EL SALVADOR

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

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

	1996	1997	1998 1/
Income, Production and Employment:			
Nominal GDP	10,358.0	11,264.0	12,500.0
Real GDP Growth (pct)	2.1	4.0	4.0
GDP by Sector:			
Agriculture	1,340.0	1,450.0	1,400.0
Manufacturing	2,156.3	2,391.0	2,686.0
Services	5,088.1	5,576.0	6,025.0
Government	698.0	747.0	800.0
Per Capita GDP (US$) 2/	1,789.0	1,906.0	2,050.0
Labor Force (000s) 3/	2,219.0	2,260.0	2,305.0
Unemployment Rate (pct) 4/	7.6	7.6	6.7
Money and Prices (annual percentage growth):			
Money Supply Growth (M2)	14.0	9.4	12.0
Consumer Price Inflation	7.8	2.0	4.0
Exchange Rate (Colon/US$)	8.75	8.75	8.75
Balance of Payments and Trade:			
Total Exports FOB 5/	1,790.3	2,425.0	2,705.0
Exports to U.S. 5/	955.0	1,312.0	1,527.0
Total Imports CIF 5/	3,222.4	3,740.0	3,940.0
Imports from U.S. 5/	1,606.0	1,975.0	2,077.0
Trade Balance	-1,432.0	-1,325.0	-1,235.0
Balance with U.S.	-651.0	-633.0	-550.0
External Public Debt	2,524.0	2,680.0	2,500.0
Fiscal Deficit/GDP (pct)	2.3	2.0	2.0
Current Account Deficit/GDP (pct)	-1.7	-1.9	-1.6
Debt Service Payments/GDP (pct)	4.2	3.0	3.0
Gold and Foreign Exchange Reserves	1,100.0	1,462.0	1,860.0
Aid from U.S.	57.0	38.0	38.0
Aid from All Other Sources 6/	78.0	38.0	38.0

1/ 1998 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 1997, El Salvador's economy grew by 4 percent, compared to the meager 2.1 percent growth posted in 1996.

Data from the first eight months of 1998 indicate that the economy continues on a 4-5 percent growth path, in line with 1997. As of September 1998, the twelve months moving average of the index of economic activity, IVAE, increased to 4.5 percent from 4.2 percent in June. Growth has been led by strong performances in the external and financial sectors, as well as a resurgence in manufacturing, transport, and energy. Economic growth has taken place within the context of a low inflation rate which is expected to be 3 to 4 percent in 1998, compared to 2.0 percent in 1997 and 7.8 percent in 1996. The economic outlook for 1999 is somewhat clouded due to the significant damage wreaked by Hurricane Mitch (at the end of October and early November) on the country's infrastructure and on agricultural production. However, at this juncture, modest growth of about 4 percent is expected in 1999 within the framework of continued price stability.

The central bank continues to pursue a conservative monetary policy, increasingly independent from central government policies. The money supply expanded only 9.4 percent in 1997, versus 14 percent in 1996. The money supply is expected to expand 12 percent in 1998. Interest rates on loans for less than a year have declined to 15 to 16 percent in mid-1998, compared to 18 percent two years ago. Medium and long-term interest rates also went down from 20 to 18 percent.

In 1998, the government successfully privatized the state telephone company, the electricity distribution companies, pension funds, and sugar mills. The budget reflects the continued shift away from military spending to social investments, with about one third of the central budget dedicated to social development including health, education and public works. The expansionary 1998 budget is likely to produce a fiscal deficit no greater than 2 percent of GDP due to improved tax collection. The modest deficit has been financed with official domestic and external bonds. By law, the central bank is not allowed to finance government deficits.

1997 brought an increase in both imports (16 percent) and exports (35 percent). As in the previous years, the large structural trade deficit in El Salvador has been offset by family remittances and external aid. Remittances continue to be the second most important source of foreign exchange after exports and a major factor in El Salvador's macroeconomic stability.

Remittances are increasing at an annual rate of 6.5 percent, and an estimated 1.3 billion dollars will enter the national economy during 1998.

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. At the end of September 1998, the net international reserves at the central bank were 1.84 billion dollars, the highest level in history.

3. Structural Policies

The United States is El Salvador's main trade partner. Imports from the U.S. have increased an average of 16 percent per year since 1993. Imports from the U.S., which constitute about 50 percent of all El Salvador's imports, are projected to reach $2.01 billion in 1998, up from $1.97 billion in 1997. Key to this trend is the multi-year program, currently under way, 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 are scheduled to fall to a maximum rate of 15 percent by July 1999.

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 will be 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, and U.S. companies compete actively for contracts.

El Salvador has liberal legislation under which it has privatized the state owned telephone company (ANTEL), four electricity distribution companies, pension funds administrators, and sugar mills. The privatization of thermal and geothermal electricity generating plants is expected for 1999. All of these projects represent good opportunities for U.S. suppliers and investors.

Prices, with the exception of bus fares and utilities, which are moving toward market prices, are unregulated. Companion legislation to the telecommunications and electric privatization bills set up a commission to monitor the telecommunications and electrical sectors.

The 13 percent Value-Added Tax (VAT) is applied to all goods and services, domestic and imported, with a few limited exceptions for basics like dairy products, fresh fruits and vegetables, and medicines. At the end of 1994, the government replaced a price band mechanism, introduced in 1990 to regulate the tariffs on basic grains. The government policy on basic grain tariffs is set by seasonal supply and demand conditions in the local market. Currently, yellow corn is imported duty free; white corn enters duty free from February 1 through July 31, and is subject to 15 percent ad-valorem rate from August 1 to January 31.

4. Debt Management Policies

El Salvador has traditionally pursued a conservative debt policy. External debt stood at $2.430 billion at December 1997, a 6.7 percent increase over the previous year. In the first quarter of 1998, the government used $300 million from the sale of the electricity distributors to pay off short term external debt. Later in the year it contracted new loans, and total external debt is expected to return to the $2.4 billion level by the end of 1998. Almost 70 percent of this debt has been contracted with international financing institutions, and 30 percent with bilateral organizations and other sources. The debt service in 1997 amounted to $338 million or 3.0 percent of the GDP, and is considered moderate. 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 two 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. The debt picture might change in the years to come due the need to finance reconstruction projects to repair infrastructure damaged by Hurricane Mitch.

5. Aid

Aid grants from the U.S. totaled an estimated $38 million in 1997. Military assistance from the U.S. totaled $450,000 in 1997 and $500,000 in 1998.

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 0 to 18 percent. Current tariffs are scheduled to fall to 15 percent for final goods, and 5 to 10 percent for intermediate products, by mid 1999. Higher tariffs are applied to automobiles, alcoholic beverages, textiles and some luxury items, but the Salvadoran Government also plans to gradually reduce these tariffs before 2000.

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 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. 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 expects to implement a full range 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, is negotiating a free trade agreement with Mexico. Free trade agreements are also being negotiated with the Dominican Republic and 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 services where the law allows 50 percent. No restrictions exist on establishing foreign banks or branches of foreign banks in El Salvador.

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 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, Berne Convention, Rome Convention, Phonograms Convention, and the Nairobi Treaty.

In July 1996, the U.S. Trade Representative removed El Salvador from the "Special 301" Watch List after a newly created enforcement unit began a series of raids on copyright and trademark violators. Initial raids centered on cassette and video vendors, but also included books and trademark clothing items. In 1997 and 1998, enforcement efforts continued. Government officials have begun working with local representatives of pharmaceutical manufacturers to identify and seize pirated medicines. In addition, starting in 1998, officials have targeted software piracy as a priority.

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.

Trademarks are still regulated by the Central American Convention for the Protection of Industrial Property. 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 Salvadoran Government officials, they are working on a draft for a separate semiconductor chip law.

With international funding, the government is completing a two-year 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.

9. Worker Rights

a. Right of Association: The constitution prohibits the government from engaging in antiunion actions against workers trying to organize and the 1994 Labor Code streamlined the process required to form a union in the private sector. 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 frequently carried out strikes that, while technically illegal, were treated as legitimate. Approximately 20 percent of the workforce are members of unions, public employees associations, or peasant organizations.

b. The Right to Organize and Bargain Collectively: The constitution prohibits the government from using nationality, race, sex, creed, or political philosophy as a means to prevent workers or employees from organizing themselves into unions or associations. In practice, the government has generally respected this right. 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. By law, only private sector workers have the right to organize unions and strike. Some employees of autonomous public agencies may form unions if they don't deal with essential services. Public employees may form employee associations, but are prohibited from striking. In fact, some of El Salvador's most powerful labor groups are public employees associations, which take on the same responsibility as unions -- including calling technically illegal strikes and collective bargaining. The government negotiates with these associations and generally treat strikes as legitimate, although the labor code mandates arbitration of public sector disputes. 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. Although not specifically prohibited, forced and bonded labor by children are covered by the general prohibition, and there were no reports of its use in the formal sector. However, there is strong evidence that minors are forced into prostitution.

d. Minimum Age for Employment of Children: The constitution prohibits the employment of children under the age of fourteen. The labor code specifically prohibits forced and bonded labor in general, but does not specifically cover children. Minors fourteen or older may receive special Labor Ministry permission to work, but only where such employment is absolutely indispensable to the sustenance of the minor and his family. This is most often the case with children of peasant families who traditionally work during planting and harvesting seasons. Child labor is not usually found in the industrial sector. Those legal workers under the age of eighteen have special additional rules governing conditions of work.

e. Acceptable Conditions of Work: The minimum wage was increased by 10 percent in 1998. Effective April 1998, the minimum wage is $4.80 (42 colones) per day, for commercial, industrial, and service employees. It had remained at $4.40 (38.50 colones) per day since 1995. For agricultural workers, it was raised to $2.47 from $2.26, plus a food allowance, per day. Minimum wage for workers at coffee mills was increased to $3.56 from $3.30 per day, and for sugar mill workers to $2.60 from $2.26 per day. The law limits the workday to 6 hours for youths between fourteen and eighteen years of age and 8 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 is distributed fairly evenly inside and outside the so-called “maquilas” or Free Trade Zones (FTZs). The labor laws apply equally to all sectors, including the FTZs. During the last few years, most FTZ companies have accepted the provisions of voluntary codes of conduct from their parent corporations or U.S. purchasers. These codes include worker rights protection clauses. In April 1997, the Salvadoran Apparel Industry Association (ASIC) announced an industry wide code of conduct, currently being implemented, with worker rights protection. The great majority of companies in the FTZs provide much better salaries and working conditions than are offered elsewhere in the private sector. Nevertheless, there were credible reports of factories dismissing union organizers. In addition, accusations persist of companies abusing their workers. This year, the Labor Ministry increased the number of inspectors and inspections, improved the professional training of the inspector corps, and made a better effort to follow up on such complaints.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		135
Total Manufacturing		31
Food & Kindred Products	10	
Chemicals & Allied Products	(1)	
Primary & Fabricated Metals	10	
Industrial Machinery and Equipment	0	
Electric & Electronic Equipment	5	
Transportation Equipment	0	
Other Manufacturing	(1)	
Wholesale Trade		17
Banking		(1)
Finance/Insurance/Real Estate		(1)
Services		8
Other Industries		(1)
TOTAL ALL INDUSTRIES		221

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.