2000 Country Reports on Economic Policy and Trade Practices
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EL SALVADOR

Key Economic Indicators

(Millions of U.S. dollars unless otherwise indicated)

	1998	1999	2000 1/
Income, Production and Employment:			
Nominal GDP	11,974.01	12,389.0	13,120.0
Real GDP Growth (Pct)	3.5	2.6	3.0
GDP By Sector			
Agriculture	1,432.2	1,475.0	1,615.0
Manufacturing	2,629.4	2,760.0	2,940.0
Services	6,878.0	7,290.0	7,620.0
Government	800.0	848.0	875.0
Per Capita GDP (USD) 2/	1,985.0	2,013.0	2,130.0
Labor Force (Thou) 3/	2,305.0	2,350.0	2,395.0
Unemployment Rate (Pct) 4/	8.0	8.0	7.8
Money and Prices (Annual Percentage Growth):			
Money Supply Growth (M2)	12.0	9.0	8.0
Consumer Price Index	4.2	-1.0	5.0
Exchange Rate (Colon/US$)	8.75	8.75	8.75
Balance of Payments and Trade:			
Total Exports (FOB) 5/	2,452.0	2,500.0	3,100.0
Exports to U.S. 5/	1,454.0	1,597.0	1,740.0
Total Imports CIF 5/	3,965.0	4,084.0	4,450.0
Imports from the U.S. 5/	2,028.0	2,112.0	2,300.0
Trade Balance	-1,510.0	-1,584.0	-1,350.0
Balance with U.S.	-574.0	-515.0	-560.0
External Public Debt	2,632.0	2,810.0	2,910.0
Fiscal Deficit/GDP (Pct)	2.0	2.5	2.7
Curr Acc Deficit/GDP (Pct)	0.7	-0.9	-1.3
Debt Serv Paym/GDP (Pct	3.0	3.0	3.0
Gold and Foreign Exchange Reserves	1,765.0	1,969.0	2,045.0
Aid From the U.S.	38.0	56.8	34.9
Aid From All Other Sources 6/	38.0	38.0	46.0

1/ 2000 figures are Central Bank estimates based on August data.
2/ Per capita growth based on 1992 census data.

3/ Economically Active Population, i.e. all those over age 15.
4/ Figures do not include underemployment.
5/ Including gross maquila.
6/ Grants only; figures do not reflect NGO assistance and bilateral loan programs.

1. General Policy Framework

In 1999, El Salvador's economy grew by 2.6 percent, compared to the 3.5 percent growth posted in 1998. Growth weakened in 1999, spurred by poor international prices for El Salvador's principal export commodities, weak exports to other Central American countries recovering from Hurricane Mitch, and an investment slow-down caused by the March 1999 elections. In late November 2000 the Government of El Salvador announced two important economic revitalization initiatives: introduction of the U.S. dollar as a legal currency concurrent with the Salvadoran colon, and a $914 million national infrastructure development program.

2000—Economy's Modest Performance

Data from the first semester of 2000 shows a modest performance for the economy. During the first quarter of 2000, the economy grew at 2.2 percent, up from 1.3 percent in the last quarter of 1999. The second quarter of 2000 reports a 2.5 percent growth; however, the outlook for the upcoming months of 2000 suggests that serious efforts are needed to attain the Salvadoran government's 3 to 4 percent annual growth rate target for 2000. Positive signs are a good performance so far in maquila exports, a trend of lowering interest rates that should stimulate private investment, and increasing family remittances from Salvadorans working in the United States, which should increase aggregate demand. Though a little behind schedule, the government's execution of a moderately ambitious public investment program (including paving 200 miles of rural roads and rebuilding important stretches of the Panamerican highway) should also prop up aggregate demand. The government and business community expect the new Caribbean Basin Trade Partnership Act (CBTPA) trade preferences and pending ratification of a Free Trade Agreement with Mexico to create 75,000 to 150,000 jobs, mostly in the maquila sector. However, worrying factors such as high petroleum prices, higher electricity prices, the application of the Value Added Tax (VAT) to basic foods and medicines since April 2000, and a continuing high crime rate are an ongoing drag on investment and growth.

Sectoral Performance

The modest growth trend in 2000 has been led by agriculture (bouncing back from years of depression and the Mitch disaster), the finance sector, and maquila exports. Other sectors such as commerce, construction, and industry, are showing little or no growth.

During the first semester of 2000, exports grew 18.7 percent in value compared to the same period in 1999, reaching $1.51 billion. Of these, maquila products alone grew by 23 percent, followed by coffee, which grew by 18 percent. Imports increased by 14 percent from January-June 2000, compared to the same period in 1999, with the trade deficit staying at a relatively high level. As in the past, family remittances continue to play a key role in offsetting the deficit. From January through July 2000, remittances reached $817 million, an eight percent increase over the same period a year ago.

Fiscal Developments

On the fiscal side, Salvadoran government tax revenues reached $886 million from January to June 2000, a six percent increase over the same period in 1999. Tax revenues to June 2000 are some two points below the programmed government revenues for the period, and tax collection rates remain among the lowest in Latin America. According to government authorities, petroleum, VAT and electricity price hikes caused inflation to rise to five percent.

The official outlook for 2001 is for continued macroeconomic stability. The Central Bank continued its conservative monetary policy in 2000. The money supply is expected to expand by eight percent in 2000, compared to nine percent in 1999. Interest rates on loans with maturities of less than a year decreased to 14.5 percent by mid 2000, compared to 18.5 percent two years ago. Medium and long-term interest rates also went down from 20 to 16.6 percent in the same period.

In 1998 the government successfully privatized the state telephone company, the electricity distribution companies and pension funds. In 1999 the government successfully auctioned the thermal power plants and plans to sell its remaining shares in the telephone company. The 2000 $2.1 billion central government budget continued to shift spending from military to social investments, with about one third of the central budget dedicated to social development including health, education and public works. The 2000 budget is likely to result in a fiscal deficit estimated at 2.7 percent of GDP, compared to 2.5 percent in 1999. The deficit has been financed with official domestic and external bonds. By law, the Central Bank is not allowed to finance government deficits. The 2001 projected deficit is expected to increase by four percent over the 2000 budget.

2. Exchange Rate Policy

The colon has been informally pegged at 8.75 per dollar since 1994. Large inflows of dollars from Salvadorans working in the United States offset a significant trade deficit ($1.66 billion are expected to enter the Salvadoran economy in 2000). At the end of June 2000, net international reserves at the Central Bank were $1.9 billion, one of the highest levels in history. In late November 2000 the Government of El Salvador introduced monetary integration legislation that would introduce the dollar as a legal currency fixed at 8.75 colons to the dollar, require bank accounts to convert depositors' colon-denominated accounts to dollar-denominated accounts, and require the dollar be used as the financial system's accounting unit. Businesses would be free to sign contracts denominated in dollars, colons, and other major currencies. The government plans to have the legislation passed in December 2000, authorizing the introduction of the dollar on January 1, 2001.

3. Structural Policies

The United States is El Salvador's main trade partner. Imports from the United States have increased an average of 16 percent per year since 1993. Imports from the United States, which constitute from 55 to 60 percent of all El Salvador's imports, are projected to reach $2.3 billion in 2000, up from $2.1 billion in 1999. Key to this trend is the multi-year program (whose last phase concluded in July 1999) to radically lower tariff barriers. Under this program, tariffs for most capital goods and raw materials have been reduced to zero or one percent, and tariffs on intermediate and final goods have been reduced to a maximum rate of 15 percent. El Salvador's 1998 environmental law is providing new opportunities for exports of U.S. clean technology. Salvadorans' familiarity with U.S. products has helped fuel the U.S. export boom.

Customs Procedures: In September 1997 the government launched a new, simplified customs procedure system which reduces the former cumbersome 20 step import process to seven steps. A second stage of this customs modernization program, consisting of processing import/export papers via computer/satellite from the user's office, was implemented in November 1998, and a final stage to facilitate electronic payment of import duties was launched in February 1999. Close to 80 percent of all Salvadoran imports consist of capital and intermediate products. The government has an open procurement policy in practice, upgraded and made more transparent with recent approval of a new modern government procurement law. U.S. companies compete actively for contracts.

Privatization: El Salvador has liberal legislation under which it has privatized the state owned telephone company (ANTEL), four electricity distribution and two thermal generating companies, and pension funds. All of these projects represent good opportunities for U.S. suppliers and investors.

Price Policies: Prices, with the exception of bus fares and utilities, which are moving toward market prices, are unregulated. While fuel prices are not regulated, commercial margins on gasoline and diesel fuel are set by regulation at the import level and by the terms of an agreement between the government and the oil industry at the wholesale level. A commission to monitor the telecommunications and electric sectors (SIGET) has been established.

The 13 percent value-added tax (VAT) is applied to all goods and services, domestic and imported, with no exception (basic grains, dairy products, fruits, vegetables and medicines, which used to be exempt from the VAT, were incorporated in April 2000). In September 1999 the VAT and income tax laws were reformed to expand the country's taxable base and increase government revenues. The government policy on basic grain tariffs (applied to imports from countries outside the Central American Common Market) is set by seasonal supply and demand conditions in the local market. Last April, the Salvadoran government announced a new sectoral policy to provide agriculture incentives, based on high protective tariffs. Under this new scheme, white and yellow corn are charged 20 percent ad valorem duty; paddy and milled rice, 40 percent; fluid milk and dairy products, 40 percent; sorghum, 40 percent; fruits and vegetables, 30 percent; pork, 40 percent; and beef, 30 percent.

4. Debt Management Policies

El Salvador has traditionally pursued a conservative debt policy. External debt stood at $2.81 billion at December 1999, a 6.8 percent increase over the previous year. Almost 70 percent of this debt has been contracted with international financial institutions, and 30 percent with bilateral organizations and other sources. The debt service in 2000 amounted to $341 million, or 2.6 percent of the projected GDP. El Salvador's prudent debt policies have been recognized by improved risk ratings on its official debt instruments by organizations such as Moody's and Standard and Poor's.

El Salvador has succeeded in obtaining significant new credits from diverse international sources over the last three years. Some $300 million has been contracted from international institutions and governments (Spain, Germany, Japan) for infrastructure works and social programs to be undertaken over the next few years. In August 1999 El Salvador successfully placed $150 million in Euro-Bonds. The debt profile is expected to increase over the next several years as the international donor community has pledged $1.26 billion to finance El Salvador's reconstruction and modernization. In early October the Finance Minister announced plans to consolidate and refinance outstanding government debt. El Salvador's financing from the international community is a combination of both loans and donations; over the last six years, 80 percent of total government financing has been through low interest loans from IDB and the World Bank. El Salvador's conservative fiscal policy provides strong assurances that debt service will stay below three percent of GDP.

5. Aid

Aid grants from the United States totaled $57.7 million in 1999. Bilateral military assistance (international military and educational training) from the United States totaled $500,000 in 1999 and $538,000 in 2000.

6. Significant Barriers to U.S. Exports

There are no legal barriers to U.S. exports of manufactured goods or bulk, non-agricultural products to El Salvador. Most U.S. goods face tariffs from zero to 15 percent. The range by category is zero to 5 percent for capital goods, 5 to 10 percent for intermediate products, and up to 15 percent for final goods. Higher tariffs are applied to automobiles, alcoholic beverages, textiles and some luxury items, but the Salvadoran government also plans to gradually reduce these tariffs in the near future.

Generally, standards have not been a barrier for the importation of U.S. consumer-ready food products. Poultry is the notable exception; since 1992, the government has imposed a zero tolerance requirement for several common avian diseases such as salmonella, effectively blocking all imports of U.S. poultry. The Ministry of Agriculture (MAG) requires a salmonella-free certificate showing that the product has been approved by U.S. health authorities for public sale. Importers may also be required to deliver samples for laboratory testing, but this requirement has not been enforced. However, lately MAG is requesting plant inspections at origin to allow imports of various food products into the local market. The cost for this procedure has to be paid by the exporter or the local agent/distributor. All fresh food, agricultural commodities and live animals must be accompanied by a sanitary certificate. Basic grains and dairy products also must have import licenses. Authorities have not enforced the Spanish language labeling requirement.

El Salvador is a member of the WTO and has implemented most of its Uruguay Round commitments on schedule. The government is an active participant in the Summit of the Americas/Free Trade of the Americas process. The country is a member of the Central American Common Market, and together with Guatemala and Honduras, signed in May 2000 a Free Trade Agreement with Mexico. A Free Trade Agreement was also signed with the Dominican Republic in 1998, and currently negotiations are under way to sign a Free Trade Treaty with Chile.

El Salvador officially promotes foreign investment in virtually all sectors of the economy. Foreign investment laws allow unlimited remittance of net profits, except for some services (hotels, restaurants, etc.) where the law allows 50 percent. No restrictions exist on establishing foreign banks or branches of foreign banks in El Salvador. Recently, the Legislative Assembly approved a more open and modern Investment Promotion Law, a new Banking Law and a New Government Procurement Law.

7. Export Subsidies Policies

El Salvador does not employ direct export subsidies. It offers a six percent rebate to exporters of non-traditional goods based on the FOB value of the export, but some exporters have found it difficult to collect. Free trade zone operations are not eligible for the rebate but enjoy a 10-year exemption from income tax as well as duty-free import privileges.

8. Protection of U.S. Intellectual Property

El Salvador belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO), and is a signatory to the Paris Convention, Bern Convention, Rome Convention, Phonograms Convention, and The Nairobi Treaty. El Salvador's IPR Laws are among the most progressive in the region, and while some problems still need to be addressed, the Attorney General's IPR Enforcement Unit and National Registration Center have been vigilant in addressing IPR violations. A September 2000 USTR Watch List review of El Salvador determined that El Salvador should not be put on the list but requested continuing progress on IPR TRIPS compliance and workers' rights issues.

In 1999 and 2000 the Intellectual Property Office of the Attorney General's Office took strong enforcement measures against IPR violators in a number of areas including videos and music cassettes, medicines, books and clothing. Starting in 1999, officials began raids on software pirates.

El Salvador's current Law Protecting Intellectual Property Rights took effect in October 1994. This law, along with El Salvador's acceptance of TRIPS disciplines, addresses several weak areas. Patent terms were extended to 20 years, and the definition of patentability was broadened. Compulsory licensing applies only in cases of a national emergency. Computer software is protected, as are trade secrets. The Salvadoran government is drafting legal changes to make its IPR laws TRIPS compliant, as required by the January 2000 TRIPS deadline. These IPR legal changes are expected to be enacted by early 2001.

Trademarks are still regulated by the Central American Convention for the Protection of Industrial Property, but the Salvadoran government is preparing draft trademark and copyright legislation for presentation to the National Assembly in October 2000. It is an occasional practice to license a famous trademark and then seek to profit by selling it when the legitimate owner wants to do business in El Salvador. In November 1994, El Salvador signed an amended version of the Convention, which, among other things, would address this issue. The revised Convention will take effect upon ratification by three of the participating Central American governments. According to government officials, they are working on a draft for a separate semiconductor chip law.

With international funding, the government is completing a comprehensive reorganization of its antiquated National Registry Office. The registration process has been simplified and computerized and significant progress is being made in reducing backlogs and adjudicating disputes. The Business Software Alliance has had mixed results in its campaign to eradicate pirated software but has received increasing cooperation from Salvadoran government officials and legal authorities.

9. Worker Rights

a. *The Right of Association:* The constitution prohibits the government from engaging in antiunion actions against workers trying to organize. Unions and strikes are legal only in the private sector. Employees of autonomous public agencies may form unions but not strike. Nevertheless, many workers, including those in the public sector, form employee associations that carry out strikes that, while technically illegal, are accorded the same treatment as strikes by other unions.

b. *The Right to Organize and Bargain Collectively:* The constitution guarantees the right of workers and employers to form unions or associations. El Salvador has a small, organized labor sector with approximately 150 active unions, public employee associations, and peasant organizations, representing over 300,000 citizens, or 20 percent of the total work force. The constitution and the Labor Code provide for collective bargaining rights, but only to employees in the private sector and in autonomous government agencies. In fact, both private sector unions (by law) and public sector employee associations (in practice) use collective bargaining.

c. *Prohibition of Forced or Compulsory Labor:* The constitution prohibits forced or compulsory labor, except in the case of calamity and other instances specified by law. This provision is followed in practice.

d. *Minimum Age for Employment of Children:* The constitution prohibits the employment of children under the age of fourteen. Minors fourteen or older may receive special Labor Ministry permission to work, but only where such employment is indispensable to the sustenance of the minor and his family. Child labor is not found in the industrial sector. Legal workers under the age of eighteen have special additional rules governing conditions of work.

e. *Acceptable Conditions of Work:* The minimum wage is $4.80 (42 colones) per day, for commercial, industrial, and service employees. For agricultural workers, it is $2.47 plus a food allowance per day. Minimum wage for workers at coffee mills is $3.56 and for sugar mill is $2.60. The law limits the workday to six hours for youths between fourteen and eighteen years of age and eight hours for adults, and it mandates premium pay for longer hours. The Labor Code sets a maximum normal workweek of 36 hours for youths and 44 hours for adults.

f. *Rights in Sectors with U.S. Investment:* U.S. investment in El Salvador has increased in recent years, especially in the energy and financial sectors. The Labor Laws apply equally to all sectors, including the so-called “maquilas” (assembly or processing plants) in Free Trade Zones (FTZ). Most FTZ companies have accepted codes of conduct from their parent corporations or U.S. purchasers. These codes include worker rights protection clauses. The great majority of workers in the FTZs receive better salaries and working conditions than are offered elsewhere in the private sector. Nevertheless, there were credible reports of factories dismissing union organizers.

Extent of U.S. Investment in Selected Industries—U.S. Direct Investment Position Abroad on an Historical Cost Basis—1999

(Millions of U.S. dollars)

Category		Amount
Petroleum		(1)
Total Manufacturing		150
Food & Kindred Products	11	
Chemicals & Allied Products	25	
Primary & Fabricated Metals	8	
Industrial Machinery and Equipment	0	
Electric & Electronic Equipment	(1)	
Transportation Equipment	0	
Other Manufacturing	(1)	
Wholesale Trade		25
Banking		(1)
Finance/Insurance/Real Estate		(1)
Services		9
Other Industries		106
TOTAL ALL INDUSTRIES		722

(1) Suppressed to avoid disclosing data of individual companies.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.