarantee. More modern systems often do not permit a financing lease, by which the debtor pays off the entire value of the good and keeps it at the end of the lease, because it is frequently an attempt to create a secret guarantee. In El Salvador, however, under the *Ley de Arrendamiento Financiero*, the requirement to register the lease for validity removes that concern. Such credit arrangements are especially suited to credit purchases of industrial machinery and consumer automobiles, among other examples.

Another mechanism similar to the lease, in the sense that it exploits a legal form derived for different purposes to create an effective guarantee, is the *fideicomiso de garantía*, or guaranty

trust. This permits a trustee fiduciary to administer movable property committed to a guarantee and, in event of nonpayment, to simply sell the collateral and turn over the proceeds to the creditor.

Another means of guaranteeing credit under a special law is that provided by *cesión de derechos económicos*, a means of assigning contract or other economic rights to the creditor. One typical form of assignable contracts is known popularly among merchants as a “*quedan*”—literally, “it remains” or “it stands”—because it consists of documents beginning with that word, reciting certain conditions and/or obligations. These documents usually involve performing services or delivering goods or the obligation to perform or deliver in return for payment, which creates or has created a series of economic rights. Again, registration is required, and a mechanism is created that can be useful where a debtor needs credit to make purchases to carry out a contract and assigns contract proceeds sufficient to pay back the creditor.

A similar possibility exists for guarantees against bank accounts by use of an *endoso de certificado de depósito* or *endoso de cuenta bancaria*. Creditors routinely take such a guarantee to secure business debts in the United States and Canada, especially where the depository bank is the secured lender. Although the legal basis for such a guarantee exists under Salvadoran law, it apparently is not frequently used.

Another special law provides for a specialized financial entity, the guarantor recognized under the *Ley de Garantías Recíprocas*. Where a debtor may not have collateral sufficient to offer in guarantee of a credit, the law provides for institutions that may supply the guarantee, for a price. For creditworthy debtors with predominantly movable assets, this practice may permit the debtor to get a loan.

Finally, some lenders may use the laws of business associations to guarantee payment. The law permits companies to register as companies with variable capital (*sociedad anónima de capital variable*, or *S.A. de C.V.*) or fixed capital (simply *sociedad anónima*, or *S.A.*). The *S.A. de C.V.* must meet a minimum capital requirement of 100,000 *colones*, or about \$11,425, with variations occurring above that number.<sup>25</sup> The fixed-capital society must declare its required capital and maintain that amount, thereby guaranteeing that at least that amount will be available to its creditor in case it does not pay. This permits the creditor to require a prospective borrower to organize as a fixed-capital society and to set the level of the fixed capital high enough to cover the loan.

In summary, note two important aspects of the legal regime for creating collateral guarantees against movable property in El Salvador.

First, in the aggregate, the system is quite flexible. It allows for the creation of guarantees in most of the modern credit transactions where the debtor can offer tangible—if constantly changing—collateral consisting of movable goods or documentary rights to money or goods, including intellectual property rights (IPR). There are supplemental forms that allow creditors to constitute guarantees against debtors’ contract rights, bank deposits, and other collateral values

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<sup>25</sup> See El Salvadoran Commercial Code, Article 192. Even though since January 1, 2001, the economy has been dollarized, *colones* continue to be legal tender in the country.

that usually do not fall within the collateral contemplated by laws in other Latin American countries.

Second, many of the credit operations recognized under Salvadoran laws require guarantees as an essential element imposed by the law, without which they cannot be validly constituted as an enforceable contract. In a system in which the laws specify the required elements that must be included in a valid contract, which must then pass muster before the public registry will recognize it and register it as a public document, such requirements foreclose the possibility of unsecured loans for those transactions. Thus, if only because a guarantee is a legal element essential to the mechanisms used to set up most valid loan transactions, many credit operations in El Salvador are secured, if only in a formal sense.

In other words, the Salvadoran credit market distorts the purpose of collateral guarantee laws. Loans are made on the basis of (1) immovable collateral guarantees, including *avales*; (2) solid standing and track record in the business community; and (3) movable collateral provided in addition to (1) and (2) above. Consequently, loans are made in El Salvador without including movable collateral guarantees in the equation.

Collateral guarantees should diminish the risk to the creditor and permit the extension of credit where the risk of nonpayment otherwise would be too high (i.e., the creditor should take account of the guarantee or lack of one at the beginning of the transaction as an important factor in measuring the risk of non-payment before the creditor decides whether to make the loan). In El Salvador, the creditor normally makes the decision to extend the loan without any consideration of collateral (unless it is real, or immovable, property) offered in guarantee against non-payment. Far too often, only after the creditor has decided to make the loan, without taking into account the possibility of eventual execution against the debtor's movable collateral, do the forms of guarantee enter the transaction, as afterthoughts to the credit decision.

#### **4. Enforcement Procedures**

El Salvador's legal system neither provides for nor permits summary execution of a guarantee against collateral. Enforcement of security interests must follow judicial procedures that impose delays serious enough to nullify the effects of the guarantee—the purpose of which is to reduce the creditor's risk that the debtor will not repay the loan.

Both the Civil Code and the Code of Commerce categorically prohibit the *pacto comisorio*, defined as any contractual provision that authorizes a creditor to repossess and dispose of collateral without judicial process. Any such provisions are null and void under Salvadoran law. This prohibition is an anachronism, dating from Roman law, albeit common throughout Latin American legal systems. Its continued existence as a legal rule in the 21st century rests on the constitutional guarantee of due process (*debido proceso*) and a right to a hearing (*derecho de audiencia*) before a party may be deprived of any rights in property.

Prohibition of the *pacto comisorio* and other forms of non-judicial foreclosure is both unfortunate and unnecessary. Allowing debtors to invoke a hearing if they believe they have defenses against the creditor's claim that they have not paid may vindicate the constitutional guarantee. However, where the debtor recognizes that the debt is delinquent and the creditor's

claim against the collateral is appropriate—a very common reaction—the creditor should be able to proceed extrajudicially and execute against the collateral in a matter of days, thus radically reducing the risk of non-payment and the associated enforcement costs.

Legal practitioners with experience in this field stated that execution of even the clearest guarantee right against a non-paying debtor's collateral cannot occur in less than 9 months, and only then should it proceed "*sobre ruedas*"—that is, with no impediments or delays whatever. Local experts estimated an average time of "more than 18 months" for judicial foreclosures. The crush of work before the courts makes time periods specified in the laws wildly unrealistic and, additionally, the debtor may initiate—and many do—dilatatory procedural objections such as *recursos* (objections based on alleged irregularities in legal claims and procedures) and *amparos* (objections based on alleged violations of the debtor's constitutional rights).

Allegations against the courts for corruption and incompetence abound, contributing to another level of unreliability and ineffectiveness to enforcement procedures for guarantees under the law in El Salvador. As indicated elsewhere, both private and public sectors not only acknowledged this problem but also have initiated programs to make the judiciary in El Salvador both clean and competent.<sup>26</sup>

The lack of effective enforcement mechanisms means the Salvadoran system of guarantees against movable collateral in effect does not exist. A guarantee against movable property, in its practical effect, is no guarantee at all. Loans that, to be recognized as valid under the law, must be structured as guaranteed transactions are in fact and in practice evaluated by lenders as unsecured loans, in which the risk is the same as that for a loan with no guarantee. In other words, the law in El Salvador so far has provided no reduction in credit risk through its regime for guarantees against movable property.

Enforcement procedures in El Salvador require the creditor to procure a court order permitting a public sale of the collateral. Normally, as a prior requirement to such an order, creditors should have a judgment against the debtor for nonpayment. Although such a judgment should not be difficult to achieve in most cases, it takes considerable time. The vast majority of claims brought to court are based on promissory notes (*pagarés*) or other documents (*mutuos simples*, for example) that give rise to the possibility of a summary judicial process. Such documents have *fuerza ejecutiva* (create a presumption of debt in favor of the creditor) and their enforcement is by *juicio ejecutivo*, or a procedure in which the debtor's only defense should be that the document is invalid or fraudulent, or he/she can prove prior payment of the debt. According to court personnel and lawyers who practice in this area, many debtors do not bother to respond to the creditor's *demanda* or the formal complaint that initiated the claim before the court.

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<sup>26</sup> To the vices of the court system should be added the inefficiencies of the practicing bar in El Salvador. Although there are some diligent, creative practitioners who pursue the maximum benefits from the legal system for their clients, the bulk of the bar appears less inclined to work as hard or as competitively as a thin layer at the very top. Most of El Salvador's licensed lawyers do not enjoy the rigorous professional education and attitudes that would prepare them for rigorous professional practice. In any event, world-class lawyers are present in El Salvador, but they are few, and they do not drive credit enforcement practices.

Even in the absence of any resistance on the part of the debtor, however, it takes several months to complete all the procedural formalities and secure a judgment, after which several more months pass in securing a court order to proceed against and liquidate the collateral.

Perhaps the biggest delay lies in the procedural requirement—imposed in the name of due process and the right to a hearing—that the debtor must receive prior notice or “notification” (*notificación*) of each judicial step and resolution by court personnel. According to practitioners familiar with the situation, in the most efficient of the five mercantile courts in San Salvador, a single day’s work may generate as many as 300 such notifications for the court to deliver, a physical impossibility given available resources (a single motor scooter and two “notifiers” available to carry them out). As the notifications awaiting delivery pile up, long delays become inevitable and account for a large part of the time it takes to resolve even the simplest case and activate foreclosure processes, which also require judicial intervention and notification at each step.

In cases of extreme urgency (*notoria urgencia*), the creditor may seek an order of the judge permitting immediate sale of the collateral. Although the law requires exceptional circumstances for such a provisional remedy, some lawyers do use the procedure successfully where debtors otherwise may utilize delays to engage in destroying, hiding, or improperly disposing of collateral. As with other procedures before the courts, due process and notifications dictate the actual time elapsed, and “immediate” may become a matter of weeks or months rather than days. However, relatively accelerated procedures are possible for the diligent creditor with an energetic lawyer.

More effective methods of notification would speed up the enforcement process. Although it would entail a major change not only in the rules but also in the philosophy of notification, adding the possibility that private process servers might carry out notification would cut enforcement times remarkably in El Salvador. One interviewee suggested that notaries public, of whom the country has a surfeit, might be certified to fulfill this task. Creditors could decide to pay for private notification whenever they judged it worthwhile for more efficient execution.

In such an enforcement environment, agreements between the parties often settle payment of the obligation. Such agreements take a willing debtor, whose cooperation may be gained at the price of a reduced payment to the creditor. The system is stacked against the creditor, whose armaments are few against a debtor resolved to impose every delay possible under the law. An irony that may work in the creditor’s favor is that where the debtor has the resources to hire a lawyer and exploit procedural delays to the end, that debtor ultimately still may lose, for he/she likely has assets the creditor can take, no matter how long it takes the creditor to work through the judicial system. If the debtor wishes to maintain standing as a responsible player in the commercial system, that adds another factor in favor of reaching a settlement with the creditor.

As a result of these and other factors, assessment of debt enforcement in El Salvador should contemplate the possibility of extrajudicial settlement of debt claims. The discount that creditors may grant for such resolution is a function of the risk avoided thereby, and the risks are high in the Salvadoran system. Thus, even where the creditor and debtor settle, the costs of credit—and the risks that reflect and determine that cost—go up.

### C. IMPLEMENTING INSTITUTIONS

In 1994, El Salvador reorganized its registry system, in a disastrous state under the administration of the judicial branch, into the *Centro Nacional de Registro* (National Registry Center, or CNR). Since 1999, the CNR has enjoyed autonomous status as an agency ascribed to the Ministry of Economy but not reliant on it for budget. The CNR is self-supporting, running its operations off the fees it charges.<sup>27</sup> The President of the Republic names its Executive Director by direct appointment. As a result of the reforms, El Salvador's registry has become a more efficient and better-administered system.

The CNR now houses three registries—of companies and business entities, of real property, and of commercial operations including guarantees against movable assets—within a single complex in San Salvador, each with its own director.<sup>28</sup> Within the *Registro de Comercio* there are departments of Intellectual Property, Commercial Licenses and Permits (*Matrículas de Comercio*), and Commercial Documents, the latter of which handles those documents constituting *garantías mobiliarias*.

To head each of its registries, the CNR appointed energetic, knowledgeable lawyers<sup>29</sup> familiar with the procedures required under the laws and encouraged their innovation to improve the registries' operation. The results are impressive. For example, to avoid backlogs and delays in the Commercial Registry's processing of guarantees against movable property, the registry instituted a special after-hours process available for an additional fee of \$6 to \$7 per document. Personnel work after hours to process documents for the extra fee and receive extra pay for doing so.

As in other Latin American countries, the registry reviews all documents submitted to it to confirm their validity (i.e., ensure that they include all essential legal elements and comply with all formal requirements). Today, where they formerly took months, the submission, review, and approval of documents in the CNR take mere days for routine matters—notably, to register a new company or a *garantía real mobiliaria*. Even more complicated inscriptions run only 2 to 3 weeks. Future improvements should consider the advisability of this extensive review process, as opposed to modern methods of filing simplified or summary filing statements. If the current review process (*calificación registral*) is maintained, then the Salvadoran registry could be used as a model for the region. However, if simplified filing statements were adopted as a regional standard, the Salvadoran registration process would need to be reassessed.

The law ascribes to the Commercial Registry the following general functions: to give declarative effect against third parties to those titles and documents inscribed in the registry; to safeguard the good faith and validity of documents whose definitive versions exist exclusively as recorded in

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<sup>27</sup> Registration fees are relatively high in El Salvador, set as a function of the total credit guaranteed. For movable property, the maximum registration fee is set at \$11,429 (100,000 *colones*). For immovable inscriptions, the registry may charge no more than \$5,400.

<sup>28</sup> The CNR absorbed what had been separate entities: *Dirección General de Registros, Registro de la Propiedad Raíz e Hipotecas, Registro Social de Inmuebles, Catastro Nacional, Instituto Geográfico Nacional, and Registro de Comercio*.

<sup>29</sup> The Director of the Commercial Registry is responsible for its administrative and legal functions, including drafting a *reglamento*, or regulations, for its operations, which must be approved by the Executive Director and the Ministry of the Economy.

and certified by the Commercial Registry; to establish the status of rights that give rise to *actos de comercio*, or those commercial operations recognized in the law as appropriate between merchants; and to create legal rights or circumstances through its formal inscriptions. As a result, the Commercial Registry is the registry for publicizing guarantees against movable property—that is, achieving declaratory effect against third parties. Most of the legal devices by which such guarantees are created also achieve their validity and enforceability—are properly constituted before the law or take their constitutive effects—only upon inscription in the exclusive national Commercial Registry.

Because the central Commercial Registry in San Salvador records guarantees against movable property anywhere in El Salvador, this part of the report concentrates on that registry alone. A guarantee that comprehends both movable and immovable property, however, should be inscribed in both the *Registro de Comercio* (movables) and the *Registro de la Propiedad Raíz e Hipotecas* (immovables).<sup>30</sup> An exception provided by the law may make the Commercial Registry less complete and reliable than it could and should be. For the *prenda sin desplazamiento*,<sup>31</sup> if the guarantee encompasses both immovable property inscribed in the *Registro de la Propiedad Raíz e Hipotecas* and movable property located on that inscribed property, the guarantee for both movable and immovable property need be inscribed solely in the *Registro de la Propiedad* for the department in which the immovable property sits. Because most pledges without displacement of the property (*prenda sin desplazamiento*) will cover both immovable and movable property, many movable property pledges will not be inscribed in the Commercial Registry; a creditor must check both the Commercial Registry and all the departmental Property Registries to make sure a debtor has not already pledged movable assets located on immovable property subject to a pledge.<sup>32</sup>

Commercial Registry personnel include a number of auxiliary registrars who not only must be lawyers but also must have experience in commercial and registry law. They inspect documents submitted for inscription to see if they conform to the law in all respects.<sup>33</sup> The inspection must be based on the document submitted to the *registro* and must either approve or deny its inscription. In case of denial, the registry will indicate defects so that they may be corrected and a clean document can be submitted.

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<sup>30</sup> The category of fixtures—a type of property known as *accesorios* or *adheridos* (for example, built-in features like an air conditioner) that shares aspects of movables and immovables—also requires inscription only in the Property Registry, but Salvadoran law limits the category and in general favors the movable nature of property over immovable classification. Because the classification of a given item of property that might fall into this subjective category may always be an open question, the careful creditor inscribes a guarantee against doubtful property in both registries and would certainly attempt to inscribe a *hipoteca abierta* in both, but the registry rules are not clear.

<sup>31</sup> There is some dispute about whether the term “*prenda sin desplazamiento*” is a generic classification that includes *hipotecas abiertas* and any other security device that claims a guarantee against both immovable and movable property or whether it is a specific term applicable only to contracts so designated.

<sup>32</sup> A simple requirement would remove the problem: that the pledge without displacement be inscribed in both registries when it encompasses both immovable and movable property. Absent such a change in the law, perhaps prudent creditors will attempt such double inscription. Conceivably, they might be turned away at the Commercial Registry on the grounds that the law designates the Property Registry as the proper place for inscription and therefore the Commercial Registry may not accept the document.

<sup>33</sup> Including whether the person presenting a document has authority to do so, whether the document conforms to all formal requirements for that particular legal device, and whether the substantive obligations included in the document are valid and enforceable and properly constituted.

The Commercial Registry makes certified copies of the original documents it approves for inscription.<sup>34</sup> It indexes collateral guarantees by the name of the debtor,<sup>35</sup> so that all filings against a given debtor may be traced through the electronic records maintained by the registry in that debtor's name. It is up to date, according to the director, and includes all the *Registro de Comercio* records with current application.

The Commercial Registry offers an additional convenience, in the same spirit as the after-hours inscription of documents to creditors willing to pay for it. If a creditor—or, indeed, any third party—will pay for the system, it may access the *Registro de Comercio*'s electronic system to search for existing guarantees against a specific debtor's assets or even to submit a document for inscription. The convenience is substantial, avoiding the necessity to go physically to the Commercial Registry to research inscriptions against a certain debtor or to present a document for inscription.<sup>36</sup> Unlike the nominal fee for after-hours inscription, however, the cost of installing such access is prohibitive save for banks and major law firms.

The CNR in general and the *Registro de Comercio* in particular appear to be virtually corruption-free, including a virtual lack of "grease payments."<sup>37</sup> Likewise, the registries enjoy exceptionally dedicated and knowledgeable staff.<sup>38</sup>

## D. SUPPORTING INSTITUTIONS

### 1. Notaries and Government Institutions

Notaries are repositories of public faith (*fe pública*) and have exclusive power to certify and authorize acts where their participation is required by law, including the constitution of most of the legal documents that create *garantías reales mobiliarias*. In El Salvador, unlike in other Latin American countries, there is no limit to the number of lawyers who may become notaries.<sup>39</sup> Almost any lawyer may be a notary and is expected to be. According to a recent study shared with the assessment team, there were 8,000 lawyers in El Salvador, and 6,000 of them were notaries. Although recent notary examinations administered by the Supreme Court have become more demanding, the notary class still includes many—perhaps mostly—lawyers who lack competence for the position. The Supreme Court has responsibility for supervising notaries, including verifying that each notary's books of notarized original documents are current and

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<sup>34</sup> Thereafter, the *registro* may issue a certified copy of its records, which serve as proof positive of the document, its inscription, and its content, for all legal purposes including court procedures. The original is returned to the party submitting it.

<sup>35</sup> However, it takes original documents in chronological order as they are presented to the *registro* and assigns them a number that traces them into the 500-page books that make up the *registro*'s permanent files.

<sup>36</sup> This possibility presents a nice legal issue. If the Commercial Registry receives by electronic transmission the text of a document, rather than the document itself, and then inspects, approves, and inscribes that electronic text, can the resulting inscription create a valid certification for proof in court and other legal purposes? The lawyers interviewed for this report were not sure, because no court decision has yet confronted the issue.

<sup>37</sup> In many ways, the possibility of after-hours inscriptions has institutionalized grease payments.

<sup>38</sup> The *Universidad Centroamericana José Simeón Cañas*, one of the better law schools in El Salvador, has introduced a diploma program in Registry Law.

<sup>39</sup> In many countries, the title of notary public designates a lawyer of exceptional capacity and experience in commercial law and other notarial functions, selected through stiff competition for official designation as a member of a miniscule elite at the top of the profession. In El Salvador, that is not so.



complete at the end of each year, but the task lies well beyond its resources at this time and delinquencies abound, according to common knowledge.

Despite the generally sloppy state of the Salvadoran notaries' qualifications and practice, they charge relatively high fees, apparently often exceeding the legal fee schedules either openly or by adding extra charges. Among the better law firms and lawyers, however, notarial practice occurs at high levels of competence and the legal requirements are scrupulously adhered to.

## **2. Professional and Business Associations**

There is neither an official bar association nor any private organization to which most lawyers belong. Apparently, there is a plethora of small, common-interest associations.<sup>40</sup>

On the other hand, business and industrial organizations seem well organized and quite effective.<sup>41</sup> Medium, small, and micro enterprises have associations. These associations have often been successful in fostering special sources of credit funded by Government and/or donations from outside agencies.

FUSADES, a think tank and maker of policy consensus, is an exemplar institution, channeling money and effort into identifying reforms in laws, administration, democratic practices, and attitude.

## **E. SOCIAL DYNAMICS**

The imperative to reform is palpable in El Salvador, both within and without the Government. Many laws that will affect the issue of credit risk and collateral guarantees have recently passed the Salvadoran Assembly or are currently pending there or in sponsoring ministries.

Great care should be taken to channel the reform energy into effective laws and regulations. For example, currently a draft law to reform the Civil and Commercial Procedures and another titled *Garantías Reales Mobiliarias* are both circulating. Their impact on the credit market would be enormous, but they have not taken account of benchmark sources such as the OAS/CIDIP Model Law of Secured Transactions of 2002, and they are out of step with many of its rules and principles. These and other initiatives for legal reform should take care to incorporate into their new laws the emerging international standards for commercial law and practice, so that Salvadoran laws—even as they undergo reform—do not fall out of step and behind those of the region and other Latin American countries.

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<sup>40</sup> To cite one example, the *Colegio de Estudios Jurídicos* is composed of the upper echelon of commercial practitioners and has 242 members, according to its current president.

<sup>41</sup> General organizations such as the *Cámara de Comercio e Industria* and the *Asociación Salvadoreña de Industria de la Confección* seem to include all national merchants of consequence. The Chamber of Commerce and Industry recently opened a Center for Alternative Dispute Resolution, including arbitration and mediation. Within six months of its installation, the center had accepted six cases for arbitration. The offices of the more powerful business associations also have provided a steady stream of government executives, with interests that reflect the spectrum of economic power from top to bottom.

## **F. RECOMMENDATIONS**

El Salvador has much in its current laws and in its current consensus to law and judicial reform that—if properly and carefully channeled—could lead to greatly reduced risk in its credit market. It needs the following reforms:

- ◆ A new law of secured transactions, shaping the draft law of *Garantías Reales Mobiliarias* to make sure it is consistent with all aspects of the OAS/CIDIP Model Law of Secured Transactions. This should include participating in an effort to regionalize key credit institutions, such as the Commercial Registry.
- ◆ A new Law of Civil and Commercial Procedures that addresses and eliminates many of the delays and bottlenecks in current judicial enforcement of collateral guarantees. To cite one example, if private companies and/or notaries public were empowered to serve process and notifications, that could dramatically reduce the delays now inherent in an overburdened court system.
- ◆ Support for training judicial officials, in cooperation with the CNJ, which has in place a judicial school (*escuela judicial*) to train a pool of candidates for judicial vacancies. Training for sitting judges so far lacks such organization.
- ◆ Resources with which to purchase technology and hardware for the courts, which have approved an internal electronic system but have been unable to implement it for lack of funds.

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## VII. COMMERCIAL DISPUTE RESOLUTION

### A. INTRODUCTION

On August 21, 2002, El Salvador enacted a Law on Mediation, Conciliation, and Arbitration. Although this is an important step for the efficient resolution of commercial disputes, El Salvador still must overcome a number of obstacles to have adequate means of dispute resolution. Foremost among these is the court system itself, which suffers from numerous problems, including untenable delays, inadequate training of both professional and administrative staff, a lack of judicial independence, and otherwise unqualified personnel holding important positions, including judges.

Second, with respect to ADR such as arbitration, despite the possibility for using such tools to settle commercial disputes having existed in the law for more than a century, very few have availed themselves of this tool. One key impediment is the limited culture for ADR, meaning that many do not know about, trust, or think of it as an alternative, and only a modicum of interest has been shown since passage of the law. In both cases—with respect to the court system and ADR in general—steps must be taken, including, for example, better training of legal personnel and training in the benefits of efficient resolution of disputes, to bring El Salvador’s system of commercial dispute resolution up to par with the expectations and demands of international business.

### B. LEGAL FRAMEWORK

Generally speaking, the actual legal framework in El Salvador with respect to commercial dispute resolution is sufficient to meet the needs of the business community, both domestic and international. As will be discussed in this chapter and others in this report, however, the judicial systems that form the foundation for promoting sustainable economic development and poverty alleviation are severely lacking in El Salvador.

At the international level, El Salvador has ratified a number of relevant instruments. The 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards was ratified in February 1998. In addition, El Salvador is a party to the Inter-American Convention on International Commercial Arbitration and the Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards. According to the El Salvador Constitution, these documents have full force of law in the country and supersede any conflicting domestic legislation.<sup>42</sup>

Domestically, the framework laws of El Salvador contain the necessary norms for commercial disputes. At the constitutional level, the law provides that all persons have the right to settle their commercial disputes through “settlement or arbitration.”<sup>43</sup> The Commercial and Civil Codes act

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<sup>42</sup> Constitución Política de la República de El Salvador de 1983, Article 144:

- Los tratados internacionales celebrados por El Salvador con otros estados o con organismos internacionales, constituyen leyes de la República al entrar en vigencia, conforme a las disposiciones del mismo tratado y de esta Constitución.
- La ley no podrá modificar o derogar lo acordado en un tratado vigente para El Salvador. En caso de conflicto entre el tratado y la ley, prevalecerá el tratado.

<sup>43</sup> Constitution of El Salvador (1983), Article 23:

together to regulate commercial matters, as discussed in greater detail in other chapters of this report.

Courts exist at three levels: Courts of First Instance, or trial courts; Appellate Courts; and the Supreme Court. The Supreme Court has 15 judges, and the President of the Supreme Court is head of the Judiciary, which is independent of other branches of Government. At the trial level, El Salvador has various courts of specific jurisdiction, including commercial courts. In addition, the law created the CNJ in an effort to improve judicial independence. Among other tasks, this body is charged with nominating the Supreme Court Magistrates. For selection of magistrates, the CNJ proposes candidates to the National Assembly, which then selects the judges. It was reported, however, that the CNJ has not had the envisioned success in removing politics from the judicial process as both sitting judges and members of the National Assembly still influence its work. For other judges, the Supreme Court makes the selection. As a result of the politically influenced atmosphere in which Supreme Court Magistrates are elected, this influence is spread down to the lower courts. As a result, judges not only appear to lack impartiality, but interviewees reported they are also guilty of indiscretions such as knowing improper applications of the law, obviously limiting their effectiveness and impinging on the rule of law.

A significant issue within the El Salvador legal framework, like other Central American countries, is the *amparo* appeal. This constitutional appeal directly to the Supreme Court can be made from almost any judicial decision, including arbitration decisions, and it must be heard by the court. It is used as a delay tactic, and, as such, thousands of frivolous appeals of this sort have caused a great backlog in the Supreme Court, delaying the execution of what are otherwise enforceable decisions.

For the first time, El Salvador has made a concerted effort to bring ADR to the fore through the Law of Mediation, Conciliation and Arbitration. The law takes significant steps that many respondents hope will alleviate some of the difficulties in resolving commercial disputes. Before this, arbitration was performed on an ad hoc basis. Although procedures for such arbitrations were established, and decisions made therefrom were the equivalent of a decision by a judge of first instance, this process was infrequently used as it required extensive judicial involvement throughout the process, accordingly leading to untenable delays and complications and defeating the purpose of arbitration.

Mechanically, the law takes several steps that could greatly improve ADR processes. It repeals all other laws on arbitration in Civil and Commercial Codes and consolidates the governing principles on the issue of this law. Moreover, the law allows for, and was the impetus for the creation of, the first and currently only arbitration center in El Salvador, the *Centro de Mediación y Arbitraje de la Cámara de Comercio e Industria de El Salvador* (hereafter Arbitration Center), which began operations in November 2003. Significantly, the law allows for oral proceedings, something not allowed for in regular commercial proceedings. In addition, the law recognizes international arbitrations as well as procedures to enforce them.<sup>44</sup> Given El

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- Se garantiza la libertad de contratar conforme a las leyes. Ninguna persona que tenga la libre administración de sus bienes puede ser privada del derecho de terminar sus asuntos civiles o comerciales por transacción o arbitramento. En cuanto a las que no tengan esa libre administración, la ley determinará los casos en que puedan hacerlo y los requisitos exigibles.

<sup>44</sup> *Ley de Mediación, Conciliación y Arbitraje*, published in the Diario Oficial, August 21, 2002.

Salvador's limited use of arbitration of any kind, how well courts in El Salvador would be able to understand enforcement of international arbitral decisions is not known, although one knowledgeable respondent stated that it would not be "unusually difficult." However, given the problems of the El Salvadoran judiciary, this statement must be put in its proper context.

The law permits parties to set the terms of the arbitration for themselves. In terms of contracting, parties must explicitly agree to arbitration in writing, may determine that all or only specific matters in the contract will be sent to arbitration, and may determine their own procedures for ADR. As part of this, the parties may determine whether arbitration decisions are to be based on law, equity, specific technical knowledge, or a combination of those. Once set, the parties are bound to pursue arbitration. If no specific procedures are set in the agreement to pursue arbitration, the law and the regulations of the Arbitration Center provide adequate procedures.

With regard to actual arbitrators, both the law and the regulations of the Arbitration Center set forth ethical standards and training norms by which arbitrators must abide. Other regulations for the Arbitration Center are clearly stated and include establishing an oversight board to oversee the process of approving arbitrators as well as establishing the fees for using the center's services. Moreover, when parties submit their case to the Arbitration Center, they are generally required first to attempt to solve their dispute through mediation. According to interviewees, however, this is an even less developed concept, and so parties usually proceed to arbitration. In all cases, arbitration within the center is not to take more than 6 months. Before the law was passed, very few contracts included arbitration clauses; since its passage, more parties reportedly are including arbitration clauses, although it is still a low percentage relative to other countries in the region, such as Costa Rica where arbitration is more widely used and in some cases required.

In conclusion, the legal framework regarding commercial dispute resolution in El Salvador generally can be seen as supportive of the needs of international trade. Reforms, however, are needed. Among these is the need to place stricter boundaries on *amparo* appeals as well as ensuring the arbitration decisions can be quickly and efficiently enforced by the courts. With respect to ADR, promotion campaigns should be undertaken so that lawyers and business persons alike understand the new law and its efficacy. By taking steps such as these, the legal framework in El Salvador could begin to work to the benefit of business instead of creating opportunities for impediments.

### **C. IMPLEMENTING INSTITUTIONS**

Given the limited use of ADR in El Salvador, the courts remain the primary body responsible for resolving commercial disputes. Unfortunately, the courts of El Salvador suffer from systemic problems, from the (commercial) courts of first instance to the Supreme Court.

At the outset, it is important to note that many legal practitioners, in all roles and at all levels, lack sufficient training for their position, have attained it through fraudulent means, or both. Many of these lawyers become judges, and still other judges gain their position not through merit but through political favor and corrupt practices.<sup>45</sup> Although the situation has been investigated, only a token number of practitioners have been sanctioned or dismissed. Given that many of

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<sup>45</sup> There is currently an effort to pass a judicial career law that would seek to address these problems.

those suspected are either at high levels or well-connected politically, interviewees who assisted in the investigations expressed little hope of them bringing reform. Moreover, the problem is exacerbated as there is not an independent bar association to assist in the regulation of lawyers; the Supreme Court is responsible for lawyers' oversight. One particularly deleterious result is that judges regularly misapply the law—because of either their own lack of skill or lack of integrity—and there is little hope of predictability in the courts, a necessary aspect of a functioning legal system.

Courts at all levels have onerous administrative duties. As mentioned, in the absence of professional associations, the Supreme Court is responsible for regulating lawyers, notaries, and other judges as well as being the legal and administrative head of the judiciary, stretching thin already scarce resources. Within the courts of first instance, judges must be not only legal practitioners but also administrators, as there are few court administration or management professionals. In addition an interviewee stated that judges, responsible for managing a staff of up to 15 people in the courts of first instance, for example, do not have the power to dismiss ineffective or corrupt staff. Coupled with limited court automation/computerization of functions, these circumstances force judges to lose significant time to administrative concerns.

Courts face other challenges to efficient operations, including, for example, inadequate means of service of process, a problem made more significant because all proceedings are written and all parties must receive all documentation. In one court, a individual who is part of the judicial system stated that the service process was “two people and one moped” to serve up to 300 documents daily throughout the capital, San Salvador. Similarly, one practitioner stated that, in the *best* of circumstances, enforcement of an order to seize secured and registered property that had been used as collateral for a loan that had since gone in default would take at least 9 months. As far as lenders are concerned, this is the practical equivalent of no enforcement at all; such delays put incredible strains on the lending institutions, in terms of both the lost use of the capital in question and the effort necessary to gain enforcement.

With a lack of established alternatives, however, businesses still turn to the courts to resolve most of their disputes. As a result, there are not a sufficient number of courts to meet the demand and courts are flooded at all levels. One commercial court judge reported during an interview for the assessment that there were more than 3,000 open cases at a time in that chamber alone, of which approximately 30 would reach a decision on the merits during a month. At the Supreme Court level, the abuse of *amparo* appeals further adds to the burden. As a result, even the most basic of commercial disputes can take numerous years to resolve and still longer to have any judgment enforced.

With respect to the enforcement of arbitration decisions, although court processes in this regard should be expeditious, in practice they are not. By law, the parties should automatically comply with an arbitration decision and award (*laudo*) as they have the force of law of a court of first instance, but this is often not the case. Similar to the delaying tactics surrounding *amparo* appeals, an interviewee who works closely with arbitration matters stated that parties will not pay the *laudo* and so the matter is put before the courts for enforcement. The courts then can be asked to enforce the judgment through various means, including attachment of property, judicial auction, etc., and they have the power to skip various procedural steps to do so. This process,

however, is rarely implemented according to the law and again can take unreasonable periods to reach conclusion.

Discussion of the Arbitration Center at best would be inconclusive at this time given how recently it was opened. As of July 2004, it was reported that the center was reviewing eight cases. The center has approximately 30 registered arbiters who have technical expertise in a number of areas and have undergone substantial training in arbitration, which is required by the center.<sup>46</sup> The permanent staff of the Arbitration Center at this time consists of the executive director alone, who works there only half-time. Costs for using the Arbitration Center are based on the amount in controversy and do not appear to be at a high enough level to be a disincentive to using the center. However, until a sustained effort is made to promote arbitration as a viable concept and the center is regarded as the best place to seek such redress, it is unlikely that ADR will be more than a token part of dispute resolution. As a result, the courts will continue to be overburdened and ineffective, increasing the costs and risks of doing business in El Salvador as well as placing delays and stops on the free flow of capital caught up in seemingly never-ending lawsuits.

In short, because effective judicial systems form the foundation for promoting sustainable economic development,<sup>47</sup> El Salvador's judicial systems need modernization of administration and procedures, greater resources, and the ability to ensure that all actors in the system are qualified and principled, to meet increased demands resulting from greater international trade. Moreover, the Arbitration Center needs support and promotion; otherwise, it may fail before it has even really begun its work. As a result of the problems in the courts, businesses cannot protect their rights and accordingly their investments, making doing business in El Salvador less attractive. This is particularly problematic for the numerous SMEs, as lengthy legal proceedings are a drain because of legal expenses and they are unable to complete business transactions held hostage in the courts.

#### **D. SUPPORTING INSTITUTIONS**

Most noticeable with respect to supporting institutions is the inadequate structure in which lawyers work and are trained. First, the lack of an independent bar association or a similar body for notaries means that lawyers (most of whom are notaries as well) are not well regulated, are not held to particular ethical standards, and are not required to take any sort of continuing legal education. It was reported to the assessment team, however, that various smaller organizations of attorneys exist, but these are merely groupings of practitioners in a similar sector of law, such as the *Centro Estudios Jurídicos*, which consists of approximately 250 business-oriented lawyers. Although the Supreme Court ostensibly is responsible for regulating attorneys, respondents stated that its efforts were less than adequate and that the possibility of bringing ethical claims against an attorney before the Supreme Court was an ineffective process.

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<sup>46</sup> The law regarding the establishment of an arbitration center states that the center can set the training needed for an arbiter to be registered with a center. In the case of the only center currently existing in El Salvador, arbiters are required to complete 400 hours of training.

<sup>47</sup> World Bank working paper, "Initiatives in legal and judicial reform, Vol. 1 of 1," January 1, 2004 ([http://www-wds.worldbank.org/servlet/WDS\\_IBank\\_Servlet?pcont=details&eid=000012009\\_20040301142827](http://www-wds.worldbank.org/servlet/WDS_IBank_Servlet?pcont=details&eid=000012009_20040301142827)).

Moreover, interviewees expressed concern about the quality, or more specifically lack thereof, of legal education. Approximately 20 universities have a law faculty, but only one or two of those was reported to produce lawyers adequately prepared to practice commercial law in line with current international norms. More directly related to commercial disputes, only a few of the law schools offer classes dealing with ADR. As was discovered during the assessment, reportedly law schools face delays and other obstacles in changing their curricula as any such adjustments must be approved by the Ministry of Education. A handful of educators and practitioners still try to keep up with the constantly advancing field of international commercial practice, but they are sometimes stymied by a lack of interest. For example, one knowledgeable practitioner offered to give classes on the use of arbitration at approximately 40 schools and associations, and only 2 expressed interest in scheduling a seminar.

With respect to judges, the CNJ is the primary body responsible for their preparation, and it does offer some specific training, including commercial matters. According to interviewees, however, this training is not sufficiently specialized and does not train judges adequately in court administration, which, given that this is a significant portion of a judge's work, is a failing.

Businesses generally have sufficient access and understanding of the courts and, despite the courts' problems, still avail themselves of them. The same cannot be said of arbitration, however, historically or currently. Therefore, it will be incumbent on the private business associations to help educate themselves of the benefits of arbitration. Although little has happened in this regard at this point, there is a general interest in supporting the Arbitration Center, which easily could be bolstered by the center's board as it is composed of leaders of the business community. In addition, it was reported that other associations, some with international assistance, are advising their members regarding the efficacy of ADR, such as *Asociación de Medianos y Pequeños Empresarios Salvadoreños* (AMPES), the Association for SMEs, which has held well-received seminars on the subject.<sup>48</sup>

Without adequate regulation and training of legal practitioners, however, action taken to support ADR will not have an adequate foundation upon which to stand. Accordingly, changes to the education of legal practitioners should occur, among others: law school curricula should be reviewed and reformed as necessary to meet current commercial needs; a bar association should be created with the capacity to provide, if not require, continuing legal education for practicing lawyers; and judges should receive sufficient training.

## **E. SOCIAL DYNAMICS**

Although the Government of El Salvador (GOES) has committed to judicial reform as a priority on the national agenda,<sup>49</sup> it remains to be seen how effective such reforms will be. Leadership in public institutions to effect change in the courts was reported to the assessment team to be uneven. Moreover, although various organizations expressed a desire for court reform, advocates

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<sup>48</sup> ARCO, a Spanish organization, and SICA/FICA from England, both with expertise in ADR, are currently working in El Salvador to promote and educate on the efficacy of ADR.

<sup>49</sup> World Bank working paper, "Initiatives in legal and judicial reform, Vol. 1 of 1," January 1, 2004 ([http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2004/03/01/000012009\\_20040301142827/Rendered/PDF/250820040Edition.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2004/03/01/000012009_20040301142827/Rendered/PDF/250820040Edition.pdf)).



of such reform interviewed for the assessment expressed a feeling akin to helplessness in the face of the political forces impeding such reforms.

With respect to ADR, numerous interviewees reported that El Salvador simply does not have a culture that is accepting of arbitration and other means of ADR. Lawyers reportedly think it is better to drag a case on for years, often for no reason other than to ensure work, which is easily aided by the court's numerous inefficiencies. Quite simply, there is an extreme lack of understanding of how the use of ADR would benefit parties to a commercial dispute. According to persons close to the situation, efforts to promote the new center have been sparse, even from the Chamber of Commerce of which the center is a part.<sup>50</sup> Although public and private institutions reportedly cooperated in drafting this law, this cooperation should not cease with the law's passage; both sides should make joint and singular efforts to see that the law and the center are employed to fullest extent. As few lawyers and businesses currently trust in arbitration, it will take a concerted effort to bring about the cultural change needed to accept ADR.<sup>51</sup> The possibility for this exists, however, as the Arbitration Center reportedly has support from the Chamber of Commerce and the center's board is composed of numerous respected businessmen. However, stable and supported domestic leadership is needed, with respect to both judicial changes and the use of ADR to ensure that El Salvador pursues needed reforms.

## **F. RECOMMENDATIONS**

As was repeatedly stated in interviews and as can be seen from this report, the judicial systems of El Salvador are in crisis. Courts lack efficiency and stability. Judges lack capacity, impartiality, and independence. Lawyers lack training and regulation and, in many cases, authentic accreditation. Moreover, although most parties seem to be cognizant of the problems, the will for change seems to exist only in pockets.<sup>52</sup> With respect to ADR, a history of mistrust of the concept as well as abuse of it as a delay tactic has sent arbitration, mediation, and conciliation into the equivalent of cultural exile. To ensure stability, predictability, and transparency in commercial disputes, assistance is needed.

To start, the Law on Mediation, Conciliation, and Arbitration and the Center of Mediation and Arbitration should be broadly supported, and extensive training and promotion on the benefits and practicalities of ADR are needed. Given the palpable entrepreneurial spirit in the country, if shown the benefits of ADR, business persons will be likely to adopt its use. Specific means of promoting ADR include the following:

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<sup>50</sup> Reportedly, the Chamber of Commerce has purchased advertisement space announcing the Arbitration Center and its work, but at this point the more than 1,900 members of the chamber have shown little interest in availing themselves of the center.

<sup>51</sup> One area where some headway has been made, however, is in the area of government contracting. Apparently, most government contracts include arbitration clauses. Even this is met with mixed results, however, as the Government, if it loses the arbitration, cannot pay an arbitration award until it has been allowed for in the following year's state budget.

<sup>52</sup> For example, according to persons close to the matter, the think tank FUSADES (the Salvadoran Foundation for Economic and Social Development) has worked extensively to promote numerous reforms including, for example, the judiciary. The international organization SICA-FICA, which exists to promote high standards in the training, education, and practice of international commercial arbitration and alternative dispute resolution/mediation practices, has worked in El Salvador to promote ADR.

- ◆ Specialized training on the mechanics and advantages of ADR should be not only for legal professionals but for business persons as well. El Salvador has an extensive network of professional associations and chambers through which this could be accomplished.
- ◆ In addition, public information campaigns (literature, radio, television, etc.) should be conducted to raise the profile of the issue and inform end users and encourage use of ADR in all commercial contracts.
- ◆ To inform this campaign, a cost-benefit analysis of using ADR versus pursuing commercial dispute resolution in the courts should be completed.
- ◆ Quite simply, the benefits of ADR must be clearly spelled out to overcome the cultural hesitancy associated with it.

With respect to the courts, steps must be taken to improve processes. For the most part, however, legal and judicial reform is a long-term process and there are currently ongoing programs in this regard, which should continue to have broad support.<sup>53</sup> Elements in this regard must include the following:

- ◆ Promoting judicial independence through better appointment procedures and improving administration and management.
- ◆ Making court proceedings more efficient by greater use of oral proceedings.
- ◆ Taking other steps in the short-term that could bring more immediate results, including, for example, making the service of process more efficient and less costly. Removing this bottleneck would allow for one point of delay in the system to be removed.

Reforms with respect to the legal profession are needed as well. These reforms include the following:

- ◆ Judges and lawyers need improved and specialized training in commercial matters.
- ◆ Law school curricula should be assessed to emphasize areas that do not meet the needs of actual commercial practice.
- ◆ A bar association should be created to ensure greater integrity and capacity of both lawyers and judges. In addition, such a bar association should require continuing legal education to ensure that practitioners remain abreast of developments, a recommendation made more significant in the face of increased international trade.
- ◆ To have sustainable development, El Salvador needs to encourage greater domestic and foreign private investment. This goal cannot be reached without modifying or overhauling the legal and institutional framework and firmly establishing the rule of law, which will create the necessary climate of stability and predictability.

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<sup>53</sup> Currently, the World Bank is assisting in some such reforms, and this program should be supported. This Judicial Reform Project objective is to improve El Salvador's judicial system by promoting measures aimed at enhancing the effectiveness, accessibility, and credibility of its judicial branch. World Bank working paper, "Initiatives in legal and judicial reform," see above, note 47.

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## VIII. BANKRUPTCY

### A. INTRODUCTION

El Salvador has no bankruptcy practice as such. Apparently, the delays that plague court proceedings in El Salvador (described in the section on collateral) account for most of the debtors' lack of interest in filing insolvency cases, because they find sufficient protection in the normal delays attendant to creditors' attempts to collect debts and enforce guaranties through normal court processes. In countries where bankruptcy is more common, it is usually triggered by creditors' foreclosure procedures against debtors, who then seek the protection of the bankruptcy to halt the foreclosures.

The law also limits the parties who may initiate bankruptcies in El Salvador. The country's laws permit only voluntary bankruptcy, filed by the debtor. Creditors may not file involuntary bankruptcy against the debtor.

Lawyers interviewed for this assessment remembered a mere handful of insolvency proceedings in the country within the last generation. The legal possibilities that encompass such proceedings include *concurso* or *concurrentia*, or consumer bankruptcies, under the Civil Code; *quiebra*, or merchant bankruptcies, under the Code of Commerce; and *suspensiones de pago*, or merchant reorganizations, under the Code of Commerce. No lawyers interviewed ever had handled an insolvency proceeding let alone considered such practice part of their own expertise or normal workload, nor did they know of anyone else who did.

Insolvency proceedings in countries where modern bankruptcy laws are effectively and forcefully applied take on a character lacking in El Salvador.

First, modern insolvency regimes depend on creditors' effective remedies in collecting debts, most notably by foreclosing on collateral guaranties, to drive honest debtors to seek relief in insolvency proceedings. El Salvador's debtors lack such an incentive, because creditors cannot collect debts in a manner efficient enough to pressure debtors into insolvency proceedings and, even if they did, the insolvency proceedings do not shelter debtors from creditors' pursuit of guaranties against collateral.

Second, modern bankruptcy laws in other countries operate in tandem with collateral guaranty laws to provide two major elements lacking in El Salvador: the clear demarcation of priorities among creditors and the vindication of those priority claims. Most importantly, such legally mandated respect for creditors' security interests in movable collateral gives creditors with a guaranty real leverage against an insolvent debtor. No doubt exists as to the creditors' right to certain collateral or to the creditors' ability to foreclose on that collateral. By seeking bankruptcy in such regimes, debtors can buy time otherwise not available to them. Debtors' respite in modern insolvency regimes is temporary, however. Bankrupt debtors either gain their secured creditors' agreement to the debtors' plans—if any—for reorganization, or acquiesce in the creditors' possession of collateral assets by turning them over to the court as the first step in bankruptcy. Salvadoran insolvency and collateral laws entirely lack such internal pressure points and therefore cannot impose the proper leverage on modern creditor-debtor relations.

Finally, El Salvador's insolvency laws do not provide debtors with a full and final discharge of their debts. Although the statutes refer to *rehabilitación* for debtors, they do not require all creditors to participate by binding their claims to discharges granted within the insolvency.

El Salvador's lack of bankruptcy practice hampers business and investment by leaving creditors without an effective ultimate remedy against defaulting debtors. The typical credit dialectic runs from (1) default by debtor to (2) foreclosure against collateral by creditor, forcing (3) bankruptcy by debtor that temporarily stops foreclosures but leads to recognition of secured creditors' collateral claims and means that all debts will be resolved in the relatively short-term. Without bankruptcy, then, creditors cannot foreclose even debts guaranteed against movable collateral, let alone assert unsecured claims with any hope of payment in a realistic time frame. The attendant increased risk to any lender reduces the supply of credit offered to potential borrowers and weeds out a number of them even when their collateral should be sufficient to guaranty a needed loan.

## **B. LEGAL FRAMEWORK**

Any discussion of El Salvador's substantive and procedural rules for insolvency on the books, such as the following, must begin with the warning that they are virtually never used.

### **1. Code of Civil Procedure<sup>54</sup>**

Dating from 1882, this procedural code provides for a meeting of all creditors to sort out claims against the debtor and liquidate the debtor's assets in favor of those claims. Applicable to both natural and juridical persons, the procedure simply is not used in current Salvadoran practice.

### **2. Code of Commerce<sup>55</sup>**

Effective since 1970, this code instigated new bankruptcy and insolvency rules exclusively for merchants, consisting of two alternatives: bankruptcy and suspension of payments. The Code of Civil Procedure's provisions for a meeting of creditors may apply to supplement the Code of Commerce's laws, as necessary, but again the law simply is not used in current Salvadoran practice for either bankruptcy or suspension of payments.

### **3. Law of Mercantile Procedures<sup>56</sup>**

Drafted to accompany the new Code of Commerce and effective since 1973, this law should cover all the procedural aspects of bankruptcy and the suspension of payments. Its provisions include significant disincentives for the debtor in Salvadoran insolvency—specifically, the requirement that the causes of a bankruptcy must be determined at the outset, and it shall be classified as fortuitous, negligent/guilty (*culposa*), or fraudulent. The classification thus establishes the potential criminal responsibility of those involved in the events that lead to

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<sup>54</sup> Available at: <http://www.csj.gob.sv/leyes.nsf/ed400a03431a688906256a84005aec75/f59b09a27a90d8e106256d02005a3ffb?OpenDocument>.

<sup>55</sup> Available at <http://www.csj.gob.sv/leyes.nsf/ed400a03431a688906256a84005aec75/ff12a77cd3a8ce6206256d02005a3df1?OpenDocument>.

<sup>56</sup> Available at <http://www.csj.gob.sv/leyes.nsf/ed400a03431a688906256a84005aec75/52def0f78b16688a002564210040f391?OpenDocument>.

bankruptcy and also determines the way the court must handle the case. Special procedures and proof may be required.

#### 4. General Framework

Bankruptcy, as opposed to suspension of payments, contemplates a request for liquidation of the debtor's assets against a merchant that has stopped paying its obligations as they mature. Salvadoran law specifies only a select few eligible to initiate the proceedings: the debtor; a shareholder or administrator of the debtor; or the Attorney General's (*Fiscalía General*) office, acting on a report from the Corporation Commission (*Superintendencia de Obligaciones Mercantiles*).<sup>57</sup> For reasons set out here and elsewhere, none of these parties has much incentive to initiate the process.

Suspension of payments begins with a request by the debtor to the court to issue an order declaring suspension of all payments and the convocation of the creditors to consider an agreement that might avoid the debtor merchant's bankruptcy. Again, because of dynamics created by the laws defining creditors' rights and their enforcement in El Salvador, no Salvadoran merchant debtors are likely to find themselves in circumstances that would make suspension of payments a desirable procedure. None has for a long time.

Two types of business entities are not eligible for either bankruptcy or suspension of payments. Special laws apply to the insolvency of insurance companies and banks, which operate under the vigilance and control of the *Superintendencia del Sistema Financiero* (Superintendency of the Financial System). Should a bank or insurance company become insolvent, the *superintendencia* will carry out a liquidation of its assets, presumably by selling it to another bank or insurance company, free of its unpayable obligations.<sup>58</sup>

According to bankers and practitioners interviewed, there have been no cases of a major Salvadoran bank going into insolvency. A couple of smaller banks have failed and were absorbed into the country's bigger banks, *Banco Agrícola* and *Banco Cuzcatlán*.

El Salvador's Code of Commerce and its Law of Mercantile Procedures (*Ley de Procedimientos Mercantiles*) provide a troublesome preference for Salvadoran creditors in case of an international insolvency.<sup>59</sup> Should an insolvency proceeding in another country obtain a judicial order against assets or persons in El Salvador, the judgment creditor must submit the order to the Salvadoran Supreme Court for recognition and assimilation as a Salvadoran judgment. Although this may be a mere routine—if laborious, particularly if a language other than Spanish is involved—procedure, the current law provides that creditors resident in El Salvador shall be preferred over foreign creditors, apparently regardless of what the foreign bankruptcy judgment may establish or what the law would otherwise recognize as priorities.

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<sup>57</sup> Commercial Code, Article 51.

<sup>58</sup> (See further, Banking Law (*Ley de Bancos*), Decree No. 697/1999, Title IV, available at <http://www.csj.gob.sv/leyes.nsf/ed400a03431a688906256a84005aec75/dba2bbb1411bcc3b06256d02005a3bca?OpenDocument>).

<sup>59</sup> See Code of Commerce, Article 511, and Law of Mercantile Procedures (*Ley de Procedimientos Mercantiles*), Article 90, respectively.

Despite the lack of proper insolvency proceedings as part of Salvadoran practice, or perhaps because of it, several practices have grown up that offer de facto insolvencies to debtors. Typically, according to interviewees, the owners of a duly organized company in financial straits simply initiate the formal termination of its existence and continue their enterprise in a newly organized entity, leaving the original company as a derelict shell with little to offer creditors, who must fight over its limited assets. Legal doctrines such as piercing the corporate veil might provide creditors with relief against such practices but are unknown within Salvadoran law, although not to some of its practitioners, who nonetheless despair of any eminent application. Similarly, actions for fraudulent transfers, known as *acciones paulianas*, exist in the law and theory, but no one can remember any successful use of them against debtor fraud in El Salvador.

Another de facto bankruptcy technique described by interviewees may occur when one creditor begins a judicial proceeding to enforce a debt and execute against collateral. The debtor, who may have granted rights in the collateral to multiple creditors, simply surrenders and lets the creditors contend for limited assets before the court, which must delay the proceedings to ensure that all affected creditors receive notification and weigh in with their claims.

Finally, private agreements to refinance and/or liquidate assets often achieve resolution when a debtor cannot pay the relevant debts. Not infrequently, apparently, creditors use such agreements to carve up a debtor's assets among themselves—where the debtor has no hope of reorganization and submits to the process—simply to avoid the costs and delays inherent in court procedures. In other cases, the debtor may hope to reorganize and present a plan directly to creditors in the hopes that they will accept restructuring of debt in place of pursuing doubtful judicial remedies.

El Salvador has no functioning insolvency laws. Its current laws are out of date and do not perform the functions and purposes of modern insolvency laws, including providing a process by which the debtor may achieve a discharge of all debts or a reorganization, but only by involving all creditors and only through a process that establishes definitive priorities among those creditors and allows them to take their collateral or its equivalent in exchange for their claim. These and other basic concepts of insolvency are contained in UNCITRAL's draft of a convention on international insolvency and also in the new laws of insolvency drafted and promulgated in Eastern Europe in recent years.<sup>60</sup>

## **5. Substantive Laws on Insolvency**

### **a. Bankruptcy (Quiebra)**

Bankruptcy consists of a global procedure to wind up the bankrupt person's commercial affairs and liquidate all his/her assets, known as a universal—as opposed to a summary—trial. The law aims to control improper practices by commercial entities in prejudice and/or fraud of creditors. The limited parties (other than the debtor) who may institute a bankruptcy proceeding have the

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<sup>60</sup> The UNCITRAL Legislative Guide on Insolvency Law is available at <http://www.uncitral.org/english/texts/insolven/insoguide.pdf>. Information pertaining to insolvency proceedings in Russia, Central and Eastern European Countries is available at the website of the Organization for Economic Cooperation and Development ([http://www.oecd.org/document/18/0,2340,en\\_2649\\_34845\\_2751634\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/18/0,2340,en_2649_34845_2751634_1_1_1_1,00.html)).

responsibility of supporting their demand with documentary proof of a debtor's acts of bankruptcy,<sup>61</sup> a daunting burden that further discourages use of the process.

Whereas fortuitous bankruptcies constitute a fallback classification, should proof of other motives fail, the court will scrutinize debtors' actions to see if guilt or fraud were the cause of failure to pay. Should guilt or fraud be proved, then the bankruptcy case goes forward in a different way than if no more than fortuitous bankruptcy were proven. The prosecutor's office is notified, and criminal proceedings are instituted against the debtor.

As one of its first duties in a bankruptcy, after it has verified the debtor's failure to pay debts or other acts of bankruptcy and before it has classified the bankruptcy, the court must appoint a trustee, or *síndico*, to administer and liquidate the debtor's assets. Although the court supervises the *síndico*, neither court nor debtor has further control over the debtor's assets after the trustee's appointment.

General creditors sign up for their share—if any—of the assets liquidated in bankruptcy, after the trustee covers the costs of administration. The Civil Code sets out the priority of claims: (1) mortgage guaranties; (2) judicial costs, including those of the trustee; (3) innkeepers' claims; (4) claims for transportation and carriage; (5) claims of set-off and retention; (6) claims for guaranties other than mortgages; and (7) the remainder of creditors, who enjoy no special preference.<sup>62</sup> To ensure that the trustee, or *síndico*, carries out his/her duties faithfully and correctly, general creditors may name an intervenor (*interventor*) to monitor the activities of the trustee. Creditors with guaranties against specific assets of the debtor may continue their efforts at enforcement and foreclosure unaffected by the bankruptcy, likely the better option for those holding nonmortgage guaranties.

#### **b. Suspension of Payments (*Suspensión de Pagos*)**

Where a debtor wishes to take the initiative and propose to its creditors an agreement for restructuring the debts that it cannot pay, it may request a court to order a suspension of payments and convoke the creditors to hear the debtor's plan. The debtor must request the court order within five days of its debts becoming delinquent.<sup>63</sup> The court shall appoint a trustee to monitor the debtor's continued administration of its assets, and creditors may name an intervenor for the same purpose, in preparation for the possibility that the suspension of payments will become a bankruptcy.

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<sup>61</sup> Salvadoran law states the following as circumstances that create a state of bankruptcy: (1) nonpayment of debts due and owing; (2) insufficiency of assets subject to attachment to cover debts; (3) absence or disappearance, for 15 days or more, of the merchant debtor without leaving in charge of the enterprise someone with the legal authority to comply with all obligations; (4) voluntary closure of the enterprise, for 15 days or more, when obligations are outstanding; (5) transfer of assets to the prejudice of creditors; (6) use of ruinous, fraudulent, or fictitious measures to attend to or avoid obligations; (7) filing a declaration of bankruptcy; (8) seeking suspension of payments when that remedy is not appropriate or when that remedy fails to achieve agreement with creditors; (9) failure to comply with the agreement achieved through suspension of payments; and (10) any other action analogous to these. See Commercial Code, Article 498.

<sup>62</sup> See Civil Code of El Salvador, Articles 2217-2229.

<sup>63</sup> Law of Mercantile Procedures, Article 99.

A plan must be submitted before the creditors' meeting may take place, with the judge present. Creditors holding at least three-fifths of the total liabilities must participate to create a quorum, and the same percentage is necessary to approve the agreement and ensure its entry into force. In other words, if a minimum quorum attends the meeting, those in attendance must vote unanimously for the plan. For up to 10 days after the creditors' meeting, objections to the plan based on form, substance, authority, and feasibility may be raised, and the relative priority of claims may also be raised. The judge resolves all issues raised at the meeting and in the objection period following and gives final approval of the agreement before the creditors' vote and, should they accept it, certifies it and notifies all interested parties by a document setting out all proposals accepted by the requisite majority of creditors.

Suspension of payments has little force as a legal remedy. Although it may create a pause in collection activity against a debtor and force the creditors to listen to the debtor's proposal for restructuring debt, no creditor may be forced to participate in a reorganization agreement, even if all other creditors are willing to do so. Further, secured creditors holding valid guaranties may press forward with execution and foreclosure against their collateral. Their failure to participate would frustrate all efforts to achieve a quorum. For all these and other reasons, the legal proceeding has few or no advantages over informal efforts at an agreement between debtor and creditors.

### **C. IMPLEMENTING INSTITUTIONS**

For application of its insolvency laws, El Salvador relies on its courts. Institutional players specified in the laws, such as trustees and intervenors, are left to the appointment and supervision of the court. Judicial structures and weaknesses are discussed at length elsewhere, but they do not matter in this area of the law because insolvency proceedings simply do not occur in El Salvador.

In the capital city of San Salvador, there are five specialized Mercantile Courts, with exclusive competence in insolvency matters. Outside the capital, however, insolvency proceedings fall to the all-purpose trial courts exercising competence in mercantile matters as part of their general jurisdiction. The domicile of the bankrupt determines which court shall have jurisdiction.

According to interviewees, supplemental roles might fall to the Corporation Commission and Attorney General, according to the law, but these institutions have never played any part in insolvency matters, show no inclination to do so, and should have no call to do so, given the absence of any such proceedings.

### **D. SUPPORTING INSTITUTIONS**

#### **1. Trustees (*Síndicos*)**

Salvadoran law does not include extensive provisions regarding the qualifications and activities of bankruptcy trustees. Nonetheless, the duties are clear to a large extent. The trustee must take over all operations for an enterprise in bankruptcy and monitor the operations of any enterprise under suspension of payments. In general, trustees may do whatever is necessary to their administrative duties, under the court's supervision, including conducting an inventory of the debtor's assets, confirming it against the debtor's schedules of assets and list of affected creditors



and debtors, and taking over the operation of the enterprise, performing an audit of all operations, with special concern for any that may have prejudiced creditors' rights. The *síndico* has the power to veto a suspension of payments for cause and consign the process into bankruptcy.

## **2. Intervenorors (*Interventores*)**

Intervenorors have even fewer rules than trustees. Beyond the fact that the intervenor must meet the approval of the court, virtually no requirements exist. Once appointed by the court, the intervenor may perform any duties assigned to him/her, ranging from those carried out by *síndicos* to lesser duties such as an audit or appraisal.

## **3. Professional and Business Associations**

These are the same as for collateral and are covered in detail in Section VI (Collateral).

The supporting institutions for bankruptcy simply have little effect because the bankruptcy laws are virtually never applied. The only way to change that, and to significantly encourage business and investment by providing a more congenial legal atmosphere for their operations in El Salvador, is to make foreclosures against collateral by creditors enjoying guaranties an efficient process. Currently, the foreclosure process in El Salvador is so inefficient that it might as well not exist for many creditors. See Section VI (Collateral).

## **E. SOCIAL DYNAMICS**

Although there is strong consensus for reform of other commercial laws, the imperative to reform El Salvador's insolvency laws seems much weaker. There is a feeling that there are no insolvency proceedings in the country—neither a tradition nor a “culture” of insolvency—and no need for them. Nonetheless, at our final roundtable, the participants endorsed modernizing the insolvency laws, specifically referring to UNCITRAL's draft convention for international insolvency as a source of principles and rules, which should be incorporated into the Salvadoran system.

## **F. RECOMMENDATIONS**

To coordinate its insolvency laws with its other commercial laws, and to reduce risk in its credit market, El Salvador needs the following reforms:

- ♦ A new law of insolvency, taking into account the concepts, principles, and rules included in the UNCITRAL draft convention on international insolvency, currently in final stages of drafting, and other recent national laws of insolvency.
- ♦ A new law of Civil and Commercial Procedures and a new law of *Garantías Reales Mobiliarias*, both of which take account of and harmonize with insolvency law reforms, to eliminate the delays and bottlenecks in current judicial enforcement of commercial laws (to cite one example, if private companies were empowered to serve process and notifications, it could dramatically reduce the delays now inherent in an overburdened court system).

- ♦ Support for training judicial officials, in cooperation with the CNJ, which has in place a judicial school (*escuela judicial*) to train a pool of candidates for judicial vacancies—training for sitting judges lacks such organization and would carry quintessential importance for building judicial competence in applying insolvency laws, given the lack of experience in El Salvador today.
- ♦ Resources with which to purchase technology and hardware for the courts, which have approved an internal electronic system but have been unable to implement it for lack of funds.

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## IX. COMPETITION POLICY

### A. INTRODUCTION

Competition law provides a regulatory framework to maintain and improve efficiency in markets, promote competitive pricing practices, and restrain price rises in markets where competition is affected by anti-competitive business practices (including horizontal and vertical restraints such as collusive price-fixing, input/output allocation, and bid rigging; abuse of dominant position such as exclusion, discrimination, and predation; and certain mergers and acquisitions). Competition law by itself does not create competition but, when effectively applied, can counteract the dangers of private anti-competitive behavior. For example, cartels may deliberately create artificial shortages, which results in some consumers being able to obtain the product whereas other consumers pay an inflated or monopoly price. Dominant firms may abuse their market power, for example by tying two products without a legitimate business purpose. Entry to new participants may be blocked by firms with market power that erect protectionist barriers.

In addition to private conduct, competition law can be used to counteract inefficient government regulation and to promote efficiency within the public sector. Competition authorities can use the competition law to perform a comprehensive review of existing and proposed laws and regulations, providing suggestions and advice on government policies and measures that promote anti-competitive practices or inefficiencies. Activities can include reviewing possible sources of public restraints on competition in trade policies (tariff and non-tariff barriers, anti-dumping duties, and discriminatory export practices), investment policies (exclusionary lists, ownership restrictions, licensing requirements), and sectoral regulation (power, transportation, telecommunications, natural monopolies).

Recognizing these and other benefits, the Government of El Salvador (GOES) recently engaged in significant efforts to adopt a competition law. Since initial efforts began 10 years ago, seven initiatives have been submitted to the Legislative Assembly without enactment. Past resistance appears to have been prompted by the power of select special interest groups and weak or little understanding of competition law among assembly members. This year, however, GOES engaged in more active educational outreach and consensus building for a new draft competition law, which was prepared in the first half of 2004 and passed in November 2004.<sup>64</sup>

This section provides a brief assessment of competition law and policy in El Salvador, identifying the degree of development, the status, and the need for competition law reform. Four dimensions of legal and institutional reform were examined as a conceptual framework for comparison, including the framework laws (i.e., the basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions), the implementing institution (i.e., the governmental, quasi-governmental, or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested), the supporting institutions (i.e., governmental, quasi-governmental, or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework laws),

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<sup>64</sup> Ley de Competencia, November 26, 2005, Decree No. 528

and the market for reform (the opportunity or need for reform). These subsections are followed by a short conclusion and, finally, recommendations for further reform.

## **B. LEGAL FRAMEWORK**

El Salvador adopted a competition law in November 2004, replacing existing competition-related provisions in a variety of different laws, including the General Law on Electricity, the Telecommunications Law, the Organic Law of Civil Aviation, and the Law on Government Procurement and Contracting. The Salvadoran constitution supports the new competition law espousing economic freedom and private initiative generally and specifically preventing monopolies without government authorization.<sup>65</sup>

The law has made a promising start toward further development of competition policy in El Salvador. The law offers bright-line rules and tests for anti-competitive conduct and establishes an agency structure that could work well in practice. It is simple, clear, and concise. Despite its merits, there are some problems with it that probably will become evident upon application. In most cases, appropriate implementing regulations can resolve these issues.<sup>66</sup> The most problematic provision of the law is Article 53, which states that the implementing regulation must be prepared within 90 days after the date the law enters into force.<sup>67</sup> Experience in other countries (e.g., Indonesia, Thailand) has shown that this type of limitation may be unrealistic and could lead to the rushed promulgation of regulations that are not well suited to El Salvador's needs. First, the date the law enters into force may not coincide with the date the agency is up and running. In other countries, this has meant that those without sound expertise in Government have had to prepare the implementing regulations, which can pose difficulties and inconsistencies with international norms once it is functioning. Second, three months is insufficient time to prepare implementing regulations. Regulations are best prepared when they are based on agency experience. Because this law is dependent on implementing guidelines in order to have an important impact on the success of the law, this provision will prove demanding. As noted in the recommendations of this section, appropriate technical assistance and experts will be needed to help prepare the implementing regulations if it is to be prepared by the end of March 2006.

### **1. Agreements.**

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<sup>65</sup> Article 102 of the constitution recognizes economic freedom and asserts that the state shall encourage and protect private initiative under the conditions necessary to increase the national wealth and ensure its benefits to the highest possible number of inhabitants. Similarly, Article 101, Subsection 2, of the Constitution asserts that the state shall defend consumers' interests. Article 110 indicates that no monopoly can be authorized unless it is in favor of the state or the municipalities or when the social interest makes it necessary and that, to guarantee the freedom to conduct business and to protect the consumer, monopolistic practices are prohibited.

<sup>66</sup> Although there is no one "right" model of competition law, in recent years agreement has emerged as to principles and scope. In the case of El Salvador, the government may want to carefully consider promoting regional convergence, if not harmonization, in Central America. Trade and investment would benefit if all the countries in the region strove to adopt consistent standards. For guidance, GOES could examine the competition laws of Panama and Costa Rica, which are similar to the Mexican competition law, in preparing the implementing regulations.

<sup>67</sup> *Ley de Competencia*, Article 53.

Articles 25–29 are generally sound, and are consistent with international norms prohibiting anticompetitive agreements. In keeping with the European civil law tradition of spelling out in detail what is prohibited, Article 25 lists a series of agreements between competitors that are prohibited, such as price fixing, customer allocations, and several other types of agreements.<sup>68</sup> This section reflects international norms and regional standards whereby the most egregious forms of anti-competitive agreements, including price-fixing, bid rigging, and allocation of territories or customers do not require evidence of injury to competition and only requires proof that the agreement was made. It is no defense that the agreement was not carried out or that it did not have an anti-competitive effect. The use of straightforward rules simplifies the judicial process and provides clear guidance for businesses.<sup>69</sup> By contrast, Article 26 lists the agreements between non-competitors that are illegal, but in keeping with international practice, uses a legal standard that looks to the reasonability of the particular agreement, analyzing these agreements on a case-by-case basis (“rule of reason”).<sup>70</sup>

Absent from Articles 25–29 are provisions concerning non-cartel agreements among competitors, including information exchanges, agreements restricting advertising, agreements to set standards, boycotts and joint refusals to deal, trade associations, and export cartels. While such provisions are found in many competition laws, they are absent here. This is not problematic because it avoids overburdening a new agency with issues of complexity that may distract the agency from more clear-cut initial problems. At a later stage of the agency’s development, however, it may be advisable to consider provisions that protect against abuses of these types of agreements.

## 2. Dominance.

Article 30 describes the type of anti-competitive behavior by dominant firms that is illegal. This article appears to ascribe a *per se* standard to dominance cases.<sup>71</sup> Experience in the United States and elsewhere has shown that abuse-of-dominance cases are best analyzed taking into account all the relevant facts, circumstances, justifications, and effects of the practice (an approach known in the United States as the “rule of reason”) instead of condemning them outright, as happens with *per se* cases. This is because aggressive competition, which benefits consumers and competition laws seek to encourage, can superficially resemble conduct that has the effect of excluding competition, which competition laws should seek to prevent. For example, exclusive distribution agreements could in some circumstances restrain competition between the sellers and the manufacturers of the product, they are more typically they are effected by manufacturing to more efficiently compete against other manufacturers. Careful examination of the purpose and likely effects of this kind of conduct is necessary to avoid penalizing legitimate, healthy competition. Dominance cases do not always involve damage to competition and judging reasonability on a case-by-case basis is the preferred standard. Implementing regulation should be crafted to allow for a rule-of-reason legal standard.

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<sup>68</sup> *Ley de Competencia*, Articles 25-29.

<sup>69</sup> Such offenses are referred to as “*per se*” illegal in the U.S. In Panama and Mexico *per se* practices are called “absolute monopolistic practices,” as opposed to the other forms of agreements, referred to as “relative monopolistic practices.”

<sup>70</sup> *Ley de Competencia*, Article 26,.

<sup>71</sup> *Ley de Competencia*, Article 30.

Another area for improvement is in the predatory pricing provision. Experience shows that caution is necessary regarding predatory pricing, because the conduct at issue is offering low prices to consumers—exactly the kind of behavior the law seeks to encourage. Low prices are not anti-competitive even if they drive rivals out of the market, unless the prices are below some appropriate measure of cost. Merely pricing low, but at or above cost, and driving out rivals, is beneficial to consumers and merely has long-term detriments to competition. To make sure the law does not sanction the kind of discounting that it seeks to encourage, the predatory pricing articles could be improved by preparing the implementing regulations to require a likelihood of recoupment before low pricing will be found illegal.

### 3. Merger control.

The draft law proposes a mandatory premerger control regime that requires that all concentrations involving parties with combined total activities greater than 50,000 times the minimum wage or with assets great than 60,000 times the minimum wage to notify the *superintendencia*.<sup>72</sup> If the transaction's thresholds make it subject to notification, then the transaction cannot be consummated without clearance by the *superintendencia*. If the *superintendencia* decides a proposed merger can significantly limit competition in the market, it can prohibit the transaction.

The notification thresholds' application to the combination of total activity (*la combinacion de activos totales*) is ambiguous. It is unclear whether this threshold applies to the parties' combined activity, the acquisition itself, etc. Implementing guidelines should specify what is meant by the "combination of total activity."<sup>73</sup> A combined local sales/assets test, which may be satisfied by the acquiring person alone regardless of any local activity by the business to be acquired, can result in notifications where the transaction does not have a significant, direct, and immediate economic effect within the jurisdiction concerned. International standards suggest that thresholds apply to local activities by each of at least two parties to the transaction. This approach offers an appropriate screen, because the likelihood of adverse effects from transactions in which only one party has the requisite nexus is sufficiently remote that the burdens associated with a notification requirement normally are not warranted. (An alternative approach is that thresholds apply only to the activities of the acquired business, but in that case it is important that the thresholds be sufficiently high to ensure that notification will not be required for transactions lacking a potentially material effect on the local economy.)

In writing the implementing regulations for the merger provisions, the recommended practices for merger notification and review established by the International Competition Network (ICN), should be considered. The ICN is a voluntary organization of virtually all the world's competition agencies. At its 2003 and 2004 meetings, the ICN unanimously adopted a series of recommended practices for merger notification and procedures, representing a consensus of best practices.<sup>74</sup> Many jurisdictions have indicated that these recommended practices are of

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<sup>72</sup> *Ley de Competencia*, Articles 31-36.

<sup>73</sup> *Ley de Competencia*, Articles 33.

<sup>74</sup> These practices address 11 areas that public and private sector representatives have identified as the most important to facilitating convergence toward best practices in merger review: (1) sufficient nexus between the transaction's effects and the reviewing jurisdiction, (2) clear and objective notification thresholds, (3) flexibility in the timing of merger notification, (4) merger review periods, (5) requirements for initial notification, (6)

considerable assistance in formulating or revising their merger regime. A number of Latin American countries, including Mexico, Colombia, Argentina, Brazil, Chile, and others, have revised or are in the process of revising their merger regimes to bring them into closer conformity with the recommended practices.

### C. IMPLEMENTING INSTITUTIONS

The law creates a *Superintendencia de Competencia* (*superintendencia*), a technical agency with administrative and budgetary autonomy. Government oversight is by the Ministry of Economy. The *superintendencia* is headed by a three-member directorate composed of one superintendent and two directors. All three are nominated by the president. One area of weakness is that there is no provision for staggered terms. If all three expire simultaneously, then institutional continuity will be lost and the president who happens to be in power when the terms change will have an undue influence on agency policy and procedure. The implementing regulation could, and should, provide for staggered terms.

The superintendent is responsible for initiating and investigating cases, making information requests, interacting with other regulators, etc. The directorate is responsible for decision making, helping the superintendent select cases to investigate, making determinations on mergers, etc.

#### 1. Investigation and Decision-Making

The law appears to provide effective institutional mechanisms for investigation. There are legal and administrative processes for gathering evidence, procedures for challenging activity that the investigation reveals to be anti-competitive, and confidentiality provisions to protect evidence. Importantly, the *superintendencia* has the ability to decline to take action—that is, not to investigate every complaint. There are sound oversight provisions, requiring external audits and annual reports to ensure that this discretion cannot be misused.

There is no direct provision for external appeals of the *superintendencia*'s decisions. As is the case in some countries, appeals of decisions of administrative bodies may be provided for in other legislation. Within the agency, parties can appeal the decision back to the *superintendente* according to Article 48.<sup>75</sup> However, decisions may be appealed only on “*las ilegalidades de tramite*,” which would need to be clarified in the implementing regulation. Moreover, the lack of an appeals process could raise due process concerns. The draft FTAA chapter on competition policy would call for independent review of any agency decisions.<sup>76</sup> The existing Salvadoran courts may have limited capacity in this area, but some solution to provide for independent review will ultimately be necessary. Some countries have adopted specialized part-time courts for this purpose.

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conduct of merger investigations, (7) procedural fairness, (8) transparency, (9) confidentiality, (10) interagency coordination, and (11) review of merger control provisions. The practices are available at <http://www.internationalcompetitionnetwork.org/guidingprinciples.html> and in Spanish at [http://www.internationalcompetitionnetwork.org/rp\\_practicas\\_recomendables.pdf](http://www.internationalcompetitionnetwork.org/rp_practicas_recomendables.pdf).

<sup>75</sup> *Ley de Competencia*, Article 48.

<sup>76</sup> See [http://www.ftaa-alca.org/FTAAAdraft03/ChapterXIX\\_e.asp](http://www.ftaa-alca.org/FTAAAdraft03/ChapterXIX_e.asp).

## 2. Penalties

The penalties for unlawful conduct should be clear, designed to correct the competitive injury caused by the offense, and sufficiently stringent to deter future violations. At the same time, the penalties should not be structured in a way that will deter pro-competitive conduct. Article 14, which addresses penalties, does not appear to adequately empower the *superintendencia*. These articles allow the *superintendencia* to declare a certain conduct illegal, block mergers, and impose (low) fines.<sup>77</sup> They do not authorize the *superintendencia* to enter into consent agreements, order divestiture, impose monitoring requirements, or have other provisions ancillary to directly blocking illegal conduct. Such provisions would allow more flexibility in applying the law and generally are welcomed by the business community. Also, in certain cases, these types of remedies are deemed necessary to restore conditions of competition efficiently. Article 14, section d, “ordenar el cese de las prácticas anticompetitivas de conformidad a los términos establecidos en esta ley,” could be used to allow the agency to prepare an implementing regulation that allows for these types of behavioral remedies.

With respect to fines, although the law allows the *superintendencia* to impose fines, the maximum amount of the fines appears to be low. Fines are used to punish violations of the law but also to deter violations of the law. Experience has shown that deterrence is one of the most important benefits of a competition law, especially with respect to *per se* illegal conduct such as cartels. The size of fines should reflect the amount necessary to deter firms from violating the law. If a fine is too low, as is the case here, it will be considered only the cost of doing business.

## 3. Competition Advocacy

Competition advocacy is the ability of the competition agency to provide advice, influence, and participate in government economic and regulatory policies to promote more competitive industry structure, firm behavior, and market performance. All the competition agencies in Latin America have some competition advocacy role within the Government and several (e.g., Mexico) can overrule decisions by other government agencies. International best practices suggest that advocacy should be a priority for new agencies.<sup>78</sup> The implementing regulations could make the provisions in the law more robust.<sup>79</sup> For example, the provisions could allow for a compulsory review of new legislation and new regulations.

### D. SUPPORTING INSTITUTIONS

#### 1. Supreme Court

The Supreme Court is the court of final review, likely including the decisions of the *superintendencia*. The court is organized in chambers, and competition cases are assigned to the chamber that handles commercial disputes. Although the specialized nature of this chamber

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<sup>77</sup> *Ley de Competencia*, Article 14.

<sup>78</sup> For more information on advocacy, including its importance for new agencies, see [http://www.cfc.gob.mx/icn\\_infocenter/](http://www.cfc.gob.mx/icn_infocenter/).

<sup>79</sup> ICN has prepared a compilation of advocacy provisions, which are available on the Internet at [http://www.cfc.gob.mx/icn\\_infocenter/files/Model\\_advocacy\\_provisions.DOC](http://www.cfc.gob.mx/icn_infocenter/files/Model_advocacy_provisions.DOC).



should improve decision-making, complaints about the court abound.<sup>80</sup> The judiciary appears to be highly politicized because of a flawed appointment process, made worse by the appointment of Supreme Court justices for renewable terms of 9 years instead of life tenure. The Supreme Court also has excessive power, with control not only over the interpretation and application of legal norms but also over the administration of the judicial bureaucracy and the selection and promotion of lower court judges, within a regime of life tenure. In light of these weaknesses, it is understandable that certain groups advocate that the Supreme Court be given as limited jurisdiction over competition cases that the constitution allows—for example, by allowing appeal to the Supreme Court on procedural grounds only. Nonetheless, some solution to provide for independent review will ultimately be necessary, for example, by providing for specialized part-time courts.

## **2. Law Faculties**

There are no courses in competition law offered in the law schools in El Salvador. There are a limited number of industrial organization courses offered at universities in San Salvador. Both law and economics classes will be needed for effective implementation of the new competition law.

## **3. Nongovernmental Organizations**

Consumer organizations are active proponents of the introduction of a competition law, but their support is not utilized sufficiently. Consumer organizations could be relied on to conduct outreach promoting the new competition law with consumers and politicians, and they should play an active role in helping to build awareness of the benefits of competition.

## **4. Media**

The media has covered developments in the adoption of a competition law, but reporting demonstrates that a sound understanding of competition law and policy is absent.

## **E. SOCIAL DYNAMICS**

The Salvadoran economy is characterized by liberalized markets, privatization of a number of key sectors, low regulation, and good governance. El Salvador ranks second only to Chile in all

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<sup>80</sup> “[The Supreme Court’s] intransigence and opposition to the prosecution of judicial fraud cannot be understood merely on the basis of shamelessness and self-preservation. The behavior by the Court must also be linked to a series of legal and institutional arrangements which characterize the Salvadoran judiciary today. These elements include: centralized control of the judicial bureaucracy by members of the SJC; confusion of administrative and judicial functions, which allow high court justices tremendous latitude in the allocation of positions and financial resources within the judiciary; near-absolute legal immunity for acts of corruption, incompetence and fraud committed by judges in active service; and the reliance on judicial self-regulation to police even the most egregious forms of judicial misconduct and conflict of interest.” Lothian, Tamara (November 2003), “Priority Areas for Judicial Reform and the Problem of Corruption,” *Fundación Salvadoreña para el Desarrollo Económico y Social* at 13. Available at <http://ksghome.harvard.edu/~rhausma/elsvdr/judicial.pdf> (last visited September 8, 2004).

of Latin America in the Heritage Foundation's Index of Economic Freedom for 2004.<sup>81</sup> In government effectiveness, regulatory quality, and rule of law indicators, El Salvador ranks second in Central America, behind Costa Rica, and performs far better than countries in a similar income category.<sup>82</sup> Despite these positive elements and ongoing market reform efforts, growth rates remain low.<sup>83</sup>

The widespread market reforms have been accompanied by widespread examples of injury to consumer welfare that hopefully will be remedied by the competition law. As Yale University Economics Professor Engel writes, “[d]espite important productivity gains, reforms have benefited consumers much less than expected. . . . Antitrust legislation, consumer protection and an adequate regulation of privatized utilities are central ingredients of a successful market economy. Major reforms are needed in each of these areas. The time has come to focus on institutions that legitimize the market economy. . . .”<sup>84</sup> Professor Engel cites examples from the electricity and telecommunications sector that demonstrate the urgent need to implement the competition law. For example, the only explanation for a 200 percent price increase in the price of electricity in 2000 appears to be an exercise of market power.<sup>85</sup> Although this is the most egregious exercise of market power that Professor Engel provides, he also describes a number of other conditions in the electricity market that suggest anti-competitive conduct as well as conditions that create incentives to exploit—for example, monopsony power.<sup>86</sup> Similarly, there are a number of examples from the telecommunications sector of either actual or alleged anti-competitive conduct. A particular area of concern appears to be interconnection fees charged by the incumbent to new entrants. ITC providers who want to enter the local telephone market have had considerable difficulty obtaining interconnection agreements. Other concerns are

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<sup>81</sup> The Index of Economic Freedom is available by country at

<http://www.heritage.org/research/features/index/countries.html> (last visited September 14, 2004).

<sup>82</sup> Kauffman, Daniel, Aart Kray, and Pablo Zoido-Lobaton (2002), *Governance Matters II: Updated Indicators for 2000/1*, (Washington, D.C.: World Bank), available at

<http://www.worldbank.org/wbi/governance/data.html#dataset2001> (last visited September 14, 2004).

<sup>83</sup> In 2003, growth rates were 2 percent. See The World Bank's statistics, “El Salvador at a Glance”, available at [http://www.worldbank.org/cgi-bin/sendoff.cgi?page=%2Fdata%2Fcountrydata%2Faag%2Fslv\\_aag.pdf](http://www.worldbank.org/cgi-bin/sendoff.cgi?page=%2Fdata%2Fcountrydata%2Faag%2Fslv_aag.pdf) (last visited March 1, 2005).

<sup>84</sup> Engel, Eduardo (December 2003), “A Pro-Market Agenda for El Salvador,” *Fundación Salvadoreña para el Desarrollo Económico y Social*. Available at <http://ksghome.harvard.edu/~rhausma/elsvdr/market.pdf> (last visited September 8, 2004).

<sup>85</sup> “During 1998 and 1999, the monthly average of the spot market price for electricity generation in El Salvador oscillated between \$45 and \$77 per MWh [megawatt-hour]. Yet during the first months of the year 2000, this price began to increase, jumping to a maximum monthly average of \$173.71 in April. A major drought, possibly combined with suboptimal management by CEL (the state-owned company) of its water reservoir, exhausted CEL's ability to generate electricity before the rainy season began. This allowed Duke (a private firm) to set the market price substantially above its marginal cost, thereby tripling the price for electricity generation. This episode made evident the limitations of El Salvador's regulatory framework and, more generally, of regulatory frameworks with bid-based dispatch of electricity units.” Engel at 18.

<sup>86</sup> In the distribution market, for example, one participant accounts for 78 percent of the market. This participant's power is increased by the absence of pass through of energy purchase prices to final users, leading distribution companies to negotiate “good” conditions when purchasing energy on the contract market to keep the difference. Furthermore, the regulatory body, SIGET, cannot monitor prices to determine whether competitive conditions are being met because of rules governing the confidentiality of contracts. Professor Engel continues, “And since distributors can sell to users outside their geographic zone, this means that AES [the participant with 78 percent market share] could potentially use its monopsony power to price out competitors from the entire large-consumer market.” Engel at 16.

prospective, including the recent lifting of a ban on mergers in the telecommunications sector that recently expired, with no competition law or authority in place. Passing a competition law is an important first step in addressing these problems. Now, it is necessary to establish a strong *superintendencia* and appropriate implementing regulations.

Competition law and several microeconomic, industrial, and commercial policies such as privatization, international trade, and foreign investment are among the main instruments needed to nurture market reform. The application and interface between competition law and these related policies can have a significant bearing on industrial structure and the competitive market performance of enterprises in both the private and the public sectors as well as on economic development generally. Competition law and international trade liberalization, for example, complement each other in promoting trade, market access, economic efficiency, and consumer welfare. Promoting the objectives of a liberal trade policy supports the objectives of competition law and vice versa. For example, trade liberalization and competition law together can prevent powerful business interests with monopoly power from creating barriers to trade. Similarly, competition law and privatization interact to ensure that a public monopoly is not merely transferred to a private monopoly. When a sector has been liberalized by introducing new competitors in the market, competition law and its enforcement can fill the primary role of maintaining competition as well as avoiding distortions caused by anti-competitive practices.

El Salvador had engaged in a variety of these market reforms without introducing and enforcing a competition law and as a result was not able to realize the full benefits of these reforms. Actual and alleged anti-competitive practices caused considerable consumer injury, and one of the responses was adoption of the competition law. Now it must create the implementing agency and regulations. More detailed recommendations follow in the next section.

## **F. RECOMMENDATIONS**

If the 90-day requirement for preparing implementing regulations remains, GOES should begin this process in the very near future and take the following steps:

- ◆ Create a drafting committee that includes representatives from different sectors of society.
- ◆ Engage international experts to help prepare the implementing regulations.
- ◆ With a view toward regional convergence/harmonization, consider carefully the competition laws and regulations of Mexico and Panama and consult with the drafting committees in Guatemala, Honduras, and Nicaragua.
- ◆ Consult with sectoral regulators to clearly delineate responsibilities and ensure consistency among regulations.
- ◆ Consider promoting implementation of the competition law and building support for the new agency through the following two-fold strategy:
- ◆ Develop a series of seminars to promote private sector support, focusing on recent experiences—for example, in the telecommunications sector, regional initiatives, etc.

- ◆ Improve understanding in the public sector by holding seminars on the basic principles of competition law for all interested officials and by offering informational workshops with relevant government regulators.
- ◆ Develop a policy strategy to make the law operational, including institutional arrangements (e.g., staffing and training).
- ◆ Develop regional training programs for staff and with universities and bar associations.
- ◆ Continue advocacy initiatives, including reviews of government policies and regulation affecting competition and preparing studies on key sectors.
- ◆ Develop an enforcement strategy that focuses on investigating anti-competitive conduct in sectors that are important to consumers and that address Salvadoran market failures.
- ◆ Promote a competition culture through public communication including preparing communication/media materials; enhancing the capacity of the media in publishing competition-related issues through dialogues/workshops with journalists; and engaging in dialogues/workshops with related law enforcement officers, other government regulators, and the business and academic communities.

## **X. INTERNATIONAL TRADE**

### **A. INTRODUCTION**

El Salvador has the basic international trade conventions in place plus a regional integration commitment and several free trade agreements. Historically, El Salvador has been the most industrialized and densely populated nation in Central America. It has been a member of the Central American Common Market (CACM) since the CACM was founded in 1962, and in recent years it has been one of the CACM's most enthusiastic supporters. Industry represents 24 percent of the country's gross domestic product, compared with only 11 percent for agriculture.<sup>87</sup>

El Salvador became a member of the World Trade Organization (WTO) in 1995. It has free trade agreements with Mexico, Chile, and the Dominican Republic. Most of its exports enter the United States, Europe, and Japan duty-free under generalized systems of preferences unilaterally established by those destination markets. The country's significant level of dependence on manufactured goods, compared with agricultural goods, helps to explain in part the nation's consistent support for Central American economic integration, CAFTA, and various free trade agreements with other nations.

El Salvador imposes no special registration requirements for imports or exports, save on restricted items such as firearms, ammunition, explosives, medications, pesticides, and other items of toxic potential and on agricultural products subject to quotas, such as corn and rice. In essence, its schedule of tariff duties constitutes its only regulation of foreign trade for most goods.

Potentially, although it has no law on competition, the Salvadoran Constitution does prohibit monopolies and could be used against monopolies and monopolistic practices by either national or international concerns, but to date it never has been. Disputes growing out of its international trade generally are subject to WTO rules, also specifically applied through the special chapters in each of its bilateral agreements and by the Central American treaty for issues involving regional partners.

The Salvadoran Customs Service is a vigorous, effective agency that facilitates the movement of goods in and out of the country. Already very competent, it is striving to become more so.

Salvadoran international trade legislation is not highly developed, nor is it an area of the law that gives rise to frequent disputes before Salvadoran authorities. By and large, the country is content to allow international treaties like the WTO and the CACM, which become national law upon their ratification, to fill up the substantive rules that govern international trade. There is a concern that laws in this area need to be fleshed out, and they will continue to be reformed gradually.

As they described during the assessment process, private sector users of the agencies that administer international trade matters in El Salvador seem quite satisfied with current practices. They indicate that, across the board, procedures are handled quickly—in a transparent matter and

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<sup>87</sup> U.S. Department of State, *Background Note: El Salvador*, June 2004 (available at <http://www.state.gov/r/pa/ei/bgn/2033.htm>).

with virtually no corruption. They believe the Government, from the president down, attaches great importance to international trade and generally supports it in every way it can.

Within the Salvadoran government, notably the Legislative Assembly, significant resistance to the WTO, CACM, and freer international trade does exist. Specifically, the political party Farabundo Martí National Liberation Front (FMLN) opposes free trade economic policies and does not agree with the CAFTA. To this point, however, the FMLN has neither the votes nor the representative voice to direct policies in this area.

## **B. LEGAL FRAMEWORK**

**General Environment for Trade** – (See coverage in the International Trade Report for Guatemala for the general framework of the Central American Common Market (CACM) and its applications in El Salvador).

### **1. Domestic Laws**

*Código Aduanero Uniforme Centroamericano (CAUCA) III* and *Reglamento del Código Aduanero Uniforme Centroamericano (RECAUCA) III* have been in force in El Salvador since the beginning of 2003.<sup>88</sup> The country applies regional sanitary and phytosanitary rules through the *Organismo Internacional Regional de Sanidad Agropecuaria* (Regional International Organism of Agroindustrial Sanitation), which includes Mexico, Belize, Panama and the Dominican Republic, in addition to the five CACM countries.<sup>89</sup> In the same way, regional regulations implement rules of origin based on WTO principles. The WTO principles for applying import duties to countervail dumping or subsidies also find application in regional regulations and bilateral free trade agreements.

El Salvador has adopted the Central American Regulations on Unfair Trade Practices and on Safeguard Measures, applying the WTO rules. Nonetheless, while the country theoretically might apply countervailing duties or safeguard clauses when confronted with unfair practices or harmful circumstances from imports, the country has no developed practice in these areas. Attempts to instigate such proceedings have been limited, and have never actually resulted in the application of a countervailing duty or a safeguard against entering goods. There are apparently no practicing lawyers in the country with a specialty in such “trade” matters.

According to local experts, El Salvador recognizes that their national trade legislation is “obsolete” and “dispersed through various sources,” and that there exist “differences between community and local norms.” Since CAUCA III and RECAUCA III are not comprehensive, many gaps need to be filled by national legislation, which has been cited by some interviewees—particularly those with operations in more than one Central American country—as a problem because of the continuing lack of uniformity. However, by and large neither the Salvadoran public sector nor its private sector seems much concerned about that state of affairs. International and regional rules provide a more than sufficient framework to make the system function, and other gaps and inconsistencies in national legislation will be filled when it becomes necessary to do so. As the Salvadoran market is exposed to increased competition from exports, demand for

<sup>88</sup> Available at <http://www.aduana.gob.sv/aduanas/legislacion.jsp>.

<sup>89</sup> See <http://ns1.oirsa.org.sv/>.

more developed laws and procedures for applying countervailing duties and safeguard measures may emerge.

El Salvador has a Law of Industrial and Commercial Free Zones (*Ley de Zonas Francas Industriales y de Comercialización*) that provides a special tax and customs regime for those designated areas, which include significant *maquila*, or assembly plant, operations.<sup>90</sup> Salvadoran business people and merchants believe that in recent years China has gained *maquila* operations by diverting them away from established local interests.

## 2. Tariff Regime

El Salvador applies the Central American Tariff System (*Sistema Arancelario Centroamericano*), a harmonized classification and duty system for the region that implements a common external tariff, applied *ad valorem*. Tariff impositions do give rise to disputes—as a matter of fact, classification and valuation are continuing problems for many importers because of the lack of knowledge of some customs officials, according to several interviewees. There is a separate tariff classification department within the *Dirección General de la Renta de Aduanas* (General Directorate of Customs Revenue; DGRA). However, both DGRA and the private sector agree that the knowledge of customs officials concerning classification (and valuation) varies considerably, and additional technical training is required. Classification and other decisions may be appealed both within customs and before the *Ministerio de Hacienda* and administrative courts.

## C. IMPLEMENTING INSTITUTIONS

The Salvadoran Ministry of Commerce has principal administrative authority for applying tariff laws and duties through DGRA. The Ministry of Economy, through its Directorate of Treaties (*Dirección de Tratados*), has responsibility for applying laws against unfair trade practices, such as exporting subsidized or dumped goods, and other non-customs administrative procedures involving foreign trade.

At present, according to customs, truck shipments—when their documents are in order and “conditions are normal”—clear the border in less than two hours. Although this is exceptional for Central American customs, they believe it can be reduced to 15 minutes. Utilizing a Risk Handling Unit (*Unidad de Gestión de Riesgos*), customs currently inspects only 15 percent of shipments at the border, with follow-up inspections for the remainder after they are unloaded at their internal destination. Not satisfied with this positive performance, again, customs has the goal of reducing border inspections to 10 percent of incoming shipments within the next year.

Customs operations in El Salvador rely on authorized customs agents, *agentes aduanales*, to run smoothly. Agents facilitate generation of proper documents, registration and certification of goods, and payment of taxes. The Directorate of Customs Revenues accepts international certification of goods’ quality and weight, and private local services are accredited to perform such certification.

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<sup>90</sup> Available at <http://www.csj.gob.sv/leyes.nsf/ed400a03431a688906256a84005aec75/cdb9ecad9321c3b60625677500524351?OpenDocument>. Also available at <http://www.natlaw.com/centamcom/es/laws/stescu2.htm>.

The Customs Service in El Salvador relies on a computerized system (based on ASYCUDA/SIDUNEA++) with general access to shippers, customs agents, and other users. Its Web site provides general instructions, the applicable laws and regulations, forms, a consultation service, electronic access to carry out the necessary procedures and filings, and other data and operations essential to moving goods in and out of the country. Interviewees reported that most customs procedures and forms can be completed online, with the exception of bills of lading and required certificates, for which hard copies are necessary. The forms for those documents are also available online, on DGRA's Web site ([www.aduana.gob.sv](http://www.aduana.gob.sv)).

The Ministry of Economy sponsors *Promoviendo El Salvador* (PROESA), an inter-ministerial committee with private sector participation organized in 2000 that aims to attract foreign investment. PROESA aids commercial missions and other promotional activities supported by the same ministry's technical department (see further at [www.proesa.com.sv](http://www.proesa.com.sv)).

#### **D. SUPPORTING INSTITUTIONS**

Consistent with the usual cooperation between the public and the private sector in El Salvador, one of the most active and effective entities in the foreign trade sector is the *Comisión Intergremial para la Modernización de las Aduanas* (CIMA, or Intergroup Commission for the Modernization of Customs). Connected with the Salvadoran Association of Industry and Manufacturing (*Asociación Salvadoreña de Industria y Confección*), CIMA has been effective at arbitrating between customs officials and private enterprise engaged in foreign trade, building consensus regarding the role and operations of customs and related procedures.

The Salvadoran Chamber of Industry and Commerce (*Cámara de Industria y Comercio*), whose members depend on international trade to a high degree, likewise provides a consensus for matters dealing with the trade sector. Its membership roster has provided several cabinet ministers in this and related areas.

Given the importance of foreign trade in El Salvador, it is not surprising to find that trade associations exist for customs agents (*Asociación de Agentes Aduanales Autorizados*, or ASODAA), shipping agents (*Asociación Salvadoreña de Agentes de Carga*, or ASAC), transporters (ASETRA), and cargo handlers (ARENT).

#### **E. SOCIAL DYNAMICS**

Many steps remain before El Salvador will have a complete legal and administrative structure for international trade. On the other hand, the country is advanced well beyond its CACM partners in general commitment to regional and global free trade, and in many ways the five countries that form the Central American region must advance together or not at all. No one country can go too far ahead without imperiling harmony among the five. In addition, El Salvador's foreign trade concerns have focused on promoting and facilitating export operations to the relative exclusion of import controls. It has enjoyed generalized systems of preferences, privileges in industrialized markets for which it did not have to reciprocate by opening its borders.

Both the public and the private sectors realize that, in the long-term, legal and administrative changes must take place in the foreign trade sector. Given El Salvador's demonstrated will and capacity to maintain laws, regulations, procedures, infrastructure, controls against corruption and



inefficiency, and other factors that define operations in the sector at levels that support the country's foreign trade, such changes should prove possible as they become necessary. At present, no one in El Salvador seems moved to lead a crusade on any identified issue. The legal, institutional, and infrastructural frameworks for foreign trade in El Salvador generated virtually no concern from Government or private sector participants.

## **F. RECOMMENDATIONS**

In matters concerning foreign trade, particularly in its infrastructure and the efficiency of its customs operations, El Salvador seems quite advanced, especially within Central America. There are no pressing legal issues in this sector for the foreseeable future. The only appropriate recommendations are quite general—

- ◆ Encourage the current cooperation between the private and public sectors, and take care that it does not abate.
- ◆ Encourage and support the continuing improvement in customs administration and operations, including additional training for customs officials.
- ◆ Monitor the utility and coverage of the legal framework for foreign trade, taking into consideration that the day will come when significant reforms become necessary, including in areas such as internal administration and procedures for applying countervailing duties.

## **XI. FLOW OF GOODS AND SERVICES**

El Salvador has made great strides in facilitating trade over the past few years. It is a leader in the region in its performance of trade facilitation. Indications are that some aspects of the trading system have improved: (1) development of a stronger Customs agency; (2) development of open markets nationally, regionally, and internationally; (3) good working relationships between the public and the private sectors; (4) increases in the security environment; and (5) upgrades in infrastructure.

However, the trade-related institutions still encumber traders with trade transaction costs through delays and administrative burdens. Trade facilitation remains important to El Salvador, because declining tariffs, just-in-time manufacturing, and fierce global competition all make the cost of getting a good from the seller to the buyer more important than ever before. By eliminating the unwarranted and onerous constraints embodied in laws, regulations, and procedures, El Salvador can capture greater savings and efficiencies. In fact, improving the trade facilitation environment can reduce trade costs by as much as 15 percent of the value of traded goods. In El Salvador's market, where almost \$11 billion in goods and services were exchanged in 2003, this can lead to significant savings. In turn, these savings will make Salvadoran exporters more competitive, lead to lower prices for Salvadoran consumers, and enhance El Salvador's overall attractiveness as an investment opportunity.

The following assessment evaluates El Salvador's current status of trade facilitation and identifies areas where El Salvador can further reduce trade transaction costs. The assessment looks at the efficiency and security of cross-border flows of goods, services, people, and money and at the infrastructure that supports these flows. Currently, trade-related people and money flows pose few problems. Major areas where improvement can lead to significant results include further developing the overall capacity of the Customs agency, especially through risk management; better integrating and simplifying processes among border agencies; continuing to enhance the security environment; and establishing a national priority to develop a regional distribution and logistics hub.

### **A. INTRODUCTION**

In 2003, flows of goods measured more than U.S.\$8.9 billion with \$3.1 billion in exports and \$5.8 billion in imports.<sup>91</sup> Service flows totaled over \$1.8 billion with \$930 million in imports and approximately \$782 million in exports.<sup>92</sup> El Salvador's top five trading partners are the United States, Guatemala, Mexico, Honduras, and Costa Rica, with the United States accounting for almost two-thirds of exports and half of imports and other traders accounting for approximately 10 percent or less each.<sup>93</sup> Major products flowing out of the country are coffee, sugar, and textiles. Major products flowing into the country are consumer goods, automobiles, food, raw materials, and capital goods. Although coffee and sugar have been a significant part of the Salvadoran economy for decades, the economy has become more diversified and exports include fish, balsam, textiles, leather goods, clothing, processed food, tobacco, furniture, wood and metal products, and chemicals.

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<sup>91</sup> See <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=SV>.

<sup>92</sup> *Id.*

<sup>93</sup> See, <http://www.sieca.org.gt/SIECA.htm>.

To further facilitate trade, El Salvador must improve the laws, institutions, and operations of its trade-related institutions, including its Customs agency. These improvements will help create modern institutions that are managed, staffed, and equipped to achieve the appropriate balance between facilitation and control. These advancements, in turn, will provide reduced trade transaction costs.

El Salvador's trade-related institutions are making progress in developing more modern and reliable public services through numerous and significant changes to its regulations, organization, and operations. Recent changes include passage of customs simplification laws compliant with international standards, agency integration at border crossings, improvements in customs recruiting and training, streamlining the export process, and increased security. These actions have led to reduced clearance times and trade transaction costs.

Yet, although there has been significant progress, serious obstacles hinder the efficient and secure movement of trade across Salvadoran borders. Major challenges facing El Salvador include further streamlining customs clearance processes, further integrating of border institutions, enhancing risk management, maintaining and improving on recent gains in security and integrity, and addressing border agencies' infrastructure needs.

In this section, we analyze legal, institutional, and operational constraints that impede trade expansion and recommend ways to minimize those constraints. First, our analysis focuses on the legal framework for the primary border institution, Customs. Second, we consider the institutional issues regarding Customs management, organizational capacity, and operations. Third, we review other key public institutions involved in trade facilitation—including the Ministries of Agriculture, Health, and National Police—and their role in trade facilitation. Last, we identify major recommendations to improve trade facilitation in El Salvador.

## **B. LEGAL FRAMEWORK**

The state of the law is one of the least problematic areas for trade facilitation in El Salvador. For trade facilitation, it is most important that the legal and regulatory framework provides an adequate and coherent authority structure for the essential trade-related institutions, and clearly stated regulations and procedures for implementing these authorities that strike the balance between facilitation and necessary control. Overall, El Salvador's legal framework is in place for an orderly and well-functioning trading system. There is adequate authority for Customs and supporting institutions, particularly the national police, and the Ministries of Agriculture, Health, and Economy to perform their functions in facilitating the efficient and secure flow of goods and services. In particular, the law provides appropriate authority for all essential customs activities, including personnel, integrity, procedures, automation, and adjudication. Important areas for legal improvements include implementing CAFTA requirements and addressing penalty provisions.

### **1. Legal Authority Supporting Trade Facilitation**

Despite some legal impediments, the legal framework generally supports Customs management, operations, and procedures. Fundamental provisions that are in place that help speed trade flows and control goods flows, include the following.

There is adequate and coherent authority for facilitating trade flows under Salvadoran law generally. The CACM agreements provide the primary laws and regulations that govern El Salvador's trading system. For the regulation of goods and services, these are CAUCA III and its implementing regulations RECAUCA. Additionally, El Salvador passed laws on simplification and enforcement (1999 Law on Customs Simplification and 2001 Special Law on the Penalization of Customs Offenses). Furthermore, El Salvador has been a member of the WTO since 1995, and, although El Salvador is not a member of the World Customs Organization, it began accession in 2003.

There is also adequate and coherent authority among public institutions. Salvadoran law places authority for Customs under the Ministry of Finance and assigns the General Director of Customs with administering the customs regulations. Other trade facilitation functions, such as administration of quotas, rules of origin, and intellectual property, are delegated to the Ministry of Economy. Primary law enforcement authority lies with the *Polícia Nacional Civil* (PNC, or National Civil Police), which handles all criminal actions related to trade, such as narcotics interdiction, counterfeit goods, tariff fraud, immigration infractions, Intellectual Property Rights (IPR) violations, and corruption. The Ministries of Agriculture and Health handle trade-related food safety and security issues.

The law provides appropriate authority for personnel, including recruitment, training, and retention. The law also includes critical integrity provisions for personnel, such as a written code of conduct that is available publicly; prohibition of bribery, including favors, gifts, and other inducements; and an independent investigative body to enforce the code of conduct and other violations.

The law grants the legal foundation for efficient processing of goods. Salvadoran law requires the electronic transmission of all declarations. Accordingly, electronic declarations are considered to be legal documents. Procedures are standardized, written, and published and generally in conformity with the Kyoto Convention on the Simplification and Harmonization of Customs Procedures. Although not a contracting party to the Harmonized System of Classification, El Salvador is a user of the system. The General Agreement on Tariffs and Trade (GATT) valuation agreement was implemented in 2002, although according to interviewees, El Salvador retained the right until 2005 to value certain goods such as used wearing apparel, used footwear, used vehicles, and used vehicle parts at published minimum values.

The law effectively regulates the security of goods in the trading system by providing coherent and effective provisions for handling restricted goods, and these restrictions are published in manuals.

Salvadoran regulations adequately govern the brokerage community. Brokers are tested and licensed, and licenses can be suspended for a period of time or revoked for cause.

Salvadoran laws are adequate to protect special goods, such as IPR. IPR laws are generally compliant with WTO protection requirements. However, currently there is no protection of data exclusivity for patent holders, which will have to be added to meet anticipated CAFTA requirements.

The law provides an uncomplicated and well-ordered adjudication process for traders appealing Customs actions. The importer has the right to an administrative review of the customs decisions with respect to the valuation, tariff classification, reimbursement of customs duties, admissibility, and other customs issues. Appeals of customs decisions generally are handled administratively, but can be further reviewed at the judicial level.

## **2. Trade Facilitation Legal Issues to Address**

Although the legal framework is not a major impediment for Salvadoran trade facilitation, El Salvador can address a number of specific legal issues to improve the flow of goods.

El Salvador should consider revising customs penalty laws to eliminate the issuance of penalties for clerical errors. Currently, customs law requires and customs officials administer penalties for small infractions. Penalizing small breaches leads to unnecessary delays and frustration among customs officials and the trade community alike.

Customs should amend legal requirements to allow for binding advance rulings. Under CAUCA, the importers are entitled to an opinion on their importation and may request such in writing, providing samples or specifications and any other information necessary for an opinion. Yet, the issued opinion is only for the specific product and use and is made public only when deemed to be of general interest. Improved trade facilitation requires binding rulings so that traders can receive clarification and security in the treatment of their goods.

As noted, CAFTA may compel El Salvador to address a number of trade-facilitation-related legal issues in addition to advance rulings, including rules of origin, express consignments, and sanitary and phytosanitary standards. Proper legal implementation of these requirements will be essential to proper administrative implementation. Timely implementation should help assist trade movements.<sup>94</sup>

## **C. IMPLEMENTING INSTITUTIONS**

As Customs is the major implementing institution for facilitating trade, it is important for it to be managed, staffed, and equipped to achieve the appropriate balance between facilitation and control. A modern Customs administration should have basic organizational capacity, with solid leadership in management, reliable and sufficient equipment, and well-trained staff in appropriate numbers with the ability to execute key functions, such as risk management, payment collection, automation, basic procedures, inspections, public-private sector cooperation, and regional integration.

According to data gathered during the assessment, the Customs Authority of El Salvador is under the Minister of Finance and includes 645 staff. The overall breakdown of personnel is as follows: 94 supervisory, 409 technical, 110 administrative, and 32 service personnel. The main customs sites are San Bartolo, Port of Acajutla, Comalapa Airport, land border crossings with Guatemala (La Hachadura, Anguiatu, Chinamas, and San Cristobal) and Honduras (El Poy and El Amatillo), interior post of Santa Ana, and Port of La Union. Additional personnel are stationed at 16 free

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<sup>94</sup> The Inter-American Development Bank is undertaking a study that plans for legal implementation of CAFTA countries.

zones and 12 duty-deferred areas. Also, personnel are deployed in Guatemala, Honduras, and Nicaragua to support the transition to the Customs Union.

Overall, Salvadoran Customs has made significant progress as major changes have been implemented since 2001, when the current Director General took office. The agency is now a dynamic institution, where corruption has largely been contained. Customs is more efficient and more customer oriented. Customs uses modern customs techniques to perform key functions. Procedures are standardized and conform to internationally recognized quality control standards. However, serious work remains, including improving risk management, tackling budget issues, upgrading infrastructure, and resolving low staffing levels.

## **1. Customs Management and Operations That Support Trade Facilitation**

Not long ago, Salvadoran Customs was seen as a corrupt, bureaucratic, and inefficient organization. Processes were complicated and non-transparent and officers demanded illegal payments. Yet, over the past few years, management has worked to create a modern customs organization that will facilitate trade by creating a stronger institution and streamlined processes that ably move goods. Although there are a number of issues to address, there are a number of positive factors as well, which are detailed as follows.

Customs has a modern management and organizational structure that includes the following divisions: technical, operations, modernization, administration, quality control, enforcement, international affairs, risk management, and a user support unit.

Customs has a management vision that seeks to provide standardized services efficiently, while balancing control with facilitation; most importantly, it works to fulfill this vision through continuous improvements in all processes. Management priorities include stronger personnel competency and integrity, greater technological improvement, and deeper regional integration. Management created a quality control division that performs internal audits to guarantee that procedures are properly carried out. It was reported that the Director General has achieved recognition of his stewardship by receiving a quality management systems rating from the International Organization for Standardization (ISO) for implementation of ISO 9001 standards.

Customs has made gains in improving human resources, personnel, and training. Customs employees are better qualified and more professional because of a number of actions. There is a mandatory background investigation, medical examination, confidentiality agreement, and psychological test. Personnel are recruited through review of their resumes, and technical personnel require a university degree and three months of on-the-job training before officially being hired. When hired, employees serve under a contract, which has an annual review and renewal clause, which provides incentives for continued quality performance.

Customs has improved the integrity of the agency. Recruiting efforts identify high-quality personnel and eliminate undesirable applicants. Training provides staff with necessary ethics instruction. Identification badges and uniform shirts are required for those working with the public. Rotations and other operational systems are in place to diminish the opportunity for corruption.

Import procedures are largely streamlined, particularly relative to other CAFTA members. Import and export declarations must be electronically filed, and there is an Internet-based system for these filings. Fee-for-service filing centers are available several kilometers before the border to allow the exporter/importer to file electronically ahead of time, relieving border congestion and providing for risk analysis review before the goods arrive. Examination of space and equipment is generally adequate. Goods not requiring physical examination or documentation move on quickly after payment. As a result, examination rates are reportedly comparatively low, with a high percentage being cleared on site. For example, at Acajutla port, 60 percent of goods are cleared, and 40 percent move in transit to free zones, warehouses, or international transit. Of the goods cleared at Acajutla, only 10 percent are examined. All these activities make for relatively short processing and clearance times.

Customs' regional cooperation is excellent. Customs is working to integrate operations throughout the region, particularly with Guatemala, through the Customs Union (CA-4) with Guatemala, Honduras, and Nicaragua. Customs officers are stationed at border sites of CA-4 countries for streamlining of current operations and in preparation for final union. Additionally, El Salvador welcomes customs officials to be stationed at its sites.

El Salvador's major processing sites—La Hachadura land border crossing, Comalapa Airport, Port of Acajutla, and San Bartolo inland customs facility—have adequate hours and procedures to service traders, but not staff. For example, during an in-site visit the assessment team learned that the La Hachadura land border crossing, which has as many as 1,300–1,500 trucks moving across borders daily, is open 24 hours a day, seven days a week. This site provides a single-window system for declaration and transit processing, and officials from agriculture, quarantine service, immigration, and police are on site as well. Because of staffing and operations, ten percent or fewer trucks are sent inland for examination or final clearance.

Security of major customs facilities is largely adequate. For example, at La Hachadura, traffic is tightly controlled and the site is one of the least congested in Central America.<sup>95</sup> Consequently, the area is clear of loiterers and appears to be a very efficient operation. The Port of Acajutla appears to be well secured as well, as it is guarded by national police and there are numerous checks when passing through the port.

The risk-management system is sufficient and, within the region, it is first rate. This automated system is available 24 hours with either a dedicated phone line or a satellite link. The system randomly assigns an examining officer, which lowers the opportunity for corruption. Examination rates have decreased, and discrepancy rates have increased. Overall examination rates are now reportedly less than 20 percent, and about 20 percent of all declarations are provided electronic release without presentation of documents.

El Salvador has a postverification function performed within the Ministry of Finance (a unit charged with auditing all tax matters including customs tariffs). This unit performs postverification on specific transactions or postaudits on multiple transactions. Persons knowledgeable in this area reported that approximately 750 specific and multiple postaudits

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<sup>95</sup> Reportedly, there is a 15-minute time period from the time truckers log in at the gate to the time they must log out or justify the extra time spent or pay substantial parking fees.

occur annually. Findings result in a 70 percent discrepancy rate. Most problems appear to be in the area of free zones and tax-deferred schemes due to poor inventory controls.

Customs has an adequate information technology system in place, which is based on ASYCUDA/SIDUNEA++ with some in-house development. According to interviewees, customs headquarters is connected to customs posts through satellite communications links. The communications system is adequate, with backup dedicated lines should the satellite link fail. In-house development of modules includes the transit control module, which was installed in 2002, and the used-vehicle control module, which has a red book database of values.

Customs coordination with other public agencies is excellent. In most cases, officers at the borders work in the same office using a single window concept for processing commercial cargo. Moreover, the agencies are working to further integrate processes. For example, an electronic interface is being developed with the Ministry of Agriculture.

Customs cooperation with the private sector is very good. Salvadoran customs has been meeting with the private sector for the past seven years under the auspices of the *Comisión Intergremial de la Modernización de Aduanas* (CIMA). CIMA is the most continuous and active public-private sector trade facilitation committee in the region. Customs' achievements include a series of training sessions regarding all new customs procedures and changes; information posted on the Web site through announcements and an e-magazine; direct public outreach when necessary through television, radio, and newspapers; and regularly scheduled meetings to discuss and resolve issues of mutual concern with parties in the public and the private sectors. As a result of these actions, customs is considered one of the most responsive public agencies.

## **2. Customs Management and Operational Issues to Address**

The following issues provide a discussion of major challenges and impediments for customs to address and to improve the flow of goods.

Although El Salvador has an advanced risk-management program relative to the region, more can be done to improve this function, and this improvement can have significant effects on customs as a whole. Salvadoran Customs needs to deepen its understanding of its trading profile so that it can more accurately target potential problems and ease its control over compliant users. Better knowledge of trade will foster a better and more efficient application of customs' limited resources. Also, Customs will need better software and hardware to improve this function. Current software is inadequate to perform higher-level risk management. Last, customs will have to deepen the expertise of the risk-management unit to implement the system.

El Salvador makes much of the resources it has but faces serious funding issues in a number of key areas that impede further reform. Funding shortfalls most significantly affect staff levels and equipment for security and lab analysis. With regard to personnel, it was reported that the agency is unable to pay adequate salaries for all employees. Because of budget constraints, many officers work 16-hour shifts for 8-day periods followed by 8 days off, and the agency is unable to pay overtime. Moreover, housing is provided only to officers at foreign sites; living conditions at border sites are substandard and often lack basic needs. Unresolved personnel issues like this have the potential to lead to a resurgence in corruption. With regard to security, customs lacks



quality examination tools for inspectors and security cameras for key sites. The provision of tools and training in modern techniques of cargo examination will lead to faster, less-intrusive searches with better results. With regard to lab equipment, on-site visits revealed that customs needs improved laboratory equipment for its two-person staff, which analyzed 1,374 samples in 2003. Current lab equipment is outdated, and resource materials are needed as well.

Although much has been done to streamline trade processes, more can be done. A system similar to the streamlined export process, *Centro de Trámites de Exportación*, or CENTREX, should be created for imports. In addition to the legal revision regarding penalties, procedural mechanisms should be put in place to eliminate the issuance of penalties for clerical errors and to facilitate filing of appeals. Also, it is important to develop free-zone implementing regulations and procedures to avoid inconsistencies in customs processing.

Salvadoran customs must upgrade its technology to further improve the flow of goods. Currently, there is no electronic notification by Customs that goods are released (although the broker can be notified by phone). There is no electronic manifest capability, although it appears this function is being developed. Integrating customs systems with neighboring Honduras and Guatemala is also important, and work is under way with Guatemala. The electronic system software needs additional capabilities.

El Salvador needs to create greater personnel specialization depth. In addition to the risk-management unit, there is a division that is responsible for value, tariff, laboratory, and auction of goods. There is some expertise within the tariff and valuation areas for major industry sectors. There is a requirement for more training in the area of customs valuation, IPR laws and detection, and origin verification. This is the group that will take over actual verification of the certificates of origin if that responsibility shifts from the Ministry of Economy to the Ministry of Finance. Assistance or training in the area of valuation and particularly in the area of origin criteria, regional content, and verification is needed if the origin function is transferred to Customs.

Customs currently lacks capacity and authority over rules of origin. Administration of rules of origin lies mainly with the Ministry of Economy. Customs' role is relatively minor. There is a serious lack of capacity in rules-of-origin administration across all levels: institutions, procedures, staffing, and training. Few customs agency and economic ministry individuals have significant knowledge or technical training in most substantive and procedural aspects of rules-of-origin operations. Salvadoran officials have little training in or knowledge of the substance and applicability of the GATT/WTO Agreements on Customs Valuation and Rules of Origin, which are essential to conduct rules-of-origin analysis. The organization of these institutions is poorly structured to manage and administer its rules-of-origin obligations. A restructuring of the administration and training on rules and verifications processes will be mandatory.

Current procedures pertaining to express shipments present major problems to traders. Expedited direct delivery procedures technically allow for same-day processing of some packages. However, delays are persistent for a number of reasons: (1) a lack of standardization and uniformity in customs processing because there are no implementing regulations; (2) custom's operating system and the companies' electronic manifest files are not linked, which leads to the use of hard copies of manifests presented in advance of arrival for processing; (3) no allowance

for grouping of low-value transactions; and (4) excessive numbers of administrative penalties for unintentional minor errors or admissions. Some simplification and compilation of declarations and an electronic interface must be achieved.

## **D. SUPPORTING INSTITUTIONS**

### **1. Public**

Although Customs is the main implementing institution for the movement of goods, an efficient trading system relies on an interdependent process that includes other trade-related public sector institutions and the users of the system. Their capacities and performance can result in significant costs (or savings) within the trading system, and optimized trade facilitation depends on their active involvement.

Major public institutions involved in trade facilitation include the following: Central Bank; Ministries of Agriculture; Health and Economy; PNC; OIRSA (*Organismo Internacional Regional de Sanidad Agropecuaria*), the regional agricultural standards body; and CONACYT (*Consejo Nacional de Ciencia y Tecnología* (National Board of Science and Technology)), the national standards board. Each of these plays a role in the trading system and each has a significant impact on trade transaction costs.

Although many bureaucratic procedures need to be eliminated to reduce costs and delays, there are operations that could serve as regional “best-practice” models. For example, CENTREX provides a model one-stop export method. Also, CONACYT provides an essential service assisting the private sector in adopting international standards. Major issues involving Salvadoran supporting public sector institutions include simplification of import processes, increased modernization efforts, public sector partnerships to streamline trade processes, public-private partnerships to resolve problems, and reform of user-fee funds.

#### **a. CENTREX**

The concept for CENTREX, a one-stop processing center for exports, was initiated in 1977 under the administration of the Ministry of Economy. However, according to interviewees it was not until it was transferred to the Central Bank in 1999 and additional features were added, like Internet access, linkage to the customs processing system, and now connection to the Guatemalan customs system that it evolved into a modern, cost-effective, facilitative and efficient infrastructure for export processing. All exports, about 12,000 per month, are processed through this system. The only export permits required relate to processed food, agriculture, and plant products.

### **1. CENTREX Operations That Support Trade Facilitation**

CENTREX is largely a positive model for El Salvador and the region. Its creation eliminated long, unnecessary delays through multiple visits to various agencies. Highlights of the system include the following:

- ◆ CENTREX consolidates all necessary approvals among various agencies into one. For example, when exporting agricultural goods, CENTREX produces the required permit

online. The system also controls quantity and company verification and authorization of merchandise subject to foreign quotas.

- ♦ CENTREX has a simple, straightforward interface. Any firm registered with the state as a legal export entity can open an account with CENTREX. The exporter then transmits the required data to CENTREX, which alerts the exporter to any other agency requirements.
- ♦ CENTREX has streamlined the time required for the export review process from days to minutes. Reportedly, response time from this agency is 1 to 2 minutes, making the total processing time less than 5 minutes. When completed, the transmission is electronically passed to Customs.

CENTREX is an example of appropriate use of user fees. The system largely funds its own operations. Through a \$4 processing fee, 70 percent of CENTREX's small staff (12 people) and reliable operations are self-funded. Traders are content to pay the fee because they are satisfied with the service.

## **2. CENTREX Issues to Address**

Although CENTREX is a positive story, it needs to be further developed and expanded elsewhere, including the following project. The Ministry of Economy has authorized CENTREX to expand its system to include imports, which purportedly amount to about 33,000 transactions per month. The system will provide linkage with the border agencies. The first phase is set for implementation in early 2005. The proven experience and success of the CENTREX export operation make it the logical conduit for one-stop import processing, although imports are a more complex undertaking.

### **b. Ministry of Agriculture**

The Ministry of Agriculture (Agriculture) plays a key role in trade facilitation. Although progress has been seen and the trade community views the agency as a helpful partner, more has to be done to simplify and automate procedures, unify functions with those of the other border agencies, and upgrade the quality of its technical personnel.

Agriculture oversees and enforces all sanitary and phytosanitary (SPS) requirements for the importation and exportation of unprocessed animal and vegetable products. This role includes inspecting and certifying all foreign facilities that export these products to El Salvador and issuing import permits for each applicable shipment. Agriculture also provides export certifications for Salvadoran products as required by the receiving country. According to information gathered during the assessment, agriculture has a roughly 32-person staff at the air, sea, and land border posts, who conduct inspections to ensure products are free of disease and pests.

### **1. Ministry of Agriculture Operations That Support Trade Facilitation**

Agriculture has taken a number of positive steps, including the following:

- ◆ Agriculture is automating its processes. Soon most permits will be able to be submitted electronically and the authorizations transmitted to the customs operating system. This will significantly reduce processing time.
- ◆ The export certification process is efficient, although still manual, and is incorporated into the one-stop CENTREX processing center by having Agriculture officers on site.
- ◆ Corruption appears to be largely under control. Agriculture is making a sincere attempt to eliminate corruption by encouraging the trade community to report solicitation of bribes and by promptly investigating reports of corruption.
- ◆ Border delays due to laboratory analysis are few. Agriculture employs some risk management in the inspection process, which leads to fewer and more targeted inspections. When analysis is required, laboratory equipment for routine examination is available at the border points with only the more unusual items having to be forwarded to the central laboratory in San Salvador. It was reported that central laboratory analysis delays goods for 2 or 3 days.
- ◆ Agriculture personnel skill levels are generally adequate. According to interviews and on-site visits, field inspectors receive additional training one or two times per year, some of which is provided by OIRSA (the Central American regional organization for plant and animal health), IICA (the Inter-American Institute for Agricultural Cooperation), and the U.S. Department of Agriculture (USDA).
- ◆ Relations with the trade community are good, with complaints and concerns generally addressed effectively. Agriculture is a member of CIMA, the private-public sector group working on modernization of Customs and other public agencies.

## **2. Ministry of Agriculture Issues to Address**

Agriculture plays a key role in trade facilitation because of the high percentage of agriculture as a part of El Salvador's trade. Further refinements, in areas like the following, can have significant cost impacts:

- ◆ Individuals and businesses that use the system reported that the current process for obtaining import permits is overly burdensome. Permits can be obtained only at the Agriculture headquarters office in San Salvador by submitting hand-carried paper documents. A \$6 fee must be paid in advance and authorization takes 5–20 minutes.
- ◆ Access to user fees by Agriculture needs reform. According to interviewees, fees collected for these services are dedicated to the 15 employees in the unit and operating expenses. However, because of the lengthy bureaucratic process required to obligate these funds, much of the collections revert to the general treasury. This process must be streamlined so Agriculture can use the fees to implement necessary modernization strategies.
- ◆ A comprehensive personnel system is necessary to aid Agriculture in meeting established international SPS inspection standards. Although Agriculture reportedly is preparing a

plan to upgrade the qualifications, recruitment, and performance standards of the inspectors, it needs technical assistance to develop a comprehensive personnel system.

- ♦ To exercise the proper controls to safeguard its citizens yet facilitate trade, the agency must integrate all aspects of its import and export processing, including the laboratories, into one modern electronic operating system with linkage to all other agencies regulating the import and export process. This reform should include an upgraded risk-management system.

Central American SPS laws and requirements must be harmonized. Although the laws among the five Central American countries are generally standardized, the procedures and requirements regarding implementation vary significantly. Shippers to the region list this as a major priority. Yet, committees have been working toward standardizing procedures for many years with little success. The many reasons for this include limited number of qualified SPS specialists within each country who can work on the project, lack of political will to accomplish the task because of the desire to use SPS issues to grant unwarranted protection to domestic producers, and lack of continuity in personnel and policy at the executive level to pursue this long-term goal in a consistent manner. Outside pressure will be a necessary catalyst to move this forward.

### **c. OIRSA**

OIRSA is a Central American regional organization instituted more than 50 years ago to assist the national ministries of agriculture and livestock with implementation of effective SPS controls. Its role varies depending on the needs of the individual country. Research performed across the region revealed that while in Guatemala and Honduras, OIRSA conducts all border inspectional services, in El Salvador, 20 inspectors posted at the borders perform only quarantine and fumigation functions, when ordered by the national agricultural inspector.

#### **1. OIRSA Operations That Support Trade Facilitation**

OIRSA plays a positive role in trade facilitation, yet its actions need to be supplemented—

- ♦ In addition to inspection tasks, the agency provides technical assistance and training to Agriculture personnel and producers. It also assists Agriculture in risk profile development and prepares programs and campaigns to control and/or eradicate pests. OIRSA also operates a special laboratory for analyzing pesticides in El Salvador that is used by producers and the Ministry of Agriculture.
- ♦ OIRSA's user fees are reasonable and reinvested in its core role. Fees for quarantine services vary depending on the product. According to interviewees, OIRSA charges about 10 cents per 100 pounds for fumigation of grains imported through Acajutla and from \$20 to \$40 per trailer load for products at the land border. Roughly 60 percent of these fees are used to fund the inspectional operations in El Salvador and 40 percent are dedicated to technical assistance projects and programs within the country.
- ♦ The agency is a valuable and effective working partner of the El Salvadoran Ministry of Agriculture and performs essential services to producers and exporters.

## **2. OIRSA Operational Issues to Address**

OIRSA underutilization is the chief issue going forward. The agency is a good example of regional cooperation and deals with recognizably sensitive issues, but it needs to be more effective. Its role can be strengthened to help further regional harmonization and standardization. For example, OIRSA can play the lead role in developing a regional risk-management system for agriculture commodities.

### **d. Ministry of Health**

The Ministry of Public Health and Social Welfare (Health) is responsible for the control and safety of all processed food products and pharmaceuticals that are sold in the domestic market—imported, domestically produced, or exported. The Health unit involved in trade consists of a 35-member team: 25 work in the laboratory with 10 in the administration of registrations and permits. Import and export processed food products and pharmaceuticals must be tested and registered with Health before they can enter or exit El Salvador. For an export product, the Environmental Safety Department (DSA) must approve the sanitary conditions at the processing plant in addition to the product analysis.

#### **1. Ministry of Health Actions That Support Trade Facilitation**

Although generally in serious need of attention, the ministry conducts a few activities that support trade facilitation—

- ◆ According to information gained during the assessment, product registration is not overly expensive. Registration fees are \$35, with an additional \$100 to \$150 assessed for laboratory analysis.
- ◆ Fee soon will be accepted on site at registration.

#### **2. Ministry of Health Issues to Address**

Health is the least progressive and modern of the border agencies, and there is little positive to say about its role. Issues to address include the following:

- ◆ Health's processes need to be streamlined to reduce delays. Although the agency is now undertaking a study on how to expedite its procedures, there does not appear to be a real impetus to accomplish this goal or an understanding of the need to link electronically with its users or other border agencies to facilitate the process. First, blanket permits covering an extended period of time (i.e., annual) should be offered. Currently, permits are required for each import. Second, a comprehensive automated system with electronic interface with the trade for the filing of requests for permits and registrations should be implemented.
- ◆ Health must upgrade the speed and quality of its service. Complaints were registered about applications rejected for minor errors and inconsistency among the review staff.
- ◆ An effective partnership with the private sector must be developed as part of any modernization strategy. Unlike customs and agriculture, the trade community's

involvement in Health's modernization efforts appears to be minimal. They are not viewed as partners in trade facilitation, and the agency meets with the traders only when there is a particular problem to resolve.

- ◆ Access to user fees for Health services needs reform. Similar to the fee issues at Agriculture, because of the burdensome and lengthy bureaucratic procedures involved in approving expenditures from the user-fee fund, collected fees often revert back to the general treasury. This diversion of funds impedes modernization efforts.
- ◆ Health lab services need upgrading. The lab is not certified to conduct all product analysis. The ministry is working with CONACYT for full accreditation. Technical training and equipment need upgrading. For products that require more complex analysis, such as genetically engineered products, lab analysts need more training. Also, more modern equipment is necessary to eliminate the current need to retest products because of incorrect initial findings. Often when this occurs with U.S. products, the local USDA representative must intervene on behalf of the importer to get satisfactory resolution.

#### **e. Law Enforcement**

El Salvador's primary security authority resides with the PNC, and customs has no law enforcement authority over the flows of goods, people, or money. The Financial Police (FP), a section within the PNC, handle commercial-related activities in El Salvador's law enforcement activities, including criminal violations of customs laws. They are present at border sites when customs conducts examinations, but they do not participate in or initiate examination unless there is reason to believe there is a criminal violation. In addition to a presence at the border, the FP maintain checkpoints along the roads, where they have the authority to stop goods and review documents, including transit cargo. Their authority also allows them to detain, arrest, investigate, and conduct surveillance. They also cover certain border areas designated as blind spots that are believed to be routes for smugglers. The anti-narcotics section of the police handles narcotics. El Salvador is a narcotics transit country. Cocaine and heroin are the primary drugs moving through the country. The Pan-American Highway and Pacific maritime routes are key channels, as are Salvadoran commercial passenger flights.

#### **1. Law Enforcement Operations That Support Trade Facilitation**

The PNC play an important role in trade facilitation and their activities produce direct results for the facilitation of trade—

- ◆ The PNC reportedly have adequate forces and operations to address the movement of illegal goods. The FP has seven units and 863 officers. In comparison, Guatemala has 117 officers assigned to these tasks.
- ◆ El Salvador helps maintain control through checkpoints along major roads. Law enforcement also covers certain border areas designated as blind spots that are believed to be routes for smugglers. During stops, law enforcement checks for illegal entry of merchandise and people, investigates IPR violations, and verifies that transit goods are properly cleared and invoiced. FP may break customs seals when goods are moving

under seal, but they must notify Customs for Customs to reseal the goods. FP are trained in vessel and aircraft searches.

- ◆ Within the FP, there is a unit that handles intelligence and risk analysis services and exchanges information with Customs and Agriculture. According to information gathered during the assessment, this unit has identified 56 green border areas, 3 of which are highly vulnerable to smuggling. The Anti-Smuggling Brigade, the unit of the FP dedicated to patrolling these areas, currently has 40 officers. Because complaints of smuggling of items such as cheese continue to be received from the trade community, this staff will soon double.
- ◆ Law enforcement actions have had mixed results. In 2003, the FP referred 463 fraud cases and 28 IPR cases to the prosecutor's office. According to interviewees, none resulted in prison terms for the offenders because of the present Customs law that permits the accused to pay the lost revenue plus 300 percent before sentencing to resolve the issue. In 2003, Salvadoran law enforcement assisted U.S. authorities on cases that led to the U.S. indictment of six major foreign drug traffickers, and PNC increased their seizures of heroin. The U.S. State Department found that El Salvador's "law enforcement efforts in 2003 were adequate, given resource constraints and legal shortcomings, and in some areas represented an improvement over past years."
- ◆ The FP works with the trade community. The FP are represented in CIMA, the public and private sector group for Customs modernization. The division has also developed a good partnership with the trade in soliciting intelligence on smuggling schemes. However, the overriding issue within Central America remains transport security, although the problem is less prevalent in El Salvador.
- ◆ Regional cooperation is not great, but it is improving. In 2003, a regional office of the International Criminal Police Organization was established in El Salvador.
- ◆ Goods that are either prohibited or restricted, requiring permits from other agencies, are controlled through Customs or other agencies that are either on site or issue permits. Arms are under the jurisdiction of the Ministry of Defense and require permits.
- ◆ The Government recognizes its IPR enforcement deficiencies and is taking steps to improve its performance. A special department, Crimes Against Private Property and Intellectual Property, was created within the Attorney General's office with five prosecutors assigned to work exclusively on IPR crimes. A special IPR enforcement unit within the PNC was also created to locate and seize the violating material and conduct the investigation. The assessment team learned that the number of raids conducted by this unit is slowly rising, for example, from 120 in 2001 to 136 in 2002. Last year the PNC sent 28 IPR cases to the Attorney General for action. However, none resulted in significant penalties assessed or imprisonment of the offenders.
- ◆ The United States has been active in supporting Salvadoran anti-narcotic efforts. Through the International Criminal Investigative Training Assistance Program, the United States has reportedly provided approximately \$32 million in non-lethal equipment and training since 1992. The United States has provided funding for operational support, a mobile ion-scan machine, and essential equipment for border police. Other U.S.-funded projects



include training related to airport security, money laundering, maritime boarding operations, and antigang measures; U.S. Drug Enforcement Administration officers work closely with the antinarcotics police.

- ◆ The Anti-narcotics Division is trained in container and trailer examinations and in interviewing and interrogation techniques. The Anti-narcotics Division is equipped with basic examination tools, such as density meters, mirrors, and probes.

## **2. Law Enforcement Issues to Address**

Sadly, security remains a top issue for trade facilitation in Central America and especially in El Salvador. The following issues deserve priority attention:

- ◆ Security is a regional problem that must be addressed on a regional basis and all national PNC units have been directed by the Government to work with their regional counterparts to develop a regional strategic plan to strengthen transport security by December 2004. The first element will be sharing intelligence information between the countries. This needs reinforcing.
- ◆ PNC's database needs to be expanded to better target field efforts and link electronically to both the field offices and other intelligence services.
- ◆ Although officers received basic investigative training at the PNC Academy, more is needed for the complex conspiracy and Customs cases. Additionally, more training is needed in conducting undercover and surveillance operations. Other training priorities include container and trailer examinations, interviewing and interrogation techniques, and equipping more officers with basic examination tools, including density meters, mirrors, and probes.
- ◆ Although integrity efforts have been improved, corruption at the border between the PNC and criminals is said to be still occurring. Efforts to eliminate these activities are critical.
- ◆ El Salvador must make some significant changes in the way it enforces and protects IPR rights to comply with CAFTA. For trademark and copyright infringing material entering or exiting the country, the point of interdiction and enforcement must be moved to the border. This will require access to the Registry of Intellectual Property for both Customs and the PNC as well as training, preferably by institutions such as the Anti-Counterfeiting Coalition, the Business Software Alliance (BSA) and the International Intellectual Property Alliance, in the detection of infringing material. Such training must reach all countries in the region.
- ◆ In the case of IPR, the lengthy court process and corruption within the judicial branch often require the owner of the trademark or copyright to come to some informal agreement with the violator.

### **f. CONACYT**

CONACYT assists the Government and trade community in developing and implementing international industry standards. Entrepreneurs from diverse economic sectors as well as

government and university representatives serve on its board of directors, which is presided over by the Ministry of Economy.

## **1. CONACYT Operations That Support Trade Facilitation**

CONACYT assists trade facilitation through the following activity. The agency's role includes accrediting laboratories, drafting or reviewing operating standards to ensure compliance with international norms, training private and public personnel in the application of these standards in their work areas, and compiling a database of current international standards and informing the trade of their existence and the need to comply.

## **2. CONACYT Issues to Address**

CONACYT could further assist trade facilitation through the following activities:

- ◆ CONACYT is an important player in the regional harmonization of procedures and needs to be strengthened to function in this role.
- ◆ Salvadoran traders suffer from a lack of information from the appropriate U.S. public agencies as to industry and product standards they must comply with to compete in the U.S. market. CONACYT can be instrumental here.
- ◆ A comprehensive national quality control program to ensure producers successful entrance into the international marketplace is needed in El Salvador.
- ◆ CONACYT is the logical state entity to develop and implement this project.

## **2. Private**

Trade facilitation is a major priority for El Salvador's private sector. From importers to exporters to transportation providers to customs brokers, the entrepreneurial and hard-working spirit of Salvadorans is strong and evident. Business people are aggressive in pursuing opportunities. Business organizations that support traders are knowledgeable, efficient, and cost-effective in providing essential services. The very number of such groups and the high level of advocacy they perform are indicative of the high level of evolution of the business community. Parties have worked diligently to develop and maintain an effective working partnership to support each other and to participate in the development and modernization of trade policies and practices in the public sector. However, El Salvador needs to upgrade basic business skills, such as information technology capabilities, record keeping, English proficiency, and quality standards, especially in SMEs.

### **a. Importers and Exporters**

El Salvador has made significant progress in reforming its policies regulating trade and opening its markets in the last decade. However, the resultant steady growth in the economy has now slowed and importers and exporters are looking to CAFTA to reenergize their sectors. Much effort had been made by both the private and the state sectors, often aided by the donor community, to diversify exports, promote El Salvadoran products abroad, and prepare the sector to meet the international quality standards needed to compete in the global market.

El Salvador has a vibrant and relatively large trading community. For example, according to persons knowledgeable of the situation, there are 1,500 registered exporters in El Salvador, with 700 consistently active. The textile apparel industry is the sector's largest player, is an importer as well, and contributes about 90,000 direct jobs to the economy, operating at about 150 *maquila* (assembly) plants and 20 full processing companies. Although this work represents most of the free-zone activity, most textile operations occur at inward processing warehouses. The latter enjoy the same benefits as a free zone while located outside the zone's territory.

## **1. Import/Export Community Efforts to Improve Trade Facilitation**

Importers and exporters promote the issue of trade facilitation through the following activities:

- ◆ An extensive network supports the importing and exporting community. For example, the *Asociación Salvadoreña de la Industria de la Confección* (Salvadoran Assembly Industry Association, or ASIC) represents about 150 producers in the textile apparel industry, most of whom are SMEs, employing 30 to 100 workers.
- ◆ The associations provide key services to industry. Associations conduct industry training on safety and security, host programs on receiving international certification on labor conditions, and serve on various broad-based trade associations, such as CIMA.
- ◆ The associations provide a key advocacy role in trade facilitation. For example, COEXPORT (*Corporación de Exportadores de El Salvador*), the Corporation of Salvadoran Exporters, is the major organization representing exporters. According to interviewees, COEXPORT's relations are viewed as excellent with the pertinent public and executive levels of Government in advocating on behalf of its 300 members representing all sizes and sectors.
- ◆ The agricultural sector is presented with some unique challenges if it wants to enter the export market and is working to overcome these challenges. Although there is an eagerness to participate in the opportunities presented by CAFTA, the industry generally is not well educated on the free trade agreements, rules of origin, and international—in particular, U.S.—SPS requirements. A current USAID project is addressing this issue.
- ◆ Steps to address the other major problem of the long waiting period (five years) to secure approval to introduce a new agricultural product into the U.S. market are also being taken. The USDA and El Salvador's Ministry of Agriculture have agreed to work together to conduct pest risk assessments on seven new products. USDA will train Ministry of Agriculture technicians in the process, strengthening the agency's ability to perform such analysis. The goal is to create a regional center for pest risk assessment testing in El Salvador that will significantly reduce analysis time. In addition, a U.S. APHIS (Animal, Plant Health Inspection Service) representative will soon be stationed in El Salvador to educate and assist the agricultural sector in meeting USDA standards.

## **2. Import/Export Community Issues to Address**

The issues for this important sector are twofold: (1) the overriding issues that the community faces broadly, and (2) those everyday processing difficulties with Customs and other agencies that impede facilitation—

- ◆ Technical skills of the private sector must be improved (i.e., marketing, accounting, operations). Universities and the National Training Center should identify and address these needs. The technical needs of the SME sector must be emphasized; reportedly only a small percentage of SMEs have information technology capability.
- ◆ Coordinate and integrate the approximately 20 programs directed at assisting exporters. Exporters need a one-stop window to access all information and services available to them. Such consolidation would reduce duplication, pool funds, identify projects for better strategic targeting, and result in more effective use of limited resources.
- ◆ Create a business information Web site where all the many organizations representing the business sectors would input ongoing activities and issues they are addressing. The site must be easily accessible to importers and exporters and segregate information by topics of interest. Either the Ministry of Economy or a private organization such as ANEP, could be designated to design and oversee such a site.
- ◆ Improve product quality through the development of a national quality control program, under the auspices of the university sector and CONACYT.

## **b. Customs Brokers**

El Salvador's customs brokers are considered among the most professional in Central America. The country requires the use of a customs broker only for imports from outside Central America. Customs reportedly has licensed approximately 120 individuals to perform this function in addition to about 600 customs empowered agents (AEAs), who are employees of traders licensed by Customs to do work only for their particular company.

### **1. Brokers' Efforts to Improve Trade Facilitation**

Brokers assist trade facilitation through the following activities:

- ◆ The AEA is a Central American concept that generally is used within the textile industry and offers a lower-cost alternative to hiring the services of a customs broker for each transaction. Customs tests AEAs only on the specific product area their firm imports and exports, and the license is valid only as long as the individual stays with that firm.
- ◆ Brokers generally have high professional standards. Applicants must have a university degree, no criminal record, and 3 years of experience in the field before they qualify to take the Customs-administered examination. Customs renews licenses yearly and uses this mechanism to review past performance. According to interviewees, no revocations or suspensions were initiated by Customs in 2004. Customs and the trade community believe brokers are highly professional.
- ◆ Brokerage fees are competitive with those of other Central American countries. The fees range from \$35 to \$75 per transaction.
- ◆ Brokers have an effective professional organization. The *Asociación de Agentes Aduanales Autorizados* (ASODAA), or the Salvadoran Association of Customs Brokers, is a 35-year old organization that represents almost all licensed brokers. According to

persons familiar with the organization, every 2 months ASODAA tests its membership to determine training needs and then works to provide that training. ASODAA is a member of the Central America, the America's (ASAPRO), and the international (*Consejo Nacional de la Cultura*, or CONAC) broker associations.

- ◆ ASODAA is considered an effective partner in the facilitation and control of international trade. For example, ASODAA either assists in drafting new regulations or reviews them before implementation.
- ◆ ASODAA opened eight service centers in response to a request from Customs to facilitate the movement of merchandise within Central America with the advent of the Customs Union. Although their services are optional, interviewees explained that 70 percent of the shippers moving cargo between El Salvador and Guatemala, even those who have hired the services of a licensed broker, are processed and reviewed at these sites. For a maximum fee of \$8.00, the papers are brought by the driver to these centers located just before the border in the exporting country. ASODAA staff verifies that the information is complete and that the declared value and classification are correct, conducts an examination if it questions the description, processes the shipment through the customs system including selectivity, and alerts customs of any suspicious activities. Representatives of the other border agencies are also present to review permits. The shipment then moves to the customs office in the receiving country for acceptance and review. Although the trade is opposed to this concept and thinks the brokers are assuming custom's responsibilities, this novel approach has expedited processing at the border and reduced customs staffing demands. The fact that it is an optional service must be continually publicized.
- ◆ Another organization representing customs brokers, AEAs, and other private customs auxiliaries is *Asociación de Profesionales de la Función Pública* (AFPA), a 3-year-old organization with 35 members that was created to address issues with customs from a wider platform and to work toward establishing higher education programs for people wishing to work in these fields. El Salvador has no current university programs related to customs brokerage work, although a 7-month program in the field is now operational.

## **2. Brokers' Issues to Address**

Brokers could further assist trade facilitation through the following action: consideration should be given to allowing the AEA license to be carried with that individual as long as he or she is employed in the same sector.

### **c. Free Zones**

El Salvador has 16 active free zones that operate under the 1998 Law of Industrial and Trading Free Zones. This law also regulates the inward processing warehouses, which are operator-owned assembling or manufacturing plants located outside the zone territory but subject to the same privileges. The Ministry of Economy oversees the operators, and Customs is on site to process the user's inbound and outbound shipments. The operator is both developer and administrator of the zone, promoting business, building facilities to suit the user, approving the

applications, and granting the benefits to the client. The lease between the user and operator generally runs for five to seven years.

## **1. Free-Zone Efforts to Improve Trade Facilitation**

Free zones support trade facilitation through of the following activities:

- ◆ Security is excellent. Zones generally are well protected through a physical and manned security arrangement. As a result, there is little or no pilferage.
- ◆ Costs of the free-zone services are competitive. Free zones offer the basic infrastructure and reliable services for industry.
- ◆ Free-zone operators are well organized in promoting trade facilitation. The operators have recently formed an association that now is a member of CIMA, an effective forum for addressing issues. They also participate in economic promotional missions abroad.

## **2. Free-Zone Issues to Address**

Free zones can improve trade facilitation through the following activities: operators are concerned with the recent downturn in zone export activity and find that better market research is needed to identify niche markets in the United States, where their services would be beneficial. Accordingly, a strategic marketing campaign should be developed to target U.S. industry leaders. In addition, technical assistance or subsidized training should be afforded to small companies using the zone to train employees.

### **d. Vessel Carriers and Road Carriers**

For the size of the country and port, a well-developed market for carrier vessels and cargo transporters within Central America have the least obstacles to overcome in El Salvador. Four principal international container lines and various bulk carriers call at the Port of Acajutla. As was learned during the assessment, many small and medium-sized transport companies operate in El Salvador and ten large trucking firms operate within Central America.

## **1. Vessel Carriers' and Road Carriers' Efforts to Improve Trade Facilitation**

Transporters assist trade facilitation through the following activities:

- ◆ Security among vessel carriers and cargo transporters is adequate. Vessel carriers maintain adequate security measures. The container lines all conduct security training for their employees and incorporate international and U.S. security standards throughout their operations. Suspicious activity is promptly reported to Customs. The agents submit hard copies of the manifest to both Customs and the port authority, *la Comisión Ejecutiva Portuaria Autónoma* (CEPA), because neither has electronic manifest capability. As to cargo transporters, high-risk cargo moves in convoy, and corruption appears to be minimal. Most road carriers perform background checks before employment.
- ◆ Vessel agents and cargo transporters generally enjoy a good relationship with Customs. Vessel agents find that problems are dealt with openly and promptly. As was learned

during the assessment, the El Salvadoran Association of Cargo Transporters (*Asociación de Transporte de Carga*, or ASETCA), represents 70 of the industry players, most of which are small to medium-sized firms operating with one or two trucks. ASETCA is an active organization in the country and the region and addresses issues effectively with Customs and the other public agencies through CIMA. It is working on educating drivers and suppliers and is responsible for issuing identification cards for the operators. Salvadoran transporters cooperate regionally through the *Federación Centroamericana de Transporte* (Fecatrans), the Central American Cargo Transport Association, whose members represent all the associations in the region. This group coordinates national interests, promotes professional conduct, and facilitates development of the industry within the region.

## **2. Vessel Carriers' and Cargo Transportation Issues to Address**

Transporters can further aid trade facilitation through the following measures:

- ♦ Currently there is an oversupply of cargo transporters in El Salvador and the fleet is old. However, credit to modernize is difficult to secure because of the high collateral required for small firms. The oversupply also tends to squeeze the medium-sized firms that do not have the economies of scale of the larger companies or the low overhead costs available to the smaller one-truck operators.
- ♦ One reoccurring problem is with the contractor of the trucking services who fails to complete paperwork or payment on a timely basis. As a result, the trucker must wait at the border where the truck becomes a free temporary storage warehouse. The trucker receives no compensation for such delays because rates are determined by load and distance.

### **e. Warehouses**

The four bonded warehouse operators have all their facilities in San Salvador and provide sufficient space to meet industry demand at competitive costs. According to interviewees, these warehouses are privately owned sites, where clients can store imported merchandise for up to 1 year and defer payment of duty and taxes until withdrawal. Goods not withdrawn soon are considered to be abandoned and are sold at auction by Customs. There are about 1,000 repeat users of these facilities, who store predominantly automobiles, consumer products, and electrical goods.

#### **1. Warehouse Efforts to Improve Trade Facilitation**

Operators back trade facilitation through the following measures:

- ♦ Operators have a cooperative relationship with Customs. They provide customs on-site office space and equipment free of charge at all locations. They maintain automated inventory control systems and issue monthly activity reports to Customs. Although Customs has no linkage to the system, its officers have unlimited access and conduct a minimum of two audits per year.

- ◆ Security is adequate. Losses and leakage are minimal, but the operators should install warehouse logistical software in addition to the inventory system to increase security and control.
- ◆ The industry is organized and works to promote trade facilitation. The El Salvadoran Association of Logistics and Warehouse Operators (*Asociación Salvadoreña de Operadores Logísticos y de Almacenadoras*, or ASOLA) represents this group at CIMA and before the Government and private sector as required.

## **2. Warehouse Issues to Address**

Operators can better support trade facilitation through the following actions:

- ◆ Although the operators and Customs enjoy a unique relationship, seeing themselves as partners in facilitating and controlling commerce flowing through the warehouses, streamlining of procedures would both expedite the process and alleviate Customs staffing problems.
- ◆ More responsibility should be placed on the operators to accurately control and report movements through the facilities with Customs employing an audit approach to oversight. Because the operators post guarantees equal to the value and taxes due on stored merchandise, potential losses of revenue with this methodology would be minimal.

### **f. Express Shipment Companies**

Eight express shipment companies currently operate in El Salvador, representing a growing industry, but one that is little recognized for its service to the international trader.

#### **1. Express Shipment Efforts to Improve Trade Facilitation**

Shippers back trade facilitation through the following measure: the industry is organized and works to promote trade facilitation through GENTE, the El Salvador Association of Express Transporters. Also, GENTE addresses its concerns through CIMA.

#### **2. Express Shipment Issues to Address**

There is little cooperation among customs and express shippers, partly because of the close partnership between the agency and the customs brokers who generally oppose attempts to facilitate express processing.

## **E. SOCIAL DYNAMICS**

The overall social dynamic for trade facilitation of goods and services in El Salvador is quite positive. The Government and the private sector are actively engaged in a partnership to expand and facilitate trade in El Salvador. Dialogue is used effectively to resolve differences and set public agency agendas. The business sector's initial optimism that the new Government would adopt an aggressive pro-business outlook and push for modernization of public institutions and respond favorably to private sector concerns was well founded. The public agencies are struggling to meet these demands, some with more success and direction (Customs) than others.



Within the extensive dialogue and cooperation between the pertinent entities, there is no disagreement on the ultimate goal—to make El Salvador the most progressive, modern, facilitative, and open-market economy in the region and thus to propel it to become the logical regional center of international trade and distribution.

The Government has taken several steps to expand the capabilities and opportunities of its people to participate in the global market. One such innovation is the establishment of the office for export promotion, under the vice president, which seeks new markets for Salvadoran goods through market research, publication of promotional material, and organization of trade missions.

The business community, regardless of the size of the company or the sector it is engaged in, has many organizations that represent its concerns before the Government, provide it with technical training, and serve as a source of information. Generally, these groups serve their constituency well by being a collective and therefore more powerful voice for industry concerns, offering professional services, and making companies more competitive in the marketplace through their training and information efforts. Assessment interviews garnered information on numerous organizations involved in this process. A few of the more prominent organizations are ASI (*La Asociación Salvadoreña de Industriales*), the Salvadoran Association of Industrialists, whose 500 companies represent 70 percent of industrial production within the country; AMPES, the Association for SMEs; the El Salvadoran Chamber of Commerce, with 2,000 members and offices in three other cities outside the capital; and those previously mentioned such as COEXPORT and ASIC. In addition, groups representing the sectors that service the actual traders, such as customs brokers, cargo transporters, vessel carriers, and foreign trade zone operators, are well organized and actively engaged in dispute resolution, in improving the quality of service, and in facilitating the process.

The National Association of Private Enterprise (*Asociación nacional de la empresa privada*, ANEP) serves as the syndicate representing 41 of these organizations. Its mission is to identify obstacles to the creation of an effective business climate and to make recommendations to the executive branch about how to resolve these issues and promote business in general. A yearly report outlines their findings and recommendations.

One of the most successful committees for dialogue between the public agencies and the private sector is CIMA, a customs modernization group consisting of 17 private sector groups and 9 government agencies. When it was created 7½ years ago, its purpose was to modernize the movement of goods and people, with the goal of creating a paperless environment. Initially, its efforts were targeted at minimizing the intervention of the customs officer in a transaction to lessen the opportunity for corrupt behavior. As a result, Customs and to a lesser degree the other agencies have made significant progress both in moving to a more electronic environment that facilitates trade while retaining adequate controls and in reducing corruption. Problems are resolved as they arise through consensus building, and there is good cooperation and consultation among the committee members. CIMA also sponsors training for the public sector on customs-related issues.

The press in El Salvador is open to the business community and diligent in reporting its the problems and opinions. The textile apparel industry recently used one of the daily newspapers to report the *maquila* industry's contributions to the economy and the benefits of CAFTA. Customs

is another example of effective use of the press to publicize its agenda. Its public affairs officer has direct contact with television, radio, and newspapers and each project that Customs believes should be public knowledge is given publicity through organized press conferences, interviews, visits to sites, and shows.

Corruption is still pervasive in El Salvador. Although it has been reduced among public officials, especially customs, it still is a way of life and permeates all aspects of society. The resolution must lie in raising citizen awareness of the costs of complicity in such actions to the economic prosperity of the country.

## **F. RECOMMENDATIONS**

Although many issues and recommendations included in this section will help to reduce trade transaction costs, there are a few priority issues for El Salvador to address, such as the following:

- ♦ Improve risk management. We recommend improving risk management as the top priority, because it is the cornerstone of modern customs administration. It provides the balance between customs' twin missions of facilitation and control. Risk assessment can significantly increase the efficiency and security of trade flows by allowing compliant users to use the system with fewer delays and by helping customs more accurately target illegitimate goods. As noted, it should decrease the overall number of inspections, thereby lowering the transaction cost of traders. It should increase the incidence of identifying illegitimate trade, thus increasing revenues. These outcomes may increase the volume of exports and improve the overall environment for foreign investment. Risk assessment has the ability to transform the institution on a number of levels, particularly in the realignment and reapportionment of resources. Once high-risk commodities and/or traders are identified, the natural consequence is to reallocate staff to address these threats and to have program officers dedicated to the periodic and systematic review of low-risk shipments or sectors to ensure their continued compliance. GOES Customs has made a good start with its existing system and a USAID program can build on this start. A few targeted programmatic interventions can assist GOES, including the short-term assistance we discussed: technology analysis, economic sector analysis and training, and audit training. This program would assist GOES with a key CAFTA requirement.
- ♦ Streamline and modernize key trade processes. This should include upgrading the professionalism and modernization of public agencies involved in international trade. El Salvador should develop a unified border agency approach that includes a true one-stop process for imports similar to CENTREX. A revision of Customs penalty law to eliminate the issuance of penalties for clerical errors and to facilitate filing appeals should be included in these actions. The Ministry of Health should develop a modern system of electronic registration and import and export permit processing. Also, there should be a development of free-zone implementing regulations and procedures to avoid inconsistencies in Customs processing. El Salvador should establish an integrated training program for all border agencies. Field officers should be trained in a pro-business approach to their functions so that reliable traders are treated as valuable clients who should receive expedited processes and facilitation.

- ◆ Implement more user fees and improve access to user-fee funds. We recommend developing a sound user-fee system as a priority, because user fees are an essential and underutilized tools to increased modernization. Customs is a key trade institution that is clearly well managed but underfunded. User fees may have a significant impact. When applied to customs processes, the budgetary impact can be very significant and can fund specific modernization efforts. Furthermore, improvements in customs institutions and processes (i.e., import, ROO administration, risk assessment) can have a major effect on the efficiency of trade flows. These modernization efforts decrease overall costs for traders and increase the attractiveness of doing business in the country. Funding from appropriate user fees can be transformational for the institution by assisting its modernization efforts in critical areas. GOES has some positive experience in this area. As relevant officials reported, the recent export process streamlined by CENTREX includes a \$4 fee per transaction. Traders do not mind paying this fee, because it is reasonable and the new process is a significant improvement to the old, time-consuming one. USAID assistance in this area is useful and appropriate. GOES has little expertise and experience in this area. The appropriate expert(s) can provide this knowledge and develop a plan for GOES. Although this is not a CAFTA requirement per se, it could be structured to help fund CAFTA requirements.
- ◆ Sustain and improve the security environment. It is critical to sustain the gains made in the security arena. The PNC should seek to increase law enforcement skills in key areas such as cargo examination, surveillance, and search investigations. Also, critical equipment should be obtained to increase effectiveness in cargo examination (such as probes, density meters, and fiber optic scopes). Integrity programs should be improved.
- ◆ Promote regional standardization and strategies for the Customs Union. As Salvadorans well know, the country will thrive only through further integration. Therefore, it should continue to seek integrative solutions at every opportunity, such as developing a regional CACM center for risk assessment, creating a coordinated information center for all data relating to Customs Union procedures, and coordinating lab analysis for customs and agricultural issues at a regional level.
- ◆ Improve administration of rules of origin and implement other CAFTA requirements. We recommend this for the following reasons. The economic impact of CAFTA ROO is difficult to gauge without deeper economic analysis. As for customs ROO administration, GOES ROO administration will focus mostly on imports. Increased capacity should produce a more capable administration that results in identifying more goods that are entering that should *not* be receiving preferential treatment. The economic results of closer monitoring of imports may lead to greater duties collected and fewer imports. On the other hand, better ROO administration may lead to increased Salvadoran imports and exports by helping traders take full advantage of CAFTA's benefits. Identifying and exploiting new markets could have significant economic impacts. Regardless, it is safe to say that ROO will affect El Salvador significantly, and it is a critical function that GOES should be prepared to handle. Improved ROO administration by itself will not have a broad impact on the institution. However, ROO, as noted, is a critical function and a key part of the specialization that needs to occur in a modern, well-functioning customs administration. El Salvador currently has low ROO capacity. It has a poor institutional structure for administering ROO and little institutional knowledge and expertise. GOES

must present unambiguous direction providing the Customs agency with clear authority for ROO management. If this authority is provided, USAID–El Salvador can assist GOES through a few targeted programmatic interventions, such as development of a management plan and specialized training. This program would assist GOES with a key CAFTA requirement.

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## **XII. FLOW OF PEOPLE**

### **A. INTRODUCTION**

Overall, Salvadoran laws and public and private institutions support trade-related flows of people. However, El Salvador could do more to modernize its management of highly skilled visitors seeking longer-term stays and could do much more to address illegitimate flows. The issue of illegal people flows remains a significant problem. El Salvador's borders with Guatemala and Honduras are long and porous. El Salvador serves as a key origin and transit country for illegal immigration to the United States. The risk of kidnapping is moderate, but it rarely affects foreigners.

In this section, we analyze legal, institutional, and operational constraints that impede trade-related people flows. First, our analysis focuses on the legal framework for business-related visits. Second, we consider the institutional issues regarding people flows. Third, we review other key institutions involved in facilitation, such as police. Last, we identify major recommendations to facilitate trade-related people flows in El Salvador.

### **B. LEGAL FRAMEWORK**

Generally, the laws and regulations require no undue burdens for those traveling on temporary tourist or trade-related business.

The law does not require a visa for visitors from the United States, European Union, Canada, Mexico, and the CAFTA countries.

With regard to regional harmonization, the CA-4 requirements reflect serious progress in the area of immigration. These new requirements allow CA-4 members to travel freely without passports and soon will allow international travelers to move within the CA-4 with only one immigration review at the point of entry.

### **C. IMPLEMENTING INSTITUTION**

Overall, the major implementing institution, the Immigration Agency, has a clear mission and is adequately staffed and equipped.

#### **1. Immigration Operations That Support Trade Facilitation**

The Immigration Agency further aids trade facilitation through the following measures:

- ◆ Officials are posted at border crossings and ports and airports have modern equipment for handling people flows efficiently and securely, including passport-reading technology.
- ◆ Headquarters is connected electronically to border sites. When issues do arise, records are investigated electronically.
- ◆ Regulations require a visa fee on arrival and an airport tax on departure, but the fees are nominal, \$10 and \$27, respectively. The fee is collected by airlines. These measures

appear not to result in corruption at these sites and there were no complaints about immigration officials at borders.

- ♦ Salvadoran immigration officials use watch lists from Interpol, the United Nations, the United States, and other sources to monitor the entry and exit of dangerous people. This procedure is executed electronically.

**a. Immigration Issues to Address**

El Salvador can further support trade facilitation and its development through the following measures:

- ♦ Like other Central American countries, El Salvador's system is considered cumbersome for those seeking longer trade-related stays. Those international visitors who seek an extended stay and work permit could benefit from a new facilitated process. Procedures are few and fairly transparently executed and the cost is reasonable. However, processing times can vary and may take months because of bureaucratic hassles and visits to the Immigration Agency.
- ♦ As a place for the origin and transit of illegal immigration, El Salvador is improving the relevant institutions, but they remain inadequate for safeguarding the borders.

**D. SUPPORTING INSTITUTIONS**

The primary supporting institution, the PNC, is viewed as a strong partner with the Immigration Agency. As in other Central American countries, the Immigration Agency administers the laws, and the police provide the law enforcement function, such as detentions and arrests. The police force is considered fairly adequately staffed and equipped.

Infrastructure and services regarding people flows, as elaborated further in this report, are adequate. El Salvador effectively has one international airport in San Salvador, where there are daily direct flights to and from many cities in the region and in North and South America. Intra-country road travel along the Pan-American Highway is adequate because of decent infrastructure. However, major highways traveling north are few and in poor shape.

**E. SOCIAL DYNAMICS**

Trade-related people flows are generally supported at all levels as El Salvador is relatively open. People flows, particularly in the form of tourism, are widely supported and encouraged at all levels—executive branch, legislature, private institutions, and the general public. There is support in the business community and the Government for a more efficient immigration processing system to further facilitate business travelers.

**F. RECOMMENDATION**

El Salvador should work to improve and encourage business knowledge transfer by facilitating the process for longer-term visitors. Attracting knowledge and skills from beyond Central America should be strongly encouraged. Knowledge and skill transfer will help counter the drain

that exists from skilled Salvadorans moving abroad, encourage more skilled Salvadorans to stay, and encourage more foreign direct investment. Those persons who are trying to support existing multinationals in El Salvador residing in the country should find a process that is rapid, predictable, transparent, and inexpensive. Those persons with skills needed by El Salvador (doctors, engineers, computer scientists, etc.) should be encouraged to stay and should find an uncomplicated and reasonably priced system.

### **XIII. FINANCIAL CRIMES**

#### **A. INTRODUCTION**

El Salvador has in place the basic necessary legal framework, institutions, and public will to combat financial crimes. However, some improvements are needed and the country must remain vigilant as, among other reasons, the 2001 adoption of the U.S. dollar as legal currency has made the country more attractive to money launderers and much in the world has changed since El Salvador first passed its laws regarding money laundering in 1998. More specifically, a law on terrorist financing, currently being developed, must be passed. In addition, the problems faced by the judiciary, as discussed in greater detail in other sections, also have a deleterious effect in this area. Nonetheless, the changes needed in El Salvador with respect to combating money laundering in particular, and other financial crimes in general, are ones primarily of updating and fine-tuning as opposed wholesale revision and reform.

#### **B. LEGAL FRAMEWORK**

Over the last few years, El Salvador has taken numerous steps to create and bolster its legal framework, both internationally and domestically. Fundamentally, El Salvador's "Law Against the Laundering of Money and Assets" and associated regulations, as well as other steps the country has taken to participate in the international effort against financial crimes, as one interviewee stated, can serve as a model for the rest of the region.<sup>96</sup>

Internationally, the government of El Salvador has signed numerous agreements to combat money laundering, including agreements for mutual legal assistance, both regionally and within the Organization of American States (OAS), as well as other OAS treaties dealing with narcotics and terrorism. In addition, El Salvador is a party to numerous relevant United Nations treaties as well as being a member of the Financial Action Task Force, the Caribbean Financial Action Task Force, and the Egmont Group. The country also welcomes bilateral assistance from various countries, including the United States.<sup>97</sup>

Domestically, with respect to money laundering, the "Law Against the Laundering of Money and Assets" clearly puts forth the needed tenets to ensure proper protections. The crime itself is clearly and broadly defined and is shown to be related to a number of illicit acts.<sup>98</sup> A conviction for money laundering carries substantial penalties, as do other separate offenses that can be seen as aiding in efforts to launder money.<sup>99</sup> In addition, the law contains a thorough list of

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<sup>96</sup> Legislative decree no. 498, "*Ley Contra el Lavado de Dinero y de Activos*," (*Ley Contra el Lavado de Dinero*) came into force December 23, 1998. Decree no. 2, "*Reglamento de la Ley Contra el Lavado de Dinero y de Activos*," came into force January 20, 2000.

<sup>97</sup> El Salvadoran personnel have received training on many occasions from international experts, many from the United States, and have undergone evaluations by international groups, such as the Caribbean Financial Action Task Force, the World Bank, and the International Monetary Fund.

<sup>98</sup> *Ley Contra el Lavado de Dinero*, Articles 4 and 6.

<sup>99</sup> A conviction for money laundering can be punished by "a prison term from five to fifteen years and a fine from fifty to two thousand five hundred minimum monthly salaries currently being paid by the business, industry or service at the time the corresponding sentence is imposed" (Article 4). In addition, "special cases of money and asset laundering are included in the definition"—i.e., hiding or concealing laundered money or knowingly possessing laundered goods without any intent to legitimize them can be punished by "eight to twelve years [in



organizations that are to be specifically subject to the control of the law, and upcoming amendments to the law will expand this list further.<sup>100</sup>

The law establishes El Salvador's version of a financial intelligence unit, the *Unidad de Investigación Financiera* (UIF).<sup>101</sup> One of the shortcomings of the law deals with the organizational setup of the UIF, as it exists as part of the Office of the Attorney General and not independently. As one interviewee described it, however, this is due to a lack of resources rather than an effort to control the UIF's activities. Regardless, however, the UIF is subject to the Attorney General's, as opposed to its own independent, authority.

The law also establishes clear and thorough obligations and reporting requirements of both transactions and the persons making them for the organizations subject to it. The law establishes threshold levels at which organizations must deem a transaction suspicious and report it to the UIF; more than one interviewee stated that the amount in question, approximately U.S.\$57,000 is perhaps too high. The law also requires continual training and internal auditing of financial organizations and sanctions for noncompliance with those requirements.<sup>102</sup>

Last, the law establishes clear powers of investigation and grants strong authority for asset seizure/forfeiture during the investigative process.<sup>103</sup> In addition, the law specifically sets out clear exceptions to bank confidentiality measures for the Attorney General and judges investigating money-laundering cases.<sup>104</sup> The law has provided a strong basis for combating financial crimes, and amendments under consideration will bolster these efforts.

At the same time, although a specific law dealing with terrorist financing has not yet been passed, creating a gap in El Salvador's financial crimes regime, more than one interviewee stated that a draft currently being considered, developed with outside technical expertise and support, would be passed in the near future, as the need for such a law is recognized. Until that time, interviewees stated that they had been using various parts of the criminal code, including, for example, antifraud provisions, to help fill this gap. With the passage of this law, El Salvador's financial crimes legal framework will be the most complete in, and continue to serve as a model for, the region.

### C. IMPLEMENTING INSTITUTIONS

El Salvador's institutions for combating money laundering and terrorist financing at present are sufficiently entrenched and empowered to perform necessary tasks. As mentioned, however, reforms are needed so that these institutions remain apace with changes in the nature of financial crimes.

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prison] and a fine from fifty to two thousand five hundred monthly minimum salaries" (Article 5). In addition, even negligent or ignorant concealment of laundered goods is punishable by 2 to 4 years in prison (Articles 7 and 8).

<sup>100</sup> *Ley Contra el Lavado de Dinero*, Article 2, (a)-(p). Under proposed amendments, accountants, lawyers and notaries, and auditors will be added to the list.

<sup>101</sup> *Ley Contra el Lavado de Dinero*, Article 3.

<sup>102</sup> *Ley Contra el Lavado de Dinero*, Articles 9–16.

<sup>103</sup> *Ley Contra el Lavado de Dinero*, Articles 16–23. As one interviewee put it, "by force of law, all regulatory bodies are obliged to cooperate with us, and they do cooperate."

<sup>104</sup> *Ley Contra el Lavado de Dinero*, Articles 24 and 25.

According to one interviewee, although the UIF staff is not large, there exists an array of professional expertise to investigate financial crimes from various vantage points—accountants, lawyers, insurance experts, etc.—although more resources are needed. This office investigates not only money-laundering crimes specifically but also crimes that may involve monetary transactions more generally such as fraud and corruption. In addition, the UIF has the ability to prosecute cases on its own as it is part of the Attorney General’s office. The office enjoys high levels of cooperation with and access to those organizations also involved in this area. For example, the UIF reportedly has open and regular communications with the government office that deals specifically with corruption and organized crime, the PNC, other prosecutors outside the UIF, and the *Superintendencia del Sistema Financiero* (SSF; i.e., the governmental financial system supervisor) as well as other supervisory bodies. In short, except for being part of the Attorney General’s office and being able to directly prosecute its own cases, it acts as a classic financial intelligence unit.

Despite having strong investigatory powers, however, the UIF does not have the resources to perform complex investigations. In this case, they turn to the PNC and the SSF. As stated, cooperation between the police and the UIF is described as good. This is important as the police must first file a preliminary report with the UIF, who then must approve further investigation. In this area, the relationship suffers from what seems to be acceptable levels of inter-institutional and bureaucratic complications, but both organizations are trying to improve in this regard. However, because the police efforts with respect to financial crimes suffer from resource shortcomings similar to those of the UIF and they have relatively less training, their investigations, according to one interviewee, are often “deficient,” making it difficult to take financial crimes cases from investigation to prosecution.<sup>105</sup>

The PNC has a devoted unit that deals with financial crimes investigations, which is part of the anti-narcotics division. *Ab initio*, this unit lacked specific experience, although it has developed such experience in the six years since the law was passed. Although the unit has some permanent analysts on its staff, it still lacks financial experts such as auditors and accountants but has received some training from other Latin American countries and the United States. Reportedly, the unit enjoys strong cooperation with relevant regional partners but on an informal, networking basis. Uniquely, the anti-narcotics division reports directly to a presidential anti-drug commission, showing the importance of this issue. As a result, the division reportedly maintains the highest professionalism standards of the police.

One particular resource shortage mentioned was with respect to computers and vehicles, the lack of which places limitations on the unit’s investigatory abilities. In the case of financial crimes enforcement, it is a telling statement and indicative of the problem when a law enforcement official interviewed for the assessment states that the PNC “make[s] do with what they have.”

With regard to the SSF, according to interviewees, this organization sets as two of its highest priorities fighting money laundering and terrorist financing. Because of the strength of the law and cooperation of the banks, as well as the insurance agencies, credit unions, and *cambios*

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<sup>105</sup> Since the law was passed, there have only been four convictions for money laundering despite numerous investigations. As will be discussed, however, the quality of the investigations is not the only reason, as the courts also create obstacles.

(offices where one can convert currency) the SSF also supervises, it has sufficient powers to perform its job. Moreover, banks and the SSF reportedly are very conservative to ensure security and to ensure the flow of remittances between El Salvador and the United States, which is an important part of the El Salvadoran economy. All banks must register with the SSF and are required to have an officer responsible for reporting any suspicious transactions. As a result, almost all suspicious transactions are reported and, according to one interviewee, those involved in this fight use a broad definition of what is considered suspicious. To continue to bolster these efforts, the SSF undergoes training, although it is not regularized, which it then passes on to its registrees through guidelines and other assistance.

In addition, the SSF has within it a newly formed, albeit small, specialized auditing unit devoted to money-laundering issues. However, one interviewee stated that without better and continually modernized equipment, such as computers, the efforts of this unit and others in the SSF involved in the fight against financial crimes would be hampered. To help further investigations, the government of El Salvador also has regional agreements so that its SSF can investigate in other countries as well as have extra-territorial supervisory authority over remittance banks in the United States, which it achieves with the cooperation of U.S. authorities. In addition, the heads of each of the regions' financial system supervisory bodies meet on a regular basis. With respect to terrorist financing, the SSF currently abides by internally developed standards and provides guidelines to banks. The need for an actual law, however, is recognized.

As with other areas of this report, the courts play a deleterious role in the efficient enforcement of financial crimes laws. According to one interviewee, judges lack sufficient knowledge and understanding of the law to ensure its adequate application. In addition, there are limited standards of evidence, leading judges to make ad hoc determinations on the probative value of complicated and unfamiliar evidence, decisions that are not based on sufficient experience. As a result, although there have been numerous investigations with respect to financial crimes and money laundering in particular, there have been few convictions. Accordingly, despite a solid legal framework and numerous well-intentioned and capable individuals in the relevant institutions, the fight against money laundering is hampered by shortcomings in the institutions.

#### **D. SUPPORTING INSTITUTIONS**

Numerous institutions play a secondary role with respect to financial crimes enforcement. Most interestingly among them, there exists a "*Grupo de Acción de Alto Nivel Contra el Lavado de Dinero y de Activos*" (literally, the high-level inter-institutional group against money laundering), created by a formal memorandum of understanding in 2001 to facilitate inter-governmental cooperation and ensure a clear focus on the issue. The group is composed of key figures with respect to money laundering in the country, including the Attorney General; the Presidents of the Central Bank and the Salvadoran Banking Association; the Directors of the National Center of Registries, the SSF, and the PNC; the Superintendents of the Securities Exchange (*de Valores*) and Business Obligations (*Obligaciones Mercantiles*); and the Minister of the Interior.<sup>106</sup> Although primarily advisory in its role, the mere existence of this aptly named high-level group shows El Salvador's commitment to combating financial crimes. The

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<sup>106</sup> "*Memorando de Entendimiento del Grupo de Acción de Alto Nivel contra el Lavado de Dinero y de Activos*," signed August 9, 2001 (on file with *Unidad de Investigación Financiera* (UIF)).

memorandum of understanding clearly states the importance of combating money laundering and that the group will take steps to ensure that this challenge is met.

With respect to institutions responsible for training those involved with financial crimes, this is an area where El Salvador perhaps could stand some improvement. All interviewees stated that, to various degrees, the police academy, the CNJ, and schools responsible for training professionals, such as law and accounting schools, all fail in providing sufficient opportunity for individuals to develop a skill set for combating financial crimes before being assigned the role in a professional setting.

Last, a brief mention of those institutions that make up the actual functionaries of the system—the banks, insurers, etc.—is needed. In short, as one knowledgeable interviewee stated succinctly, “they get it.” Despite copious and obligatory reporting and cooperation requirements, all interviewees agreed that the businesses and end users that make up the system take the necessary steps to ensure meeting legal obligations with respect to the laws regarding financial crimes. Accordingly, with such support from end users and the interest of the *Grupo de Acción de Alto Nivel Contra el Lavado de Dinero y de Activos*, El Salvador is in a good position to continue to develop its fight against financial crimes.

#### **E. SOCIAL DYNAMICS**

In general, for a variety of reasons, financial crimes often lack a public constituency to provide the social, cultural, and political energy to determine the course and scope of reform in that society. Whereas in some countries this can be a particular failing, such as was discovered in a similar assessment done in Indonesia (October 2003), El Salvador is already buttressed by an active and involved Government and professional community as well as an established legal and institutional framework, which ameliorates such concerns. As such, the country is well-positioned to undertake needed reforms and apparently the political will exists not only to do so now but to continue to do so in the future as the need for combating financial crimes evolves.

#### **F. RECOMMENDATIONS**

El Salvador is in a strong position with respect to combating financial crimes. In fact, as other countries in the region are behind in such activities, El Salvador stands to be a leader in the region in this regard. To ensure that this continues, however, reforms are needed. In this connection, El Salvador again is uniquely positioned; given the existence of the *Grupo de Acción de Alto Nivel Contra el Lavado de Dinero y de Activos*, political will could more readily be brought to bear to move reforms.

Primary among these reforms is training involved professionals from all vantage points. These include the following:

- ◆ Law enforcement officials, particularly police, could benefit from regular, tailored training and technical assistance on best practices for financial crimes-related investigation procedures as well as specific case-building techniques (e.g., evidence gathering, interviewing, research).

- ♦ Law schools should provide students with greater background in the arena to ensure a more comprehensive understanding of the complicated nature of financial crimes before they actually work with relevant laws.
- ♦ Institutions charged with training judges should include specific education on financial crimes, including both domestic and international legal concerns, to ensure, inter alia, that the complicated and unique evidence associated with these crimes is understood and properly weighed.
- ♦ Last, training for professionals involved with financial crimes (i.e., in the SSF and the UIF) should be done continuously to ensure that these individuals are kept abreast of developments.

With respect to resource allocation, efforts should be made to ensure that supervising and investigating entities are provided with sufficiently sophisticated equipment, such as state-of-the-art computers, to meet the demands of the technical nature of investigating financial crimes.

In addition, efforts should be made to bring in relevantly experienced professionals, such as accountants and auditors, to the PNC and UIF, which currently lack depth in such expertise. Moreover, efforts should be made, despite resource constraints, to ensure the UIF's independence from the rest of the Attorney General's office. Although there is no evidence that this relationship has at this point created any conflicts of interest between the UIF and the Attorney General, the possibility clearly exists. Because the relationship between these entities is established by law, it would take legislation to effect major changes. In the meantime, clear regulatory buffers could be established to ensure the avoidance of improprieties.

Last, the following additional legal reforms are needed:

- ♦ Primarily, the law on terrorist financing currently being discussed should be adopted to ensure that El Salvador's legal framework comes up to date with current international exigencies.
- ♦ In addition, money laundering and other financial crimes should be made extraditable offenses, and other reforms, such as including accountants on the list of entities held accountable by the money-laundering law, should it be passed.

With these reforms, El Salvador will be able to continue as a regional leader with respect to financial crimes.

## **XIV. FLOW OF MONEY**

### **A. INTRODUCTION**

Cross-border goods and services transactions reflect a relatively small, yet significant, amount of monetary exchange that pays for those goods and services traded—approximately \$8.9 billion in goods and \$1.7 billion in services traded annually in 2003.<sup>107</sup> In 2003, an estimated \$2.1 billion dollars poured into El Salvador through remittances of El Salvadoran workers and families abroad<sup>108</sup> or roughly 14 percent of gross domestic product. El Salvador is the second-most remittance-dependent country in Latin America on a per capita basis.

Overall, Salvadoran laws and public and private institutions support these trade-related money flows. Trade finance products are available to all traders. The economy is fully dollarized and other foreign currency exchange is widely available and easily exchanged for all traders. Credits for export are very difficult to gain because of serious structural issues, such as high collateral requirements and a poorly functioning judicial system. As with other CAFTA members, El Salvador is challenged by illegal money flows.

In this section, we analyze legal, institutional, and operational constraints that impede trade-related money flows. First, our analysis focuses on the legal framework for the primary transactions—trade finance and currency exchange. Second, we consider the institutional issues regarding trade finance, currency exchange, and illicit money flows. Third, we review other key institutions involved in trade facilitation, such as development funds. Last, we identify major recommendations to facilitate trade-related financial flows in El Salvador.

### **B. LEGAL FRAMEWORK**

In El Salvador, the legal framework regarding the efficiency and security financial flows is generally sufficient.

#### **1. Legal Issues That Support Trade Facilitation**

- ◆ Foreign and domestic private banks operate throughout the country.
- ◆ The Trade Finance Guidelines by the International Chamber of Commerce are generally applied, and the laws are in conformity with the Uniform Customs and Practice for Documentary Credits.
- ◆ The legal structure for trade-related finance allows for payment through wire transfers, foreign checks, commercial letters of credit, standby letters of credit, documentary collections, and open accounts. Factoring is available.
- ◆ Importers and exporters do not find the legal framework for exchanging payments to be overly cumbersome or complicated.

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<sup>107</sup> See <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=SV>

<sup>108</sup> Economic Intelligence Unit (EIU) Country Profile – El Salvador, 2004-2005.

- ♦ The legal framework for currency exchange also provides for suitable flexibility for traders. El Salvador's official currency is the U.S. dollar. Under the law, traders have the freedom to exchange currency at financial institutions and non-bank institutions alike.
- ♦ There are no restrictions on repatriation of profits by foreign business people. Products that allow traders to hedge finance risk are also legal.
- ♦ Laws are in place addressing illegitimate financial flows. El Salvador has enacted and implemented a law criminalizing the laundering of the proceeds of crime.
- ♦ Since dollarization, interest rates have dropped and are approaching U.S. levels. Bank financing for those who can acquire credit offers relatively low interest rates.

## **2. Trade Facilitation Issues to Address**

Credit beyond the short term can be difficult for traders to access and the legal system is one part of this problem. Credit is scarce for multiple reasons, but two prominent reasons are a poor banking legal framework and a poor judicial system.

### **C. IMPLEMENTING INSTITUTIONS**

#### **1. Banks**

##### **a. Bank Operations That Support Trade Facilitation**

There is a relatively well-developed banking system that includes 12 private domestic banks, including international banks such as Citibank. In fact, El Salvador's top banks are the largest in Central America.

- ♦ Almost all the banks provide some form of trade financing. The banks maintain correspondent relations with U.S. and other international banks.
- ♦ Their trade finance offerings range from basic letters of credit to foreign exchange to hedging contracts. Many El Salvadoran imports are financed through short-term lines of credit (60-day), which are extended directly from the exporter to the El Salvadoran importer. This method of financing usually is available only to large importers and long-term clients.
- ♦ The U.S. Export-Import Bank provides short- and medium-term guarantees for sales to the private sector, and El Salvador participates in the USDA's programs for import credit guarantees of U.S.-origin agricultural products.

##### **b. Bank Issues to Address**

Although these financial institutions offer trade finance payment methods to domestic importers and exporters on reasonable terms, qualifying for credit beyond short-term payment is extremely difficult for smaller and medium-sized traders.

- ◆ In addition to the legal inadequacies, access to credit is considered poor because of credit information scarcity, stringent credit requirements, and a weak business environment; El Salvador has achieved low growth over the past few years.
- ◆ Few alternative facilities are in place to assist would-be traders (i.e., export finance banks), although the Central American Bank for Economic Integration (*Banco Centroamericano de Integración Económica*, or BCIE) does have a program of credit, training, and technical assistance.

## **2. Central Bank**

The Central Bank of El Salvador manages currency regulation in this dollarized economy. Currency exchange occurs at numerous institutions, including banks, currency exchanges, and hotels. Currency exchange operates at rates that are highly competitive, and fees for wiring money abroad are less than ten percent of the amount of money to be wired.

## **3. Financial Crimes Unit**

The main implementing institution for money laundering—financial crimes enforcement unit—is working to attack money laundering. It is early in the development of this capacity, but it appears that the institution is making progress on this very critical issue. The supporting institutions that address illegitimate financial flows—banks, regulators, prosecutors—are generally cooperating. (See financial crimes section.)

## **D. SUPPORTING INSTITUTIONS**

The national supporting institutions that facilitate trade-related finance are relatively weak. El Salvador has no Government-sponsored export credit agency. The Banker's Association is viewed as an effective instrument for advocacy in El Salvador. Salvadorans do benefit from the *Banco Centroamericano de Integración Económica* (BCIE). One of BCIE's program involves awarding credits to traders for circulating and fixed capital. BCIE targets economically viable projects and exporting companies to upgrade regional export capacity.

## **E. SOCIAL DYNAMICS**

The lack of access to trade finance credit is a serious issue in El Salvador and receives a good deal of attention at all levels. The Government, banks, smaller exporters, and potential traders are all interested in and focused on the need for change. Although the solutions are difficult, the dynamics lean in the right direction through positive and consistent engagement of the principles of modern banking.

The issue of money laundering too is one that receives attention at many levels. The Government has been working to improve its capacity to deal with the problem through passage of legislation and establishment of the appropriate institutions and processes. The private sector, in turn, has been responsive to implementing its responsibilities, such as know-your-customer regulations.



**F. RECOMMENDATION**

Improve access to credit for small and medium-sized importers and exporters. A more vibrant trade system will provide small and medium-sized traders with the ability to finance their export and import activities. The current system requires them to self-finance their activities, which imposes a significant cost on their products and services. This added cost makes their product less competitive in export markets and the domestic market as well. Trade and financial institutions must develop strategies to more effectively provide credit to reliable firms. These strategies should include such activities as establishing associations among producers for pooling resources and risks, establishing a guarantee fund that provides credit to a group of exporters for fewer guarantees than are currently demanded, and increasing producers' knowledge of bank instruments.

## XV. SUPPORTING INFRASTRUCTURE

Infrastructure is an important component of a well-developed trading community. Without it, the ability for a region to participate in the world of international trade would be nonexistent. Easily understood as a functional requirement for trade, implementation of a highly efficient, user-friendly infrastructure system, offering cost-effective and reliable services, can be viewed as a competitive advantage. In the broader context, there is a direct link between economic growth and infrastructure quality. Implementation and administration of a quality infrastructure system reduces costs, expands market reach, and induces demand for increased services. Within the context of CAFTA and its participating countries, regional competitiveness is an emerging key theme, with infrastructure playing an important role.

This section discusses El Salvador's stock-of-trade infrastructure, which typically includes transportation components, such as roadways, airports, seaports, railroads, and border crossings. In addition, supporting infrastructure, such as electrical power generation, transmission and distribution, telecommunications, and information technology are necessary components of an efficient trading environment and consequently are included as part of this overall assessment. To the extent possible, this assessment provides a description of the nation's trade infrastructure inventory and responsible administrating entities; evaluates its overall condition, capacity, and utilization; describes proposed improvement projects; and provides recommendations as appropriate. This assessment relates key findings to the common theme of competitiveness, which encapsulates the following three key components: service quality, reliability, and cost.

### A. INTRODUCTION

Overall, El Salvador's stock-of-trade infrastructure sufficiently meets the existing demands of the marketplace. Individual infrastructure components are generally well maintained and in reasonably good condition. Both recently implemented improvements and contemplated transportation projects employ industry best practices in design and construction. However, broad differences in capabilities and service levels exist between the various infrastructure components. Consequently, any global statements to summarize the effectiveness of the nation's entire stock of infrastructure would be misleading. Hence, a summary assessment and key findings for individual components are presented in Exhibit 1.

**Exhibit 1. Summary Infrastructure Assessment Findings**

Infrastructure Component	Overall Assessment	Key Positives	Key Negatives
Roadways	Competitive	<ul style="list-style-type: none"> <li>• Expansive deployment of high-capacity corridors along key transportation routes</li> <li>• Sound pavement systems with limited wearing surface deterioration</li> <li>• Good geometric design with appropriate escapes</li> </ul>	<ul style="list-style-type: none"> <li>• Dense traffic conditions within city limits</li> <li>• Undercapacity overpasses and bridge structures</li> <li>• Lack of authority to enforce maintenance of right-of-way</li> <li>• Incomplete network upgrades located along the northern part of the country</li> <li>• Prevalence of user abuse</li> <li>• System security/safety</li> </ul>

<b>Infrastructure Component</b>	<b>Overall Assessment</b>	<b>Key Positives</b>	<b>Key Negatives</b>
Seaports	Less competitive	<ul style="list-style-type: none"> <li>• Successful public-private partnership initiatives; service concessions</li> <li>• Availability of moderate modern handling equipment</li> <li>• Recent ISPS certification; strict access control</li> <li>• West coast landside access</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of high-capacity, dedicated facilities</li> <li>• Facility reaching limits of operational capacity</li> <li>• Frequency of extensive delays</li> <li>• Internal data transmission and communication deficiencies</li> </ul>
Airports	Highly competitive	<ul style="list-style-type: none"> <li>• High-capacity air operations area and terminal facility</li> <li>• High-capacity dedicated transportation corridor</li> <li>• Recent terminal expansion</li> <li>• Significant growth potential</li> </ul>	<ul style="list-style-type: none"> <li>• Limited passenger processing capability</li> <li>• Passenger contamination issues; mixing of embarking and debarking international passengers</li> <li>• Lack of multiple facilities</li> </ul>
Railroads	Unavailable	<ul style="list-style-type: none"> <li>• Implementing institution currently evaluating rail transportation alternatives and benefits</li> </ul>	<ul style="list-style-type: none"> <li>• No railway service is currently provided</li> </ul>
Border crossings	Competitive	<ul style="list-style-type: none"> <li>• Existing dedicated facilities</li> <li>• Information technology coordination with neighbors</li> </ul>	<ul style="list-style-type: none"> <li>• Customs Union initiatives have precluded investment</li> <li>• Information technology system reliability issues</li> </ul>
Electricity	Less competitive	<ul style="list-style-type: none"> <li>• Multiple power-generation sources</li> <li>• Private sector participation</li> </ul>	<ul style="list-style-type: none"> <li>• Perceived monopolistic power transmission environment</li> <li>• Insufficient generation capacity</li> <li>• Insufficient cross-border transmission capacity</li> </ul>
Telecom/information technology	Competitive	<ul style="list-style-type: none"> <li>• Open &amp; competitive market</li> <li>• Advanced technology</li> </ul>	<ul style="list-style-type: none"> <li>• Perceived negative impacts of CAFTA on telecommunications market</li> </ul>
<p><b>Assessment Scale</b></p> <p><b>Highly competitive</b>      Deployed systems exhibit high quality in both fixed assets and operations, are uniformly deployed nationally, and have significant opportunities for growth</p> <p><b>Competitive</b>              Deployed systems adequately meet market demands, may exhibit potential inconsistencies nationally, and have opportunities to maintain service levels over time through thoughtful capital planning and implementation</p> <p><b>Less competitive</b>        Deployed systems currently suffer from problems inhibiting efficient trade</p> <p><b>Developing</b>                Systems have only recently been deployed, providing very limited existing service capabilities and consequently are immeasurable</p> <p><b>Unavailable</b>              Systems are not deployed</p>			

Observations and interview results indicate that El Salvador has experienced consistent success in implementing multiple components of its infrastructure investment programs. The country does not suffer from significant bottlenecks or service gaps from a national perspective. However, targeted initiatives to create a seamless infrastructure environment are required going forward. Specifically, El Salvador should focus its efforts on the following areas.

## **1. Roadways**

El Salvador's roadway infrastructure has seen significant improvement over recent years. This is evidenced through recent development of four-lane divided highways along major transportation corridors. Overall, El Salvador's primary roadway system is in good condition, with pronounced capacity improvements in the southern region of the country. However, the nation's roadway network suffers from capacity and quality deficiencies along the northern region of the country. Although this region is currently planned for upgrading, funding capacity has been a significant impediment to realization of full system upgrades. Currently, development of this region is considered a minimal impediment to El Salvador's competitiveness within the CAFTA context.

The greatest challenge currently facing El Salvador's roadway network is overcoming the lack of actionable legal authority to vigorously protect its existing public investments from abuse. The nation lacks legislation empowering its roadway implementing institutions to impose penalties against non-compliant system users, putting overall system reliability and anticipated net benefits at risk. It is highly recommended that assistance to enable enforcement be provided to help maintain El Salvador's current competitive advantage in roadway transportation.

## **2. Seaports**

Although currently considered adequate for continued handling of bulk and neo-bulk cargoes, El Salvador's seaport facility is reaching the limits of its operational capacity with regard to containerized cargo. This is due to both operational deficiencies and capacity constraints. Recognizing these constraints, El Salvador is vigorously pursuing development of a dedicated, purpose-built containerized cargo terminal at La Union, located at Port Cutuco. This proposed transportation project is planned in cooperation with Honduras and will include development of a mini-land-bridge system efficiently connecting the Pacific Coast of El Salvador to the Caribbean Coast of Honduras. Regionally, this is an important project because it provides development opportunities for value-added services and distribution centers along the proposed logistics corridor. However, there are risks, which should be thoroughly understood before project execution. It is highly recommended that support in regional-planning efforts be provided to minimize potential risks while capitalizing on the CAFTA opportunity.

## **3. Airports**

El Salvador is host to the region's highest-capacity international air-traffic facility. This facility, El Salvador International Airport, is the nation's gateway for international air traffic and currently is the only regional hub for in-transit passengers en route to other Latin American destinations. However, terminal upgrades are required to eliminate passenger contamination conditions that currently exist at the terminal. Support in this area will improve the overall security environment at the terminal. In addition, the passenger terminal requires expansion of its passenger-processing facilities—i.e., ticket counters, immigration, and customs. On the cargo side, the facility has tremendous potential as a regional air cargo distribution hub, which should be supported through strategic planning efforts.

## **4. Railroads**

Currently, El Salvador has no rail network in the country.

## **5. Border crossings**

El Salvador's border crossing facilities are considered highly productive in terms of annual throughput capacity. This is due to both the limited cross-border inspections conducted at the facilities and policies enacted to maintain consistently low transit times per vehicle using the facility. Common to other Central American countries, regional initiatives include removing border-crossing facilities; consequently, little or no investment is currently contemplated for El Salvador's borders.

## **6. Electricity**

On an annual basis, El Salvador is a net importer of electricity from neighboring countries. The country lacks sufficient power-generation facilities to meet user demands independently. As a result, potential demand increases would further increase El Salvador's dependence on imported electricity. Currently, international transmission capacity serving El Salvador is limited and inadequate to support significant increases in electricity imports. El Salvador's competitive position, consequently, is at potential risk because of electricity supply. Regional plans to upgrade transmission capacity are currently being studied; however, it is recommended that efforts to improve generation capacity in El Salvador be supported. Improvement in self-sufficiency would improve overall competitiveness from the perspectives of reliability and cost.

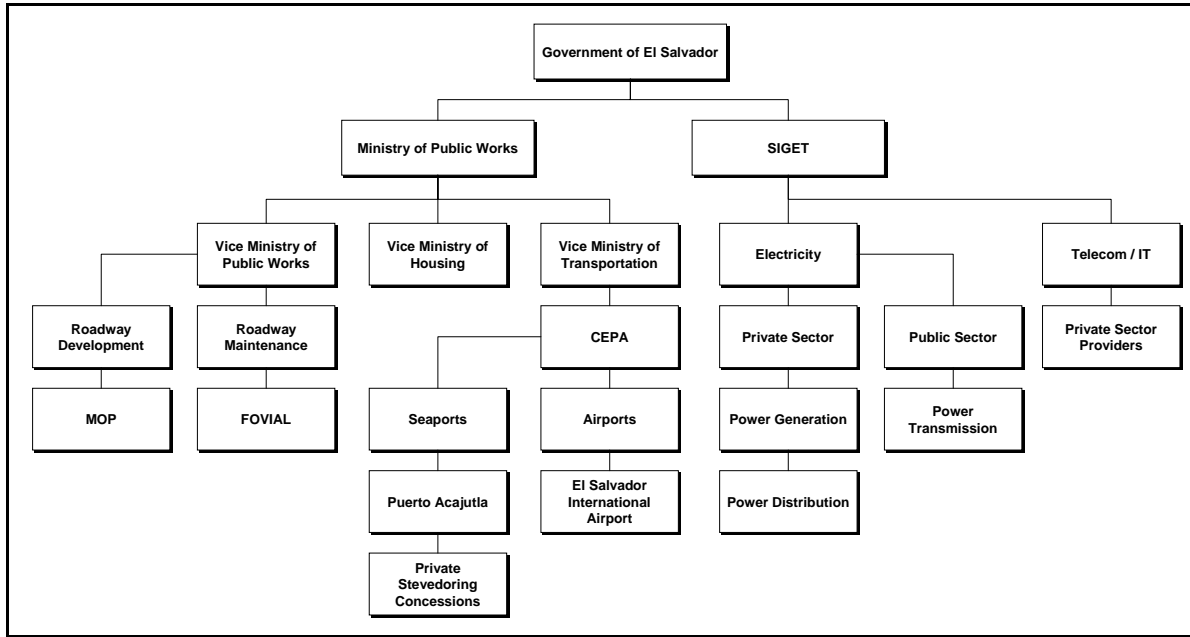
## **7. Telecommunications**

El Salvador enjoys an open and competitive telecommunications market, providing reliable service and modern technology. Common to developing countries, further densification of telecommunications access is required but is anticipated to occur naturally as service becomes more affordable. Additionally, the region requires assistance in developing a harmonized plan for recovering regional international termination costs.

## **B. LEGAL FRAMEWORK**

Transportation infrastructure planning, coordination, supervision, implementation, and maintenance are the responsibility of El Salvador's Ministry of Public Works. This ministry consists of three subministries: the Vice Ministry of Public Works (roadway networks), the Vice Ministry of Transportation (airports, seaports, and railroads), and the Vice Ministry of Housing. Electricity, telecommunications, and information technology are regulated by SIGET (*Superintendencia General de Electricidad y Telecomunicaciones*), a government regulatory body. Exhibit 2 provides an organizational chart outlining the institutional relationships.

### Exhibit 2. El Salvador Infrastructure Organizational Chart



Roadway network development and maintenance are the responsibilities of the Ministry of Public Works under two distinct implementing institutions. The Vice Ministry of Public Works is responsible for implementing roadway development and expansion projects, and *Fondo de Conservación Vial* (FOVIAL) is responsible for maintenance. Development projects are funded through approval of funds from the Ministry of the Economy or through donor agencies. Roadway maintenance is funded through a recently enacted user fee collected through gasoline taxes. Although both agencies are autonomous in operations and funding, they work together closely in implementing a high-quality system.

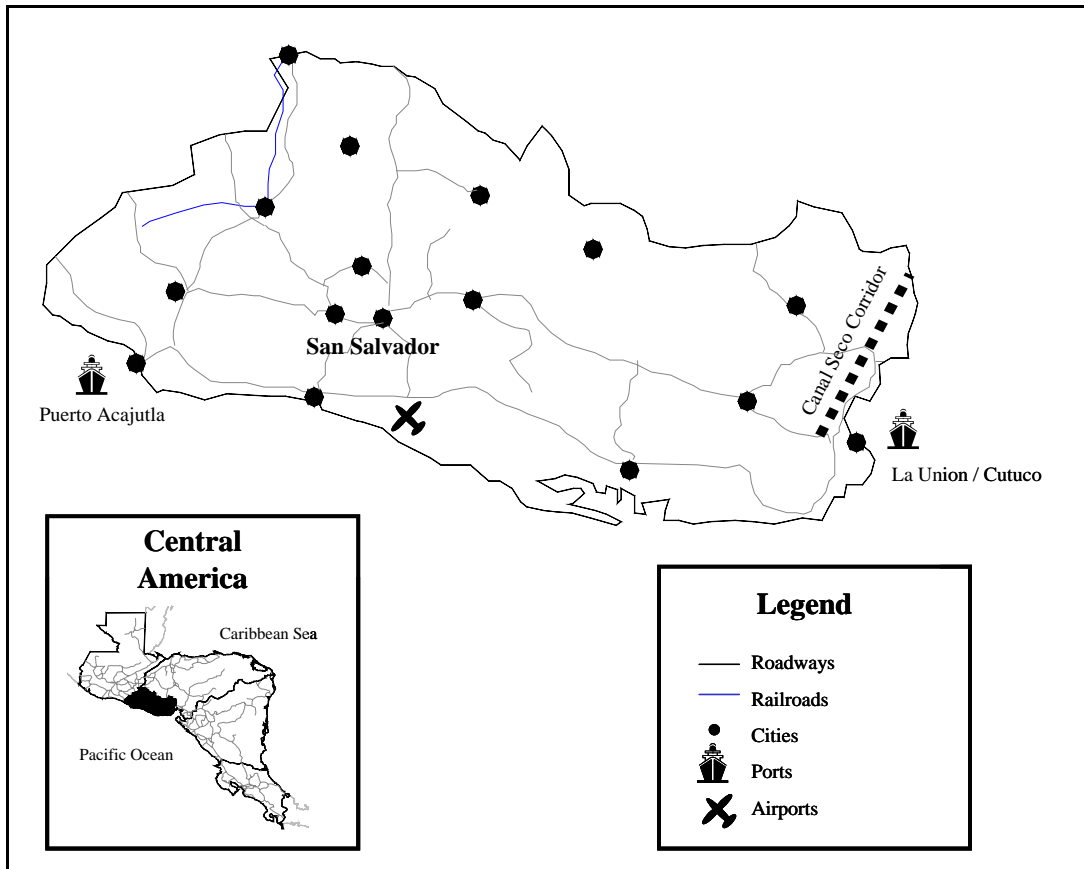
El Salvador’s airport and seaport infrastructure is administered and operated by *Comisión Ejecutiva Portuaria Autónoma* (CEPA), an independent authority under the Vice Ministry of Transportation. CEPA consists of an independent board of directors representing both public and private concerns. CEPA is required to maintain economic independence through collection of tariffs and control of operating expenses. With that charge, CEPA is authorized to set its own tariffs to cover operating costs, within legal guidelines. CEPA is organized along strategic business units (SBU) representing the various modes of transportation under its direction: airports, seaports, and railroads. Although independent SBUs are structured to operate as independent profit-and-loss centers, all revenues from overall CEPA operations are pooled and allocated across SBUs at the discretion of the CEPA executive level. Although CEPA enjoys autonomous status, its annual operating budgets and investment plans are subject to approval by the nation’s General Assembly.

Electrical power and telecommunications are regulated by *Superintendencia General de Electricidad y Telecomunicaciones* (SIGET), which is authorized to regulate power generation, transmission, and distribution, with additional authority to license telecommunications and Internet service providers.

### C. IMPLEMENTING INSTITUTIONS

The following sections provide an overview of each of El Salvador's major trade infrastructure components. The discussion provides a brief description of major facilities and overall operations and provides recommendations for improvement as appropriate. For reference, Exhibit 3 provides a regional map of El Salvador.

**Exhibit 3: El Salvador Country Map (N.T.S.)**



#### 1. Roadway Networks

Through implementation of a number of strategic roadway improvement projects and collection of network user fees, El Salvador enjoys a highly developed intercity highway network. Road improvement projects have included development of four-lane divided highways along principal corridors between major population centers and national trade gateways. Furthermore, these improvements incorporate high-capacity geometric design principles recommended by modern highway design associations such as the Association of State Highway and Transportation Officials (AASHTO). Currently, four-lane divided highway corridors are provided principally along the southern portion of the nation with city bypass projects under way toward the north of San Salvador. Augmenting El Salvador's high-capacity intercity highway system is a network of secondary two-lane, paved roadways as well as unpaved roadways. In the nation's southern region, two-lane paved roadways are of new construction and incorporate industry best practices

with regard to geometric design. Estimated levels of service are below B during non-peak periods on two-lane roads and at B or better on four-lane divided roads during non-peak periods. The system is considered to provide competitive service levels within the region because of its overall condition; however, it requires continued upgrades to complete network capacity and policy reform to protect the nation's investments.

To facilitate trade, El Salvador's roadway network and administrative authority will require targeted improvements, many of which have been identified by the Ministry of Public Works. Key improvements and recommendations include the following:

- ◆ Empower roadway development and maintenance authorities to impose penalties for non-compliant system users. The greatest challenge facing El Salvador's roadway network is protecting the nation's investments from abuse. Legal reform is required to empower implementing institutions to impose penalties for noncompliant users. According to interviewees, current law, enacted in the late 1950s, provides limited capabilities for the MOP to protect its investments from rapid decay resulting from user abuse (i.e., overloaded trucks). In addition, little power exists for implementing institutions to maintain right-of-ways from physical and visual obstructions introduced by others. For example, there are multiple instances of unauthorized commercial enterprises and signage erected along primary thoroughfares. Current law does not empower removal of these obstructions by implementing institutions and should be reviewed and updated to protect the nation's investments.
- ◆ Implement safety measures in the nation's roadway design and operations. Currently, users include motorized vehicles (trucks, buses, and automobiles), human- and animal-powered vehicles, and pedestrians. Although shoulder areas developed alongside recently improved roadways provide adequate clearance for passage of these users, the density of nonmotorized vehicular traffic represents an impediment to safety. This is simultaneously a societal awareness issue and a corridor design issue. It is recommended that a national campaign be implemented to improve overall highway safety awareness. At the same time, it is recommended that future corridor designs incorporate dedicated nonmotorized vehicle lanes (i.e., bicycle lanes) along densely populated areas. The combination of these recommendations will improve overall highway safety, reducing accidents and impedances to free flow.
- ◆ Focus future roadway network improvements on completion of four-lane divided highways along major corridors and in the northern region of the country. The existing roadway between San Salvador and Cutuco varies in design capacity. However, implementation of the planned La Union container terminal at Cutuco will necessitate capacity upgrades along this key corridor. Along the northern region, two-lane roadways will require upgrades to improve traffic flows. Currently, according to interviews, little or no funding is available to execute improvements in this region. Predominant thinking involves future public-private partnerships to realize future roadway improvement projects. Continued support to El Salvador's infrastructure improvement program will be necessary to realize completion of these projects.
- ◆ Implement bridge and overpass upgrades and improvements along principal freight corridors. Common to the region, many of El Salvador's existing highway bridges are



undercapacity with regard to existing highway loads. As is common throughout much of Central America, many of these bridges were designed and constructed with loading limits of approximately 25 tonnes. Today, load limits are typically more than 40 tonnes. Although funding to improve the entire portfolio of El Salvador's bridges would be difficult to acquire, targeted improvements along major freight corridors is highly recommended. Improvements would enable the nation to realize the benefits of high-capacity truckloads, reducing both traffic congestion and labor costs.

## 2. Seaports

El Salvador currently has one primary operating seaport facility located along the Pacific Coast. This facility, the Port of Acajutla, is a multipurpose facility handling general cargo, containers, and liquid and dry bulk cargoes. The facility operates as an independent port authority under the umbrella of CEPA. As with the nation's international airport, the Port of Acajutla enjoys economic autonomy with regard to revenue collection, operating costs, and investments, subject to approval of the national budget by the General Assembly. CEPA operates Acajutla as an operating port authority utilizing private sector concession contracts for major maritime services, such as stevedoring operations. Currently, CEPA administers seven concession contracts at the port. Port authority responsibilities exclude Customs, Immigration, and Agricultural inspection services. The Port of Acajutla was recently certified under International Ship and Post Security (ISPS) codes and is in the midst of executing its security plan. Observations indicate that landside access security procedures may be considered high.

### Exhibit 4 Breakdown of Key Infrastructure Elements at Puerto Acajutla<sup>109</sup>

Component	Puerto Acajutla
Location	Pacific Coast
Operation	Public operating port authority; private sector service concessions
Main wharf	2 finger piers 1,192 m total available berth length 3 additional private terminals
Water depth	Varies (9 m – 12 m)
Number of berths	8 – (6 effective)
Cargoes handled	Containers Liquid bulk Dry bulk General cargo
Dedicated wharf equipment	Liquid bulk discharge systems Dry bulk evacuators Conveyance systems
Container yard layout	Straddle carrier
Expansion potential	Low
Comments	Excellent access, both landside and waterside
Overall assessment	Less competitive

As was learned during on-site visits and relevant interviews, the facility's support backlands includes two dry bulk distribution facilities; leased liquid bulk storage facilities; dedicated container storage areas; four covered storage warehouses; and open storage facilities for neobulk,

<sup>109</sup> Information gathered from interviews conducted and marketing materials received during on-site visit to the Port, on file with author.

automobiles, and other roll on, roll off cargo. Currently, one warehouse is leased by Customs for inspection services. All facilities are secured through facility-wide perimeter fencing and accessed via one of two manned gate facilities.

To facilitate trade, El Salvador's seaport system would benefit from the following key improvements and recommendations. Develop a purpose-built, dedicated container-handling facility to meet growing needs for Pacific Coast regional capacity. The Port of Acajutla can best be characterized as a combination general-cargo- and bulk-cargo-handling facility that has been adapted to accommodate containerized cargo. As assessment interviews revealed, Although recent statistics for container handling indicate that annual volumes have grown from approximately 10,000 to 65,000 containers over the past three years, the facility is nearing the limits of its operating capacity with regard to container operations, while creating capacity constraints on traditional bulk cargoes. Development of a purpose-built facility elsewhere along the Pacific Coast will provide El Salvador with a competitive advantage for high-value time-sensitive goods, while maintaining capacity for traditional cargoes at its existing facility.

CEPA has identified that an important part of its international trade infrastructure development strategy must include development of a dedicated, purpose-built container-handling facility along the Pacific Coast. For the past several years, CEPA and other interest groups have conducted detailed studies aimed at redeveloping the Cutuco port area, located in the southeast quadrant of the nation. According to interviews, the proposed facility, La Union Container Terminal, is currently being pursued and has received significant funding from an international lending institution. The future La Union terminal would enjoy 14+ meters of natural deep water, providing El Salvador the opportunity to accommodate Post Panamax class container vessels. Coupled with the Canal Seco project, and incentives for the development of value-added facilities in the region, El Salvador's strategic transportation vision has the potential to establish El Salvador as the leader in international trade and distribution. It is strongly recommended that the nation continue to study the economic viability of this strategic vision. The following steps are recommended:

- ◆ In the near term, establish priorities to build container yard operational capacity. Puerto Acajutla's container yard is at the limits of its operational capacity because of two infrastructure shortcomings: appropriate storage space and appropriate numbers of deployed equipment. The container yard is currently highly congested, resulting in significant delays for cargo movement and hurting competitiveness from a service reliability standpoint. A large percentage of containers in the yard are characterized as long-dwell empty containers. Establishing tariff policies that impose penalties for extended storage of empty containers would quickly eliminate this constraint. After implementation of such policies, CEPA may consider developing additional storage space as required. The facility also needs additional container-handling equipment. As of this writing, three of four CEPA-owned straddle carriers were operational. The facility will require two or three additional straddle carriers to improve operational efficiency.
- ◆ Establish priorities to improve electronic data connectivity within the terminal. Currently, interconnectivity of communications systems between gate facilities, yard operations, and vessel operations is lacking. For example, because of non-connectivity of systems, trucks entering one gate must exit the same gate to be weighed. Inbound weigh data currently

cannot be transmitted to the second gate to complete the outbound weighing requirement. Improvement in this area will improve overall service and reduce costs associated with landside carrier delays.

- ◆ Establish procedures and deploy facilities to eliminate landside carrier congestion. Current operations at Puerto Acajutla necessitate truck drivers parking vehicles at multiple locations to process paperwork at a centralized office. Highly efficient port terminals maintain a policy to keep truck drivers from leaving their vehicles to process paperwork by providing drive-up processing facilities. Puerto Acajutla should consider implementing such policies to improve overall truck processing times, reduce congestion, and eliminate delays. Improvement in this area will improve overall service and reduce costs associated with landside carrier delays.

### 3. Airports

El Salvador currently operates two qualified international airports; however, only one airport is of significant importance with regard to commercial passengers and air cargo. The primary international airport, Aeropuerto Internacional El Salvador, is located approximately 50 kilometers southwest of San Salvador and accessed via a four-lane divided highway providing good vehicle access. The facility is considered to be one of Central America's best international airport facilities, operating as both a destination airport as well as a hub airport for transit passengers. Data for 2003 indicate the facility handled approximately 1.8 million international passengers. Construction of the facility was initiated in 1973 with initiation of Phase I (now called the "Old Terminal"), an 8-gate passenger terminal. Phase II, completed in 1998 (now called the "New Terminal"), consists of an additional eight gates. The 16 gates include a total of 14 articulated passenger jetways. The facility is located at sea level and is equipped with two runways: a single, unobstructed, 3,200-meter flexible pavement runway, capable of accommodating the industry's largest commercial aircraft, and a smaller general aviation crossing runway. Current plans include lengthening the primary runway by an additional 200 meters. Future expansion potential exists for development of a parallel runway through availability of adjacent land, currently unowned by CEPA.<sup>110</sup>

To facilitate trade, El Salvador's airport infrastructure will require targeted improvements aimed at capturing business opportunities, improving security, and improving overall operations. Key improvements and recommendations include the following:

- ◆ Mitigate security breaches through segregation of arriving and departing international passengers. Although considered an international airport, with no domestic services, El Salvador's primary airport currently provides no means of preventing passenger contamination (i.e., mingling of international arrival passengers with international departure passengers within the terminal). In this manner, the terminal operates similar to a domestic facility, which is undesirable for international airport terminals. This deficiency should be addressed through development of segregated international passenger arrival corridors bound for immigration and customs halls before entry into the

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<sup>110</sup> Information collected through site visits, interviews and CEPA marketing materials, on file with author.

country. Implementation of this improvement will improve the overall security reliability of the existing facility.

- ◆ Develop a strategy to capture growth opportunities in regional air cargo. El Salvador's primary airport terminal has a highly competitive advantage, with regard to installed infrastructure capacity, to emerge as a regional leader in air cargo operations. The facility has generous space to facilitate growth in this area. It is highly recommended that El Salvador identify and pursue strategies to realize its potential as a regional air cargo hub.
- ◆ Improve landside passenger-processing facilities. Although the airport terminal has been expanded to accommodate a large number of arrivals and departures simultaneously, passenger-processing facilities, such as ticketing counters, immigration, and customs inspections have not kept pace with these expansion efforts. Consequently, passenger congestion can be a serious problem during peak operating periods. Expanding passenger-processing facilities will improve overall service and reliability at the nation's key international airport facility.

#### **4. Railways**

Railway service is currently unavailable in El Salvador. Considering the economics of rail transportation, any future rail service initiatives must involve a Central American regional approach to realize the potential benefits of rail service. El Salvador's geography and land mass necessitate a regional rail concept to justify investment in rail service to the nation.

To facilitate trade, El Salvador would benefit from evaluating rail service alternatives. The following action item is recommended for consideration. Recognize the economic benefits of rail service through length of haul and consolidated cargo characteristics. Rail services realize economic value across long distances, typically 500 miles or more. Services across long distances provide a competitive edge over trucking services. Considering the available lengths of haul within El Salvador, it appears that rail service would not provide competitive cost benefits should service be developed. However, to improve freight mobility competitiveness, regional strategic thinking is required. El Salvador should work with its neighboring countries and the United States to develop a regional intermodal rail strategic plan to realize the potential benefits afforded to rail service.

#### **5. Border Crossings**

El Salvador provides fixed administration and vehicle inspection facilities at all of its international border crossings. These facilities are designed to house Customs, Immigration, and Agriculture officials while providing vehicle and pedestrian travel ways. Historically, frequent vehicle inspections were conducted at each of the border crossings; however, customs procedures have been modified to speed traffic flow, easing the individual operational demands at each of the nation's border crossings. On-site visits and interviews with knowledgeable personnel revealed that the facilities may be considered highly productive in terms of annual throughput capacity due to both the limited cross-border inspections conducted at the facilities and policies enacted to maintain transit times below 15 minutes per vehicle. The study team sampled one facility for inspection. It was considered adequate to facilitate trade. In many cases, inspection facilities remain at the border crossings but see little use, typically for Agriculture

only. As noted earlier, regional initiatives include removing border-crossing facilities and, consequently, little or no investment is currently contemplated for El Salvador's borders.

Although the future intent is to remove formalized border crossings, near-term improvements are required to facilitate trade. The following improvement is recommended in the interim. Improve the reliability of computerized communications equipment. El Salvador's border-crossing facilities are electronically connected to those of its' neighboring countries. This technological advancement is a major plus; however, reports indicate there is low reliability with existing connections. Efforts to improve the reliability of electronic connections at the border crossings would further enhance overall service and reliability.

## **6. Electricity**

El Salvador's electrical power-generation, transmission, and distribution-implementing institutions are a mix of private and public entities. Power generation consists primarily of hydroelectric power plants operated by two predominant private electric companies, CEL and Duke Power. Approximately 65 percent of the nation's electric power is generated through hydroelectric power plants. Fossil fuel and geothermal power plants make up the balance of the nation's power-generation facilities, each operated by private entities. Power transmission is provided by the El Salvador Electricity Transmission Company (ETESAL), a Government-owned entity. Five independent private companies provide local distribution; however, four of the five are wholly owned subsidiaries of a single power-distribution company.

To facilitate trade, El Salvador's electricity system would benefit from the following key improvements and recommendations:

- ♦ Vigorously support ongoing regional transmission capacity upgrades. An important regional project, currently supported by the Inter-American Development Bank, involves inter-country connectivity and improvement of transmission capability within the region. On an annual basis, El Salvador is a net importer of electricity, having insufficient generation capacity within its borders to meet peak demands. However, existing transmission capacity is limited and poses a potential threat to the nation's competitiveness should planned upgrades not be realized. Consequently, continued support in this area is highly recommended.
- ♦ Develop self-sufficiency in electricity generation through development of efficient generation facilities. The CAFTA opportunity has great potential to induce compounding increases in the demand for electricity. Although El Salvador has sufficient capacity to accommodate existing average demand and relies on imports to accommodate peak demands, without increased generation capacity the nation will quickly become more dependent on imports to meet average daily demands, which will increase costs. From a competitiveness standpoint, El Salvador's attractiveness would be affected. Consequently, it is highly recommended that support be provided to seek alternatives for the development of additional electricity-generation capacity.

## **7. Telecommunications and the Internet**

Telecommunications and Internet services are provided by a number of private sector service providers throughout the metropolitan areas of the country. El Salvador's telecommunications market is considered an open and competitive marketplace, providing opportunities for users to benefit from modern, high-capacity technology. Both fixed and wireless communications are provided within this competitive landscape. According to interviews with individuals involved with the telecommunications industry, the current ratio of telecommunications service to population density is 29/100. Wireless communications represent 16/100, whereas fixed-line communication represents 13/100.

As with other regional telecommunication service providers interviewed in neighboring countries, providers fear downward pressure on international call pricing, forcing a rebalance of local and national call subsidies. Additionally, it is important to note that the region has yet to come to terms with a harmonized plan for recovering international termination costs for calls between Central American countries. Currently, providers initiating calls retain all revenues. This practice creates inequities in recovering costs depending on the ratio of outgoing to incoming calls placed between the Central American countries. It is perceived that implementation of CAFTA will put significant pressures on the telecommunications industry to resolve this issue. Consequently, it is highly recommended that support be provided to identify and evaluate solutions to harmonize the international telecommunications industry.

#### **D. SUPPORTING INSTITUTIONS**

##### **1. Trucking Companies**

Private trucking companies operate throughout the country with significant capacity provided at seaport and inland distribution terminals. Trucking companies provide drayage and inland distribution services for all international trade. The quantity and quality of trucking companies available in El Salvador are considered adequate and scalable to facilitate trade.

##### **2. Airlines**

Aeropuerto Internacional El Salvador is served by most all major airlines, currently providing service to accommodate more than 1.8 million annual passengers. The facility serves as the major transit hub for Grupo TACA, the major Central American airline carrier. Major carriers also provide air cargo service. Air service is considered adequate and scalable to facilitate trade; however, landside passenger-processing facilities are considered to be inadequate during peak operating hours in the near term. This includes ticketing facilities and security checkpoints. It is recommended that CEPA continue to work closely with law enforcement agencies to guarantee adequate staffing and facilities during peak operating hours.

##### **3. Ocean Carriers**

El Salvador serves a significant number of international ocean carriers calling at regular intervals. Services include containerized cargo, breakbulk, neobulk, and liquid bulk cargoes. Private sector companies provide vessel stevedoring and landside transportation. Sufficient supporting institutions participate in the maritime activities of El Salvador.

##### **4. Railways**

Railway service is currently unavailable in El Salvador. Considering the economics of rail transportation, any future rail service initiatives must involve a Central American regional approach to realize the potential benefits of rail service. El Salvador's geography and land mass necessitate a regional rail concept to justify investment in rail service for the nation.

## **5. Power Distribution**

Power distribution from private sector generating plants is provided through two primary generation companies, with a large percentage of imported electricity during peak demand periods. Supporting institutions include transmission and distribution companies. International transmission capacity is inadequate to accommodate future demands. Consequently, either upgrades of international transmission capacity or capacity building of local power-generation plants will be necessary to meet power demands.

## **6. Telecommunications and the Internet**

Landline and wireless telecommunications and Internet services are provided through private sector concessions in an open market and competitive environment. This environment provides users with a number of technologies and reliable services from which to choose.

## **E. RECOMMENDATIONS**

El Salvador's transportation infrastructure has seen significant improvements in recent years, particularly in the area of highway corridor development. The system is at risk because of abuse from non-compliant system users. Implementing institutions require legal reform to enforce compliance with regulations. The following steps are recommended:

- ◆ Continue roadway improvement. El Salvador's roadway network improvement program is incomplete. Continued execution of highway improvement projects is required in the northern regions of the country. Highway improvement projects should be coupled with further development of the Canal Seco project.
- ◆ Assist ports through technical capacity building, especially in operations and equipment acquisition. El Salvador's seaport facility will require capacity building and operational enhancement in the near term to facilitate trade. Technical support in policy reform is required to reduce congestion. In addition, technical support in operations planning and equipment acquisition is required to improve overall service.

El Salvador's existing seaport container facility is inadequate to facilitate trade in the long term. The nation's contemplated La Union Container Terminal project should be considered a national priority to enable El Salvador to participate heavily in international trade. The execution of this project, in conjunction with further landside transportation improvements and development of value-added facilities, has the potential to make El Salvador a regional leader in regional distribution and international trade. Technical support in demand analysis, risk assessment, and business planning is required before execution of this project. The following steps are recommended:

- ◆ Improve security and operations at Comalapa Airport and seize the opportunity to remain the leading regional hub. El Salvador's international airport facility requires terminal upgrades to improve security and accommodate peak passenger-processing demands at ticketing and processing areas. Technical support is required to realize these improvements. El Salvador's international airport facility has strong potential to grow substantially in both transit passenger handling and regional air cargo distribution. Strategic planning support is required to capture this opportunity.
- ◆ Consider regional cooperation and development of a rail network. El Salvador's rail network is non-operational. The size of the country limits opportunities for cost-effective rail operations; however, through partnering with its neighboring countries, El Salvador may develop a regional rail network that would benefit the overall CAFTA nation region. Technical support on a regional-planning level is required to fully understand the potential benefits of rail transportation for both the country and the region.
- ◆ Improve the electricity and telecommunications sectors. El Salvador's electricity supply is at risk. The nation requires upgrades to regional transmission capacity and development of additional power-generation facilities. Technical and strategic planning support is required to mitigate this future risk. El Salvador's telecommunications sector, common to all Central American nations, is at risk of significant price increases for local calls and inequities associated with regional international calls. Technical support and focus groups are required to develop a regional plan to harmonize the recovery of termination costs.



## ATTACHMENT 1: COMPILATION OF RECOMMENDATIONS

### COMPANY LAW

No.	Type	Recommendation	Priority	Duration
1.	Training/education campaign	Corporate governance training is needed for business people, lawyers, judges and governmental officials, as well as a promotional campaign on corporate governance for the society at large.	Medium	Long term
2.	Legal reform	Regulations need to be passed to establish better supervision and discipline of lawyers and notaries.	High	Medium term
3.	Legal education	Modernization of law schools curricula, legal education for common people and modern international commercial law training to lawyers and judges using the case approach teaching methodology as a complement to existing USAID and UNPD programs.	Medium	Long term
4.	Legal Reform	Legal reform of the Commercial Code is needed to incorporate world-class corporate governance principles, protection to minority shareholders and exceptions when the legal personality of companies could be disregarded.	High	Long term
5.	Monitor	CIDA's Commercial Registry integration project should be followed up and cooperation offered to evolve into a one-stop shop.	Medium	Long term
6.	Analysis/Strategy Development	Perform a diagnostic of the micro and small business situation to help identify and remove obstacles that affect the growth of SMEs and slow consolidation of SMEs programs and SMEs clustering.	High	Short term

### CONTRACTS

No.	Type	Recommendation	Priority	Duration
1.	Consensus Building	Hold workshops and working groups to build consensus on need of judicial reform, depoliticization of the judicial system and litigious culture.	High	Long term
2.	Legal reform	Regulations need to be passed to establish better supervision and discipline of lawyers and notaries.	High	Medium term
3.	Institutional strengthening	Efforts should be made to promote existing arbitration centers, other alternative dispute resolution mechanisms, and ADR generally. The abuse of <i>amparo</i> in arbitral cases should be restricted by legal reform and judge training.	High	Long term

No.	Type	Recommendation	Priority	Duration
4.	Legal education	Modernization of law schools curricula, legal education for common people and modern international commercial law training to lawyers and judges using the case approach teaching methodology as a complement to existing USAID and UNPD programs.	Medium	Long term
5.	Monitor/Consensus building	Approval of new civil and commercial procedure code, add notification by electronic means, fax, and certified mail and training for oral procedures.	High	Short term
6.	Monitor	Assist as possible with ongoing World Bank project on judicial reform, including suggestion of guidelines for judges and justice selection, as well as case management techniques that can introduced in court system.	Medium	Long term
7.	Legal reform	Approve Electronic Contract Law and change in distribution and agency agreement law to allow choice of foreign law and jurisdiction	Medium	Medium term

#### REAL PROPERTY

No.	Type	Recommendation	Priority	Duration
1.	Consensus building	Build consensus around national registry reforms.	High	Short term
2.	Legal Reform	Establish enhanced regulatory standards of notaries.	Medium	Long term
3.	Legal Reform	Work to pass law on zoning and territory order.	Medium	Short term
4.	Legal reform	Law on securitization should be passed, allowing credit to be obtained publicly by granting guarantee on non-liquid assets.	High	Medium term
5.	Legal Reform	A new law on real property lease should be passed.	Medium	Long term
6.	Monitor	Monitor the World Bank Real Property/Cadastre Registry project, offer support and follow up with a “show-up or shut-up” law and assistance to consolidate data and technologically coordinate with other governmental offices.	Medium	Long term
7.	Technology/ Institutional strengthening	Develop and implement a plan whereby remittances can be invested on-line from abroad in Real Estate.	Low	Long term

**COLLATERAL**

No.	Type	Recommendation	Priority	Duration
1.	Legal Reform	A new law of secured transactions is needed, shaping the draft law of <i>Garantías Reales Mobiliarias</i> to make sure that it is consistent with all aspects of the OAS/CIDIP Model Law of Secured Transactions. This should include an effort to regionalize key credit institutions, such as the commercial registry.	High	Long term
2.	Legal Reform	A new law of Civil and Commercial Procedures should be drafted, that addresses and eliminates many of the delays and bottlenecks in current judicial enforcement of collateral guarantees.	Medium	Long term
3.	Institutional Reform	Support for training of judicial officials, in cooperation with the <i>Consejo Nacional de la Judicatura</i> (CNJ), which has in place a judicial school ( <i>escuela judicial</i> ) to train a pool of candidates for judicial vacancies, is needed. Training for sitting judges lacks such organization, which adversely affects the judicial system.	Medium	Long term
4.	Institutional Capacity	The court system is significantly behind with respect to technology and hardware for its operations. A pilot plan has been tested but due to a lack of funds, the plan has apparently been abandoned. Funding and guidance should be given to revive and assist in this effort.	High	Short term

**COMMERCIAL DISPUTE RESOLUTION**

No.	Type	Recommendation	Priority	Duration
1.	Training/promotion – private/public sector	In order to take advantage of recent passage of the Law on Mediation, Conciliation, and Arbitration, and subsequent creation of the Center of Mediation and Arbitration, extensive training and promotion on the benefits and practicalities of Alternative Dispute Resolution (ADR) is needed: <ul style="list-style-type: none"> <li>▪ Promote and train on the mechanics (e.g., standard use of arbitration clauses in commercial contracts) and advantages of ADR through El Salvador’s network of associations and chambers.</li> <li>▪ Conduct public information campaigns (literature, radio, television), seminars, etc. to inform on and encourage use of ADR.</li> <li>▪ In areas of law where ADR is required, provide additional, specialized training in these areas to legal professionals.</li> </ul>	High	Short term
		<ul style="list-style-type: none"> <li>▪ Introduce throughout El Salvador’s law schools, courses specifically devoted to arbitration, mediation, and conciliation.</li> </ul>	Medium	Long term

2.	Analysis	Conduct cost-benefit analysis survey of using ADR versus pursuing commercial dispute resolution in court. Specifically look at fees associated with institutional arbitration and cost to business in terms of time and opportunity costs. Use results in public education campaign on benefits of ADR.	Medium	Short term
3.	Institutional Reform	Continue on-going reform of the commercial courts in order to ensure expeditious, efficient, and predictable results.	Medium	Long term

### BANKRUPTCY

No.	Type	Recommendation	Priority	Duration
1.	Legal Reform	A new law of insolvency, taking into account the concepts, principles and rules included in the UNCITRAL draft convention on international insolvency, currently in final stages of drafting, and other recent national laws of insolvency.	High	Long term
2.	Legal Reform	A new law of Civil and Commercial Procedures and a new law of <i>Garantías Reales Mobiliarias</i> , both of which take account of and harmonize with insolvency law reforms.	Medium	Long term
3.	Institutional Reform	Support for training of judicial officials, in cooperation with the <i>Consejo Nacional de la Judicatura</i> (CNJ), which has in place a judicial school ( <i>escuela judicial</i> ) to train a pool of candidates for judicial vacancies, is needed. Training in this vein is of greater importance for building judicial competence in applying insolvency laws, given the total lack of experience in El Salvador today.	Medium	Long term
4.	Institutional Capacity	The court system is significantly behind with respect to technology and hardware for its operations. A pilot plan has been tested but due to a lack of funds, the plan has apparently been abandoned. Funding and guidance should be given to revive and assist in this effort.	High	Short term

**COMPETITION**

No.	Type	Recommendation	Priority	Duration
1.	Assessment/ Legal Drafting/ Legal Reform	<ul style="list-style-type: none"> <li>▪ Conduct a dual assessment of the policy agenda and the institutional setting to fully understand the breadth and scope of policy potential.</li> <li>▪ Consider carefully the institutional structure of the Dirección General de Competencia. Conduct detailed examinations of the advantages and disadvantages of different institutional models of competition authorities in LAC.</li> <li>▪ Disseminate proposed law to legal, business, and academic communities for input in the drafting process.</li> <li>▪ Finalize draft of law.</li> <li>▪ Develop a series of seminars to promote private sector support for passage and implementation of a competition law.</li> </ul>	High	Short term
2.	Institutional Capacity Building	<ul style="list-style-type: none"> <li>▪ Develop a policy strategy to make the law operational, including institutional arrangements (<i>e.g.</i>, staffing and training).</li> <li>▪ Strengthen the regulatory and enforcement capabilities of the agency, including analyzing and achieving synergies with consumer protection law enforcement; and developing capacity for detecting, investigating, analyzing and remedying suspected violations of the competition law, etc.</li> <li>▪ Engage in advocacy initiatives, including conducting reviews of government policies and regulations affecting competition, and preparing studies on key sectors.</li> </ul>	Medium	Long term
3.	Outreach/Education	<ul style="list-style-type: none"> <li>▪ Promote a competition culture through public communication including: preparing communication/media materials; enhancing the capacity of media in publication of competition-related issues through dialogue/workshops with journalists; engaging in dialogue/workshops with related law enforcement officers, other government regulators, and the business and academic communities.</li> <li>▪ Develop regional training programs with universities and bar associations.</li> </ul>	Medium	Long term

**INTERNATIONAL TRADE**

No.	Type	Recommendation	Priority	Duration
1.	General	<p>In matters concerning foreign trade, particularly in its infrastructure and the efficiency of its customs operations, El Salvador seems quite advanced, especially within Central America. There are no pressing legal issues in this sector for the foreseeable future, but steps are still needed to improve the situation:</p> <ul style="list-style-type: none"> <li>▪ Encourage the current cooperation between the private and public sectors;</li> <li>▪ Encourage and support the continuing improvement in customs administration and operations, including additional training for customs officials; and</li> <li>▪ Monitor the utility and coverage of the legal framework for foreign trade, taking into consideration that reforms in areas such as the internal administration and procedures for applying countervailing duties will be necessary in the future.</li> </ul>	Medium	Long term
			Medium	Long term
			Low	Long term

**FLOW OF GOODS & SERVICES**

No.	Type	Recommendation	Priority	Duration
1.	Regional Harmonization	<p>Promote regional standardization and strategies for the Customs Union through the following:</p> <ul style="list-style-type: none"> <li>▪ Develop a regional CACM center for risk assessment to develop a regional selectivity system, compliance measurement program, audit verification approach, joint investigations and verification of country of origin processing.</li> <li>▪ Create a coordinated information center for all data relating to Customs Union procedures, easily accessible by the trade community and with required advance notification time lines. As this concept continues to develop, the trade community will be presented with a multitude of changes it must be informed of and adapt to. Procedures should be fairly detailed to minimize discretion by the Customs officials. SIECA would be a strong candidate to coordinate the project. However, it is essential that each participating country notify the center of implementing regulations and procedures in a timely manner.</li> </ul>	High	Long term
			Medium	Long term

No.	Type	Recommendation	Priority	Duration
2.	Facilitate trade processes	<p>Upgrade the professionalism and modernization of public agencies (other than Customs) involved in international trade through the following actions:</p> <ul style="list-style-type: none"> <li>▪ Assist Ministry of Agriculture in developing a comprehensive personnel system that would upgrade candidate qualifications, improve recruitment procedures, establish job-specific performance and evaluation standards based on existing international SPS inspectional standards.</li> <li>▪ Train the Financial Division of the National Civil Police in examination of containers and trailers, investigative and interviewing techniques, and surveillance and undercover operations.</li> <li>▪ Provide contraband detection kit equipment, such as probes, density meters, mirrors, and fiber optic scopes to the financial police to increase their effectiveness in cargo examination.</li> <li>▪ Provide technical assistance to Ministry of Health laboratory personnel, to upgrade their ability to perform competent and expeditious analysis of processed food products in an environment that meets international certification requirements.</li> <li>▪ Simplify the process of obligating expenditures from the user fee funds available to the agencies so that they can be used to modernize processes and upgrade personnel rather than reverting back to the Ministry of Finance every six months.</li> <li>▪ Develop a modern system of registration and import and export permit processing by the Ministry of Health. This must include at a minimum filing of applications and payments electronically or through withdrawals from an existing account, electronic transmission of the permits and approvals to the applicant and linkage to the Customs processing system.</li> </ul>	<p>High</p> <p>High</p> <p>High</p> <p>High</p> <p>Medium</p> <p>High</p>	<p>Short term</p> <p>Short term</p> <p>Short term</p> <p>Medium term</p> <p>Medium term</p> <p>Long term</p>

No.	Type	Recommendation	Priority	Duration
3.	Customs Modernization	<p>Modernize Customs processing to facilitate trade by the following actions:</p> <ul style="list-style-type: none"> <li>▪ Revise the law regarding Customs penalties or its interpretation to eliminate the issuance of penalties for clerical type errors and facilitate filing of appeals. This should also include revising the concept of personal responsibility that hampers use of good judgment within the agency. Minor errors such as missing information should be handled outside the penalty provision unless it indicates a pattern of poor performance on the part of the filer. The appeal process should not be so onerous and costly that users simply pay the fine rather than challenge the assessment when they feel they are correct.</li> <li>▪ Issue the AEA license by sector, designing the test so that the license remains valid as long as the party continues to work in that industry, not necessarily with only one company.</li> <li>▪ Develop Free Zone implementing regulations and procedures to avoid inconsistencies in Customs processing.</li> <li>▪ Implement a one-stop processing center to include all agency personnel at Acajutla for the clients.</li> <li>▪ Train field officers in a pro-business approach to their functions so that reliable traders are treated as valuable clients who should receive expedited processes and facilitation.</li> </ul>	<p>High</p> <p>Medium</p> <p>High</p> <p>High</p> <p>High</p>	<p>Long term</p> <p>Medium term</p> <p>Short term</p> <p>Medium term</p> <p>Long term</p>
4.	Private sector improvements	<p>Provide assistance to the private sector trade community to increase their competitiveness in the international market through the following actions:</p> <ul style="list-style-type: none"> <li>▪ Develop a national quality control program, through CONACYT and the university sector.</li> <li>▪ Develop and implement a coordinated plan for SME's to address their general, not sector specific, training needs. This would include such areas as IT capabilities, English proficiency, accounting techniques and cost analysis.</li> <li>▪ Coordinate the approximately 20 programs now available to exporters into a one-stop operation to increase the various programs' effectiveness and reduce costs by reducing duplication and providing easy access to the services by the export community.</li> <li>▪ Develop a national web site to disseminate information on the projects and actions of the various private associations representing the trade community. This would include training, seminars, and issues the organizations are dealing with before the public sector. It must be easy to access and provide information by topic and sector.</li> </ul>	<p>High</p> <p>High</p> <p>High</p> <p>Medium</p>	<p>Medium term</p> <p>Short term</p> <p>Short term</p> <p>Medium Term</p>



No.	Type	Recommendation	Priority	Duration
5.	Promote international standardization	Develop and promote WTO compliant User Fee legislation for Customs services (such as declaration processing) to augment budget and to create a fund for: <ul style="list-style-type: none"> <li>▪ payment of salaries</li> <li>▪ purchase of equipment and tools</li> <li>▪ modernization of Custom and upgrading of facilities</li> </ul>	High	Medium Term -6-18 months
6.	Developed of integrated border functions	Develop and promote a Border Agency approach to trade to include Customs, National Police, Agriculture, Immigration and Health; <ul style="list-style-type: none"> <li>▪ integrated training program for all Border Agencies similar to that of US Federal Law Enforcement Center approach</li> <li>▪ intelligence gathering and sharing information and one stop processing</li> <li>▪ law enforcement skills in areas such as cargo examination and searches</li> <li>▪ investigations in areas such as tax fraud, financial, and technology crimes</li> <li>▪ sharing of techniques and tools among Border agencies</li> </ul>	High	Medium Term 6-18 months
7.	Customs Modernization	Continue to promote modernization and upgrading of Customs automated systems, including: <ul style="list-style-type: none"> <li>▪ electronic exchange of trade information with other CAFTA countries</li> <li>▪ provide additional training to further develop risk analysis system and automate risk processes</li> <li>▪ electronic interface with the courier industry to expedite processing</li> </ul>	High	Medium Term 6-18 months
8.	Customs training	Provide training to increase capacity of Customs officers in the area of: <ul style="list-style-type: none"> <li>▪ Customs Valuation agreement</li> <li>▪ Rules of origin: determination of regional content and verification of certificate</li> <li>▪ Commercial fraud detection techniques</li> </ul>	High	Short Term 3-6 months
9.	Customs facilities improvements	Identify and provide funding for additional tools for Customs examination sites and to upgrade Laboratory facility, including: <ul style="list-style-type: none"> <li>▪ Modern tools for personnel dedicated to examination of cargo</li> <li>▪ Resource materials and software for laboratory</li> <li>▪ Updated equipment for laboratory</li> <li>▪ Major equipment such as container scanners for a less intrusive but more productive approach to detection of weapons, drugs and contraband and to improve border protection</li> <li>▪ Cameras for goods warehouse, commercial cargo lots to prevent access to or pilferage of goods under Customs control</li> </ul>	Medium	Medium/ Long term 6-24 m

## FLOW OF PEOPLE

No.	Type	Recommendation	Priority	Duration
1.	Legal and Regulatory	Harmonize and implement CA-4 immigration visa so that trade-related visitors may enter one country and visit all with appropriate security.	High	Medium term
2.	Legal and Regulatory	Amend laws to create streamlined process for highly skilled individuals (engineers, doctors, attorneys, etc.). Simplify the process by implementing a one-stop processing center at most appropriate ministry. This process should include, at a minimum, filing of applications and payments through one agency with transparent, predictable process for review and determination.	Medium	Medium term
3.	Legal and Regulatory	Eliminate review requirement for all exiting parties by strengthening risk assessment and enforcement function. It should be mandatory for citizens and visitors to “check in” but departure procedures should be unencumbered and lead to less delays at borders.	Medium	Medium term
4.	Operational	Modernize and upgrade automation for people processing at the border, including passport readers and networked computers so that borders have capacity for the following: <ul style="list-style-type: none"> <li>▪ electronic exchange of people information with other CAFTA countries</li> <li>▪ enhanced risk analysis system and automate risk processes</li> </ul>	Medium	Long term
5.	Operational	Provide training to increase capacity of Customs officers in the area of: <ul style="list-style-type: none"> <li>▪ Document fraud detection techniques</li> <li>▪ Customer service</li> <li>▪ Risk management</li> </ul>	Medium	Medium term

## FINANCIAL CRIMES

No.	Type	Recommendation	Priority	Duration
1.	Training	Provide training and technical assistance to relevant law enforcement agencies on best practices for general financial crimes-related investigation procedures as well as specific case-building techniques (e.g., evidence gathering, interviewing, research, etc.).	Medium	Short term
2.	Legal reform	Review current anti-money laundering laws and policies to ensure it meets current norms and standards, including anti-terrorist financing.	High	Short term

**FLOW OF MONEY**

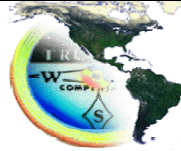
No.	Type	Recommendation	Priority	Duration
1.	Institutional	<p>Improve access to credit for small and medium-sized exporters and importers. While the basic tools for conducting exchange of payment for trade (i.e., letters of credit), trade and financial institutions must develop strategies to more effectively extend credit to reliable small and medium-sized traders. A robust trading system provides small and medium-sized traders with the ability to finance their export and import activities, yet the current system often requires many smaller traders to self-finance their activities. This reality imposes serious costs on importers and exporters making them less competitive. Strategies to pursue, include such activities as:</p> <ul style="list-style-type: none"> <li>▪ establishing guarantee funds that offer credit to exporters for fewer guarantees than currently demanded;</li> <li>▪ developing associations/cooperatives among producers for pooling of resources and risks to acquire lower cost credit;</li> <li>▪ increasing importers and exporters understanding of existing bank instruments through seminars and training.</li> </ul>	Medium	Long term

**INFRASTRUCTURE**

No.	Type	Recommendation	Priority	Duration
1.	Roadway Network Maintenance	<p>Promote extension of useful life of newly developed high capacity roadway infrastructure</p> <ul style="list-style-type: none"> <li>▪ Minimize maintenance costs associated with user deployment of overweight vehicles</li> <li>▪ Minimize traffic impacts associated with user deployment of malfunctioning and/or inadequate equipment</li> <li>▪ Empower regulatory bodies to impose penalties for non-compliant users</li> </ul>	High	Short term
2.	Roadway Network Safety / Security	<p>Promote safety and security measures to minimize accidents</p> <ul style="list-style-type: none"> <li>▪ Develop social awareness and educate users with regard to traffic safety</li> <li>▪ Eliminate encumbrances and user distractions along the nation's right-of-ways (i.e. keep the right-of-way clear.)</li> <li>▪ Incorporate pedestrian and human-powered vehicle right-of-ways within corridor cross-section design</li> <li>▪ Minimize pedestrian access to highway network</li> </ul>	Medium	Short term

No.	Type	Recommendation	Priority	Duration
3.	Roadway Network Development	<p>Promote re-development and expansion of regional highway network, particularly along the northern territory</p> <ul style="list-style-type: none"> <li>▪ Evaluate economic benefits of improvements to northern territory highway networks</li> <li>▪ Continue development of four-lane divided highways as appropriate along key corridors</li> <li>▪ Establish alternative funding sources outside donor agencies through user fees, concession agreements, or taxes.</li> <li>▪ Empower regulatory bodies to execute “eminent domain” in acquisition of right-of-way rights.</li> </ul>	Medium	Long term
4.	Seaport Facilities	<p>Increase operational capacity of existing containerized cargo facilities</p> <ul style="list-style-type: none"> <li>▪ Deploy appropriate quantities of cargo handling equipment, particularly within the container storage yard</li> <li>▪ Eliminate long-term storage of empty containers through evaluation of existing tariff structure</li> <li>▪ Develop gate infrastructure to eliminate truck driver departure from vehicles</li> </ul>	High	Short term
5.	Seaport Facilities	<p>Establish national priority to develop a purpose-built container handling facility</p> <ul style="list-style-type: none"> <li>▪ Continue initiatives associated with development of La Union</li> <li>▪ Establish goals to attract private sector shippers/distributors through development of free trade zones</li> <li>▪ Consider, evaluate, and execute the potential benefits associated with development of high capacity roadway networks from the proposed La Union development site to San Salvador to attract carriers.</li> <li>▪ Discount the perceived benefit of mini-land bridge (Canal Seco) service in the absence of free trade initiatives</li> </ul>	High	Medium term
6.	Regional Distribution Hub	<p>Exploit and further develop existing transportation infrastructure asset base through</p> <ul style="list-style-type: none"> <li>▪ Development of co-located warehousing / assembly / manufacturing facilities</li> <li>▪ Development of free trade zones</li> <li>▪ Leadership in regional intermodal strategic thinking</li> </ul>	High	Long term
7.	Airport Facilities	<p>Increase operational capacity of landside access facilities</p> <ul style="list-style-type: none"> <li>▪ Work closely with Customs, Immigration, and ticketing agents to improve passenger throughput capacity during peak periods</li> </ul>	High	Short term

No.	Type	Recommendation	Priority	Duration
8.	Electricity Generation, Transmission & Distribution	Provide service reliability and cost consistency for end-users <ul style="list-style-type: none"><li>▪ Continue to pursue Plan Puebla y Panama and IADB initiatives</li><li>▪ Pursue privatization of state power transmission provider</li><li>▪ Understand nation's dependence on imported electricity, international transmission limitations, and potential cost savings through investment in new power generation facilities</li><li>▪ Provide training to regulatory body</li></ul>	High	Medium term
9.	Railroad	Evaluate benefits associated with redevelopment of nation's existing rail corridors <ul style="list-style-type: none"><li>▪ Seek optimal length-of-haul opportunities through partnering with international neighbors</li></ul>	Low	Long term



## **ATTACHMENT 2: ROUNDTABLE PACKAGE**

### **Preparación para el CAFTA y la Armonización Regional Comercio, Derecho Comercial y Estrategia para el Fortalecimiento Institucional Mesa Redonda**

22 de julio de 2004 • 13:30 – 18:30  
Hilton Princess Hotel • San Salvador, El Salvador

#### **Temario**

1:30 – 2:00 **Registro**

2:00 – 2:30 **Palabras de bienvenida**

- Presentación del temario: Emad Tinawi, Booz Allen Hamilton
- Repaso de los objetivos regionales estratégicos de USAID: Ron Greenberg, USAID
- Bienvenida y repaso de las medidas para la armonización regional: Juan Carlos Rivas, Ministerio de Economía
- Metas Estratégicas y Objetivos de la Actividad de Diagnóstico del CAFTA: Booz Allen

2:30 – 3:15 **Sesión I: Presentación de las conclusiones del diagnóstico sobre el comercio y el Derecho Comercial**

- Perspectiva de un Experto Salvadoreño: Javier Castro, FUSADES
- Conclusiones referentes al Derecho Comercial: Omar Garcia Bolivar, BG Consulting
- Conclusiones referentes a las aduanas y el comercio: Andrew Mayock, Booz Allen

3:15 – 3:30 **Café**

3:30 – 4:45 **Sesión II: Discusión en grupos**

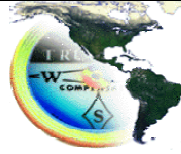
- Medidas en pro de un mercado más abierto
- Implicaciones estratégicas para apertura e integración regional
- Eliminación de los barreras comerciales
- Fortalecimiento de un crecimiento empresarial sostenible: un nuevo régimen jurídico sobre la insolvencia

4:45 – 5:00 **Presentación de los resultados de la discusión grupal**

5:00 – 5:30 **Comentarios finales y clausura**

- Ministerio de Economía
- USAID

5:30 – 6:30 **Cóctel**



### **Breakout Discussion Topics**

#### **Mechanisms to Fostering Greater Openness in the Market**

- What additional steps can be taken to ensure adoption of the current or other effective competition draft law is enacted?
- How can effective implementation and application of competition laws and policy be achieved? What are the institutional, regulatory, and policy needs for implementation? What may be the impediments to implementation?
- What are other major challenges to expanding investment?

#### **Exploring the Strategic Implications of Greater Openness and Regional Integration**

- What are the priority legal/regulatory, policy, and other challenges that SMEs in general will face in CAFTA? What specific challenges will SMEs in priority economic growth sectors face?
- How can the private sector and civil society complement government efforts to improve the environment for SME export growth?
- What are the implications for increased participation of the informal sector in the formal economy? How can SMEs in the informal sector be encouraged and assisted to participate in the formal economy? How can the private and public sectors better support SMEs transitioning to the formal sector?

#### **Breaking Down Trade Barriers**

- What are the linkages between trade, security, and competitiveness?
- How can the private sector be mobilized to push for key legal and policy reforms that improve the environment for investment and trade?
- What are the critical areas where regional harmonization has not occurred?
- In areas where regional harmonization is underway, what can be done to accelerate progress?

#### **Facilitating and Safeguarding Business Growth: Long-Term Needs for Insolvency Mechanisms**

- What are the challenges to the present insolvency system?
- What would it take to foster a working, viable system?

**Conclusions/Recommendations from:  
Preparing for CAFTA and Regional Harmonization  
Trade, Commercial Law and Institutional Development Strategy  
Roundtable Discussion  
Hotel Princess, San Salvador, El Salvador, July 22, 2004**

**TOPIC #1: MECHANISMS TO FOSTERING GREATER OPENNESS IN THE MARKET**

A law on free trade must be passed that accurately and properly develops constitutional principles regarding free trade and free competition:

- The usefulness of draft law currently before the legislature must be studied to ensure its efficacy.
- There is an urgent need to disseminate the draft law throughout the public and private sectors in order to ensure that the highest quality “economic constitution” be passed and that there is a level playing field within the market, both from domestic and international trade perspectives, so that small and medium enterprises (SMEs) have the greatest chance to achieve a viable level of competitiveness.

To achieve effective implementation of a law on free trade, assuming one passes, the regulatory body which is created must:

- Be well financed and have sufficient authority in the law so that it will have real ability to perform its duties such as investigations, auditing, and sanctioning, as well as overcome entrepreneurial resistance to, and fears of, its work.
- Have sufficient technical capacity to implement it. The Ministry of the Economy must engage in training of the personnel that will work in this regulatory body. In addition, those involved in the judicial implementation of the law, including lawyers, businesspeople and judges, as well as administrators, must have sufficient technical training.

**Topic #2: Exploring the Strategic Implications of Greater Openness and Regional Integration**

- Small-to-medium enterprises (SMEs) currently face challenges with respect to the legal processes to form a company. The costs of becoming a formal part of the economy is too high for most SMEs as they are suddenly forced to pay taxes and make other required payments. One solution to this would be to give SMEs flexible treatment about legal requirements.
- SMEs have limited access to credit and difficulty to otherwise secure financing. One way to solve this would be to approve a law that allows broader use of assets other than property to guarantee financing and securitization. In addition, both the public and private sectors should develop programs to stimulate SME growth, which includes, for example, the development of greater “clusters” of businesses with certain sectors, such as agriculture.
- Most SMEs lack access to the necessary technology to compete at either the domestic or international level against larger companies as only a very small percentage even own computers. Training in the benefits of technology as well as in its use is necessary, in conjunction with greater access to technology. As a result, SME will have easier access to information about the markets, which will in turn allow better planning and longer-term strategizing.
- Because of failings within the judicial system, SMEs cannot rely on it for protection with respect to contract disputes or idea protection, trademarks, etc. The judicial system must be



reformed and strengthened to increase reliability, efficiency, and predictability, as well as similar improvements in alternative dispute resolution.

### **TOPIC #3: BREAKING DOWN TRADE BARRIERS**

- Corruption is a significant problem with respect to business at all levels in both the public and private sectors. A cultural shift is needed so that people realize that such behavior is not in their own or the country's best interests. One method to help accomplish this is through a campaign to promote honesty.
- Those involved at the functional level of trade, such as customs officials, must have adequate training and education to ensure consistent application of rules throughout ports and border crossings. In addition users of these services must have knowledge of the system so that delays can be avoided.
- A law on free competition must be passed. At a minimum this law needs to ensure internal control of monopolies already existent in El Salvador. In addition the law should help protect against the new monopolies that will inevitably occur.
- El Salvador suffers from excessive bureaucracy, which slows progress and the flow of commerce. The large number of permits required from many different offices in the course of business causes untenable delays at great expense. The issuance of such permits should be concentrated into a "one-stop shop."
- The harmonization of norms across Central American countries delegates too much discretion to local authorities, leading to different applications of the law in different regions. Region-wide norms that do not delegate any more authority than is necessary should be agreed upon in order to avoid inconsistent application.

### **Topic #4: Facilitating and Safeguarding Business Growth: Long-Term Needs for Insolvency Mechanisms**

While there exists a constitutional framework and legal principles regarding bankruptcy and insolvency, the actual legislation used to implement those principles in the real world are weak. The process of bankruptcy is long, complicated, expensive for the parties, and inefficient in its execution, and as a result, is not implemented. In judicial practice, it can often be difficult to track down the debtor and their assets. In short, the insolvency process is inadequate for debtors and creditors alike.

- A new law on bankruptcy that follows UNCITRAL principles is needed, and is within the constitutional framework. Technical aid and training is required as there is limited expertise with both the public and private sectors on these process. Great assistance is needed with the judicial process, including and beginning with an analysis of the entire system to see where other obstacles exist, for example, with the notification processes.
- A project to develop a law regarding movable property guarantees must be restarted, and should follow the available model laws.
- Banking processes should be better regulated so that they may be applied as a viable alternative to judicial actions and attempts at recovering lost assets. The process must become more flexible, predictable, and effective.



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