

Trade Policy Review Body
3 and 5 February 2003

TRADE POLICY REVIEW

EL SALVADOR

Minutes of Meeting

Chairperson: H.E. Ms Amina Chawahir Mohamed (Kenya)

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I. INTRODUCTORY REMARKS BY THE CHAIRPERSON

1. The second Trade Policy Review of El Salvador was held on 3 and 5 February 2003. The Chairperson extended a warm welcome to the Honourable Mr Miguel Ernesto Lacayo, Minister of the Economy and head of the Salvadoran delegation, Mr Eduardo Ayala Grimaldi, Deputy Minister of the Economy, and the rest of the delegation from San Salvador. The Chairperson welcomed H.E. Mr Francisco Lima Mena, who had recently been appointed to head the Permanent Mission of El Salvador to the WTO, and the discussant, H.E. Mr Hernando José Gómez (Colombia). As usual, the discussant would speak in his personal capacity and, in accordance with the established procedures, he had made available, in advance, a summary of the main issues he intended to raise (document WT/TPR/D/90).

2. The Chairperson recalled the purpose of the Trade Policy Reviews and the principal procedures of the meeting. The Report by the Government of El Salvador and the WTO Secretariat Report were contained in documents WT/TPR/G/111 and WT/TPR/S/111, respectively. The delegations of Argentina, Chinese Taipei, Japan, Canada, Colombia, European Union, Switzerland and the United States had submitted advance written questions. These questions and the replies provided by the delegation of El Salvador were reproduced in document WT/TPR/M/111/Add.1.

3. The Chairperson observed that during the last ten years El Salvador had undertaken wide-ranging economic reforms. The privatization programs in the telecommunications, electricity and transport sectors and the adoption of new laws in key areas of the economy were concrete examples of the progress achieved by El Salvador in creating an efficient market economy. These reforms were remarkable in themselves but even more so considering that the country had emerged from a situation of armed conflict only a little more than ten years ago.

4. The Chairperson noted with interest the very important contribution made by the free zone regime to El Salvador's integration in world markets. However, as indicated by the respective Reports of the Government and the WTO Secretariat, closer integration was apparently being impeded by the limited diversification of trade. It would be useful to hear the views of the delegation of El Salvador on the need to introduce changes in the free zone regime in order to stimulate the diversification of trade and economic growth. Furthermore, in the light of El Salvador's active participation in various regional economic integration processes, Members would want to know to what extent, in the opinion of the national delegation, the preferential trade agreements signed by El Salvador were consistent both with each other and with the multilateral trading system.

II. OPENING STATEMENT BY THE REPRESENTATIVE OF EL SALVADOR

5. The representative of El Salvador thanked the Chairperson, the discussant and the WTO Secretariat. A little more than 10 years since the end of the civil war in which it had been embroiled, El Salvador now had a democratic system of government characterized by broad political diversity. However, so far El Salvador's economic development had been insufficient to ensure that this diversity would be permanently sustainable. One of the basic tasks of the present government was to encourage the economic development necessary to consolidate the progress made in the political sphere.

6. The representative of El Salvador said that his country considered the WTO extremely important. The rule-based multilateral trading system was one of the principal tools of economic development for El Salvador since it was helping to lock in its own economic reforms, by establishing a stable and predictable legal framework that would attract investment and invigorate the economy, regardless of the government in office.

7. At the same time, it was necessary to concentrate on further improving the multilateral trading system. There should be room and flexibility for the small economies to be able to maximize their potential and develop the institutions necessary to support the implementation of WTO rules. In this connection, the incentive schemes to facilitate the acceptance of free trade in countries such as El Salvador deserved special attention. It was also necessary to work hard at reducing the distortions which characterized world agricultural markets by, among other things, abolishing export subsidies. The establishment of an office of the Ministry of the Economy in Geneva would enable El Salvador to intensify its efforts to achieve these objectives.

8. El Salvador had been a driving force behind several regional free trade agreements. This trend was confirmation of El Salvador's conviction that free trade was a basic tool for promoting economic development. The representative pointed out that the regional agreements were consolidating the gains made within the framework of the WTO and enabling El Salvador to improve its trade policy more rapidly than would have been possible within the framework of the WTO alone. Moreover, the processes of regional economic integration gave small countries such as El Salvador an opportunity to exert a more direct influence on the outcome of the negotiations. Regional trade agreements could also establish important precedents, thereby enabling progress to be made in liberalizing regional and multilateral trade.

9. The representative of El Salvador commented on some of the advances his country had made in connection with the modernization of the State, support for competitiveness, fiscal and monetary policy, and foreign trade. These advances were a result of the belief that an important part of the country's economic future was bound up with increased participation in world trade, since there was a close link between economic openness, freedom and development and democracy.

10. The role of the Salvadoran State in the economy was becoming steadily less preponderant and its activities were becoming increasingly focused on providing for the needs of the population in the areas of education, health and local development. During a period in which El Salvador had had to face some very serious crises, such as that affecting the coffee sector, the country had nevertheless succeeded in reducing its current expenditure and increasing the resources allocated to education, health and local development. In as little as five years, poverty rates had declined from 56 to 36 per cent of the population. The illiteracy rate had also been reduced, from 17.2 per cent in 2000 to 15 per cent in 2001. Unemployment had fallen by approximately 2 per cent between 1996 and 2001, despite the increase in the population and the difficult world economic situation.

11. The representative noted that, as part of the State modernization initiative, since 2000 El Salvador had had a new Public Administration Procurement and Contracting Law governing State

(including municipal) purchases. This Law was designed to ensure that public resources were used more efficiently.

12. The adoption of a new Law on Telecommunications had raised the levels of competitiveness and investment in that sector. At the beginning of 2003, El Salvador had more than 15 companies operating in various parts of the telecommunications sector. Between 1998 and 2002, the number of mobile phone service subscribers had risen from 40,000 to 1 million, while the number of fixed lines had quadrupled. It was cheaper to make calls from El Salvador to almost any other part of the world than vice versa.

13. At the same time, the General Electricity Law, promulgated in 1996, had served as a basis for introducing competitiveness into the generation, transmission, distribution and marketing of electricity. Concrete progress had also been made with the establishment of a Central American electricity market within the framework of the Electrical Interconnection System for Central America (SIEPAC) which was intended to create an effective and efficient regional power market. The SIEPAC operating body was located in El Salvador.

14. The efforts to modernize the State had also been directed towards improving the country's transport infrastructure. Routine and preventive maintenance on the roads had been transferred to an entity administered by the private sector (Highway Fund -- FOVIAL), financed through a tax on gasoline consumption. This tax was introduced following the abolition of a public transport subsidy that had been in force for 30 years. All this had made it possible to reduce the staff of the Ministry of Public Works from 7,000 to 700. The state of the Salvadoran road network had improved since FOVIAL was set up. At the same time, a tender procedure had been initiated with a view to placing the management and operation of the country's busiest port (Acajutla) in private-sector hands under a long-term concession, and concessions continued to be granted for various airport services.

15. In 1999, a Banks Law establishing a legislative framework based on international principles of regulation and strict principles of banking supervision had been promulgated.

16. In recent years, in order to promote the competitiveness of its enterprises, El Salvador had introduced important legal and institutional reforms aimed at reducing private-sector production costs and improving predictability. A new Investment Law had been passed to provide greater transparency for both local and foreign investors and ensure that there was no discrimination. A National Investment Office had also been established. This Office, which linked eight government agencies, operated as a single window through which all the procedures for setting up a business could be completed in only two hours.

17. Significant progress had also been made in the intellectual property domain. El Salvador had adopted a Law on Trademarks and Other Distinctive Signs, in confirmation of its compliance with its international commitments. The Law provided protection for well-known marks even if they had not been registered in the Salvadoran Commercial Register. In 2000, El Salvador submitted to a voluntary review of compliance with its obligations under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement).

18. The representative noted that with the introduction of the *Teledespacho* system in 1999, customs procedures had been considerably streamlined. Users were now able to complete import formalities on the Internet. The adoption of an ISO 9000 quality system had enabled customs to cut its operating costs and improve transparency. In the framework of the Salvadoran policy of combating smuggling, some customs personnel had been replaced.

19. Where fiscal policy was concerned, El Salvador had managed to finance the costs of reconstructing its economy without impairing its fiscal position. Tax collection and the taxpayer base had been expanded and fraud and smuggling had declined. There was also less reliance on import

duties as a source of revenue. In 2001, import duties represented just 10 per cent of tax revenue as compared with 15 per cent in 1996.

20. As regards monetary policy, the representative noted that one of the pillars of El Salvador's economic reform process, the Law on Monetary Integration, which established the US dollar as legal tender, had entered into force in January 2001. In February 2003, US dollars accounted for approximately 87 per cent of the money in circulation. The Law had helped to turn El Salvador into the country with the lowest interest rates in Latin America and to consolidate the country's monetary policy. During the last five years, annual inflation had averaged between 2 and 2.5 per cent.

21. The representative noted the increasing importance of trade for El Salvador's economy. From 21 per cent of GDP in 1996, exports had risen to almost 29 per cent of GDP in 2001. As for imports, they accounted for 43 per cent of GDP as compared with 34 per cent in 1996.

22. The free trade zones were a key part of El Salvador's economic strategy. In addition to promoting investment, these zones were an important source of employment which had made it possible to decentralize the country's poles of economic development and investment. The free zone system had made a significant contribution to reducing female unemployment, which was only one third of unemployment in the male sector. The free zones had also become an important source of stability for the country. In the last three years the area set aside for free zones in El Salvador had doubled.

23. With respect to Central American integration, El Salvador had succeeded in harmonizing 83 per cent of its tariff universe with the countries of the region. It was intended that a customs union should start operating in 2004. The countries of the region had signed the regulatory part of a Central American Treaty on Investment and Trade in Services and had finalized a treaty to regulate procurement. Moreover, five of the seven products that did not form part of the regional free trade regime had now been incorporated. All these advances were helping to create a more attractive market for domestic and foreign investment.

24. The representative concluded his initial statement by noting the importance of convincing the population of El Salvador that free trade was synonymous with a better quality of life. In many cases, civil society was criticizing globalization in general and free trade in particular because it failed to see the connection between free trade and prosperity. Cooperation could play a very important part in correcting this situation and should facilitate the implementation of concrete and visible projects that would help to raise the level of participation of the population in international markets. The representative said that he would continue his efforts to ensure that the ideas which guided the work of the WTO were put into practice in El Salvador.

III. STATEMENT BY THE DISCUSSANT

25. The discussant (H.E. Mr Hernando José Gómez) noted that in a single decade Salvadoran society had succeeded in transforming and modernizing its institutions, legislative framework and economic policy. The priority assigned to the modernization of the State had helped to consolidate peace and democracy in the country and increase private investment, mainly in the telecommunications, port and electrical power sectors.

26. By introducing an open foreign investment regime, adopting intellectual property legislation and establishing an investment promotion commission, El Salvador had improved its international competitiveness. At the same time, the new Banks Law, the Insurance Companies Law, the Pension Saving System Law and the creation of a Pensions Superintendency had helped to encourage domestic savings and make credit more easily available. The Public Administration Procurement and Contracting Law had made government procurement more transparent.

27. El Salvador had made these advances within a framework of sound macroeconomic policies. The successful introduction of the dollar as legal tender had led to a substantial fall in inflation and interest rates.

28. The discussant noted that the closer integration of El Salvador in international trade flows was the main component of the country's growth strategy. El Salvador had an open trade policy, characterized by low tariffs, few non-tariff barriers and no barriers to exports, as well as by the country's participation in the Central American Common Market, free trade agreements (FTAs) with Mexico, the Dominican Republic, Chile and Panama, and trade negotiations with Canada and the United States. The strategy of integration in international trade flows had yielded positive results. While the contribution of exports to GDP had increased by 40 per cent in six years, GDP itself had increased by 30 percent and per capita GDP by 20 per cent.

29. The discussant noted that the institutional and economic policies implemented by El Salvador in the last ten years should have led to a greater increase in exports and GDP. Apart from the behaviour of the world economy in recent years, the factors that might have prevented the more rapid growth of El Salvador's exports and economy included low investment levels, shortage of skilled labour and the inefficiencies created by the tariff structure.

30. The level of investment in El Salvador was relatively low (between 16 and 17 per cent of GDP). Given the closer link between present investment and future production and the fact that, typically, investment levels of at least 25 per cent of GDP were required in order to achieve annual rates of growth of the order of 5 per cent, the discussant wondered how savings might be encouraged in order to finance higher levels of investment in El Salvador. Considering the high level of consumption in the country, which was almost equal to GDP, consumption taxes could offer a possible solution. The discussant also asked what role private pension funds could play in raising the level of savings.

31. In connection with the availability of skilled labour, the discussant noted that, despite the gains made under the EDUCO educational reform programme and the efforts of the government to reduce current expenditure in order to increase social expenditure, the illiteracy rate in El Salvador was still high, especially when compared with that of countries with similar per capita incomes. He wished to know whether the authorities considered that illiteracy and the shortage of skilled labour were having an adverse effect on the performance of the economy.

32. Finally, the discussant pointed out that El Salvador's tariff structure was clearly marked by escalation and provided high levels of effective protection for producers of processed agricultural goods and light manufactures, El Salvador's main exports apart from goods produced in the free zones. Thus, Salvadoran tariff escalation could be generating certain inefficiencies in attracting

investment oriented towards the domestic market. The discussant said he would be interested to learn whether the authorities shared the view that a more uniform tariff might encourage more productive investment and, ultimately, stronger export growth.

33. El Salvador's economy faced a number of challenges. Firstly, the discussant mentioned the need gradually to replace remittances, which amounted to about 15 per cent of GDP, by export-oriented investment, since there was no guarantee that the income from remittances would remain stable in the long term. In this connection, the discussant requested additional information from the Salvadoran authorities on the kinds of incentive the Government was thinking of offering in order to encourage investment by Salvadorans established abroad and on the amount of resources that might be attracted in this way.

34. As regards macroeconomic policy, the discussant pointed out that if a country was unable to resort to monetary policy, fiscal policy became the main indicator used by the markets and risk assessment agencies for measuring country risk. Accordingly, one important challenge faced by El Salvador was to continue encouraging State reforms aimed at reducing current expenditure and maintaining a responsible fiscal policy.

35. The discussant said that some export subsidy schemes operated by El Salvador, although they were helping to channel investment and promote the sale of local products abroad, were costly in fiscal terms and, in accordance with WTO disciplines, should be eliminated within a maximum of seven years. It was therefore important that the schemes should be seen by domestic enterprises as temporary incentives intended to improve productivity and facilitate integration in international markets. The discussant encouraged the Salvadoran authorities to develop, together with private investors, mechanisms for consolidating investment in the free trade zones.

36. The discussant concluded his statement by noting that there were not many countries which, in only ten years, had been able to achieve the number of far-reaching reforms implemented by El Salvador. He congratulated the Government of El Salvador on its efforts and expressed the hope that the country would be successful in meeting all its challenges, since a pluralist and democratic society, fundamentally based on an open and competitive economy was the best formula for achieving progress and prosperity.

IV. STATEMENTS BY MEMBERS OF THE TRADE POLICY REVIEW BODY

37. Members welcomed the delegation of El Salvador and thanked Minister Lacayo and the discussant for their statements and the Government of El Salvador and the WTO Secretariat for their reports. A number of Members referred to the questions they had submitted in writing and looked forward to receiving the replies of the Salvadoran delegation. Members acknowledged the significant progress made by El Salvador in reforming its economy, progress which was particularly noteworthy in view of the internal strife from which the country had emerged little more than ten years ago.

38. The representative of Argentina noted El Salvador's determination to continue liberalizing its trade and investment regimes against a background of institutional stability. He mentioned, in particular, the measures adopted by the Government to diversify the supply of exportables and develop export markets, as well as the reduction in tariffs achieved in recent years which had resulted in relatively low average rates, namely, 12 per cent for agricultural and 6.7 per cent for non-agricultural products. The tariff structure was characterized by a high degree of transparency due to the fact that all the tariffs were *ad valorem*. Nevertheless, the Salvadoran tariff exhibited marked escalation. The representative praised El Salvador's active participation in the multilateral trade negotiations, especially in the agricultural area, where it was helping to drive the reform process towards a fair and market-oriented trading system for agricultural products. Argentina was concerned about the health barriers being encountered by its exports of meat and dairy products to El Salvador. These barriers were inconsistent with the provisions of the IOE's Zoosanitary Code and were being maintained even though the IOE had declared Argentina's meat exports completely disease-free. Argentina hoped that these difficulties would be overcome as quickly as possible.

39. The representative of the European Union said that El Salvador had an important function to perform with respect to regional and world trade. The European Union was following with interest the part being played by El Salvador in the Central American integration process, which was helping to reduce costs, improve competitiveness and promote exports. The European Union appreciated El Salvador's firm commitment to the WTO and its participation in the negotiations in progress and trusted that El Salvador would be able to continue liberalizing its commerce on the basis of a strategy that gave priority to multilateral trade. El Salvador's liberal policy should go hand-in-hand with internal policies that ensured fair and sustainable growth. There appeared to be an increasing need to improve the representation and participation of civil society in the formulation of trade policy. On the socio-economic front, despite the progress made, problems such as inequalities in the distribution of income, demographic pressures, migration and limited natural resources still persisted.

40. As regards relations between the European Union and El Salvador, in May 2003 negotiations had begun with a view to reaching an agreement on political dialogue and cooperation between the European Union and Latin America, based on the conclusions of the summit held in Madrid the previous year. Moreover, the European Union and El Salvador had agreed to consider ways of improving their trade relations at the end of the Doha agenda, as well as ways of achieving closer integration among the countries of the Central American region. In terms of cooperation, on the basis of the framework cooperation agreement signed in 1993, the European Union was one of the principal sources of official aid for Salvadoran development. In future years, the key areas of cooperation would be good governance, consolidation of the rule of law, human rights, local development based on participation, inclusion and justice, fair economic growth and job creation. The European Union was El Salvador's third most important trading partner. The vast majority (a little over 80 per cent) of the European Union's imports from El Salvador were agricultural products. The main exports were transport and power generation products and chemicals. Despite the declining trend in trade flows between El Salvador and Europe, European investment in the country had increased during the last five years, in terms of quantity as well as quality, being mainly concentrated in the services sectors. In 2001, European imports from El Salvador under the Generalized System of Preferences had amounted to EUR 111 million.

41. The European Union requested detailed information on El Salvador's plans relating to its future strategy for bilateral and regional trade agreements, since a growing proportion of its trade was being carried on under such agreements. Although the European Union understood the importance of these agreements for El Salvador, it was also aware of the problems arising as a result of its participation in them, mainly in relation to resources and the formulation and management of trade policy. Moreover, the European Union wished to know how El Salvador had provided for macroeconomic convergence with the other Central American countries in the light of closer regional economic integration. The European Union considered El Salvador one of the defenders of the multilateral trading system and urged the authorities to confirm that their participation in bilateral and regional free trade initiatives would not divert the country from its participation in and commitment to the Doha Round.

42. The European Union also wished for information concerning the plans of the Government of El Salvador for addressing the problems of inequality of income and the duality of the economy, for example, through fiscal policy, economic growth and local development. Its representative sought information about the effect of using the US dollar on interest rates, fiscal and monetary policy, the balance of payments and social indicators. Were there restrictions on the use of economic policies as a result of the introduction of the US dollar? How would the use of the US dollar affect El Salvador's trade flows and what would be its impact on the Central American integration process? Finally, it would appear that despite El Salvador's closer integration in the world economy, diversification in terms of products and markets continued to be very limited. The main sector to benefit from the policy of openness had been the *maquila* (in-bond) sector and this had had a direct effect on job creation. El Salvador should be able to extend the benefits of its trade policy and attract greater investment in sectors that contributed more to the country's long-term socio-economic development. In this connection, the speaker requested El Salvador's opinion on the contribution of the current trade negotiations in the WTO to the development of El Salvador's institutions and infrastructure and the country's ability to attract investment.

43. The representative of Chinese Taipei congratulated El Salvador on its economic growth in general and the growth of the manufacturing sector in particular, achieved during the last few years. This growth had taken place despite the serious damage inflicted on the country by hurricane Mitch and two earthquakes. The representative praised the new Investment Law based on the principle of national treatment. This Law provided investors with easy access to information and assistance with official procedures. Chinese Taipei was pleased to note El Salvador's efforts to improve respect for intellectual property rights and, in particular, the approval of the new Law on Trademarks and Other Distinctive Signs. In 2001, Chinese Taipei and El Salvador had signed an Agreement on the Development and Protection of Intellectual Property Rights which reflected the commitment of both parties to the development of industry, science, technology and the economy. El Salvador was an active participant in the multilateral trading system and in various preferential trade agreements. Although Chinese Taipei recognized the importance that these agreements might have for the country's economic development it wished to know what were the specific advantages that Salvadoran industry expected to derive from the free trade agreement being negotiated with the United States. The representative concluded his statement by stressing his country's readiness to co-operate in the efforts El Salvador was making to continue liberalizing its trade and investment regimes.

44. The representative of Japan urged El Salvador to continue actively promoting the reform of its economy and the liberalization of trade and investment. In order to contribute to El Salvador's economic development, Japan was co-operating with that country in various key sectors of its economy such as transport, agriculture, and energy, as well as in several areas of social development, including education and medical treatment. Japan would continue to contribute to El Salvador's development to the extent necessary. In addition to participating actively in the multilateral trading system, El Salvador was increasingly participating in preferential trade agreements, including negotiations for a free trade agreement between Central America and the United States. Japan was concerned that this FTA might place Japanese enterprises wishing to gain access to the Salvadoran

market at a disadvantage as compared with enterprises located in the United States. Japan appreciated that El Salvador had bound all its tariffs. However, whereas the rates bound stood at 40 per cent, the average applied MFN rate was 7.4 per cent. As mentioned in the WTO Secretariat's report, the gap between bound and applied rates might undermine the predictability of Salvadoran market access conditions. Japan urged El Salvador to reduce its bound rates. Japan appreciated the fact that El Salvador had signed the WIPO treaties on copyright and on performance and phonograms and congratulated El Salvador on tackling the infringement of intellectual property rights. In this connection, Japan asked how El Salvador was updating the rights granted to both authors and phonogram producers in order to overcome the problems posed by the Internet and requested information about the measures that El Salvador had adopted in order to bring piracy effectively under control.

45. The representative of Canada noted El Salvador's commitment to press ahead with trade liberalization and the economic reform process, as well as the strong regional leadership displayed by that country at both bilateral and multilateral levels. Canada congratulated El Salvador on taking concrete steps to comply with its WTO obligations; gradually reducing its tariff levels; restricting the use of non-tariff barriers; and working to ratify and apply the TRIPS Agreement. Canada urged El Salvador to step up its enforcement efforts in the area of intellectual property rights. El Salvador had provided strong leadership in the region with respect to commitments in the field of telecommunications assumed under the TRIPS, including the adoption of the Reference Paper. As far as preferential agreements were concerned, El Salvador had supported various developments within the framework of the Central American Common Market (CACM) and had played a leading role in the FTAA negotiating process. As mentioned in the WTO Secretariat report, El Salvador had also signed FTAs with several countries and was negotiating similar agreements with several others, including Canada. This proved that it was possible to negotiate trade agreements between large and small economies. Once finalized, the treaty would constitute a useful model at the general and multilateral level in areas such as competition policy and trade facilitation and would serve as a vehicle for improving the trade policy capacities of the signatories. Canada was pleased to have been able to contribute to the development of capacities in El Salvador through a project carried out by the Canadian Centre for Trade Policy and Law.

46. Canada also recognized the work that El Salvador had done to improve macroeconomic conditions, promote economic efficiency, improve the distribution of resources and reform the financial sector. Although the dollarization of El Salvador had had inevitable consequences for the financial sector and posed risks associated with the lack of a central bank, it was clear that the process of introducing the US dollar as legal tender had been well managed and that the country's economic fundamentals were still sound. Moreover, El Salvador's efforts to diversify its economy had been largely successful, as shown by the increasing importance of manufactures and services in the country's economic structure. Canada praised the Salvadoran authorities for the progress they had made so far and urged El Salvador to continue working to improve the predictability, transparency and openness of its trade regime, since Canada had always maintained that governments which implemented a liberal and transparent trade regime were better placed to benefit from the expansion of world trade and economic growth.

47. The representative of Colombia stressed El Salvador's achievements in the areas of institutional stability, modernization of the State and economic growth and noted that, had it not been for various natural disasters, El Salvador's economic and social development would have been even more robust. The increase in productivity and foreign investment would enable the Government of El Salvador to reduce its dependence on a single export market. The representative noted that the application of disciplines to improve market access in goods and the adaptation of the Salvadoran legislation in various services sectors were evidence of El Salvador's commitment to the WTO and the negotiations in progress. As far as bilateral trade relations were concerned, in 2000 there had been a sharp fall in Colombian oil exports to El Salvador and an increase in exports of light industry products. At the same time, Colombian imports of Salvadoran products, mainly industrial products,

had remained almost unchanged since 2000. There was a mutual interest in increasing trade flows through partial or total reciprocal preference mechanisms, which were under discussion between the two countries.

48. The representative of Switzerland noted that the export processing zones (EPZs) had had a positive effect on Salvadoran export performance. Nevertheless, the EPZs had limited linkages with local enterprises. Switzerland wished to know how El Salvador was trying to encourage investment in non-*maquila* areas, in particular investment that would lead to technology transfer. Moreover, Switzerland would be interested to learn what measures the Government of El Salvador had taken to prepare for the end of the extension it had requested from the WTO in connection with its free zone schemes. Considering the importance of exports of agricultural products, such as sugar and coffee, for El Salvador, Switzerland requested additional information on the measures that El Salvador had taken to diversify its production base and reduce its heavy dependence on the agricultural sector. With respect to trade relations, Switzerland was closely following the development of the CACM, the FTAs that El Salvador had signed with countries in the region, the creation of a customs union between El Salvador, Guatemala, Honduras and Nicaragua, the Puebla-Panama Plan and the FTAA negotiations. Switzerland asked how El Salvador compared the progress being made with regional integration in Central America with that being made with the FTAA process. At the same time, Switzerland requested more information on El Salvador's expectations concerning the FTA it was negotiating with the United States. Finally, the representative of Switzerland wished to obtain details with regard to the impact of dollarisation on the national economy.

49. The representative of the United States noted that his country and El Salvador shared a close trade relationship and were seeking to integrate their economies to an even greater extent through the FTAA and Central America-United States FTA negotiations. The representative praised El Salvador for combating corruption, reducing expenditure, restructuring and privatizing the banking sector, privatizing inefficient State enterprises and opening its borders. The United States supported El Salvador's efforts to continue liberalizing its economy and recognized the importance of the United States market for El Salvador's future economic development. The dedication of the United States and El Salvador to the FTAA and Central America-United States FTA negotiations would help to create political and civil institutions, public confidence, transparency and the rule of law which El Salvador needed to ensure political stability and prosperity. The representative said that the United States was impressed by the energy and skill which El Salvador had shown in fulfilling its WTO obligations. However, there were areas in which El Salvador appeared not to be in compliance with the WTO agreements. The speaker praised El Salvador for its comprehensive application of the WTO Agreement on Customs Valuation, took note of the steps which the country had taken to automate and simplify its Customs procedures and asked for additional details on those procedures. El Salvador had made great progress in attracting export-oriented investment. The speaker noted, however, that there were reports of violations of workers' rights in the export processing zones. Moreover, it appeared that there were few links between these zones and the national economy. The United States was in complete agreement with the WTO Secretariat's proposal that El Salvador should reconsider the role of the export processing zones. In this way, the economic success achieved in these zones could be reproduced nationwide and benefit the entire population. The United States welcomed El Salvador's commitment to protect intellectual property rights and would like to receive details concerning the intellectual property regime and El Salvador's plans for implementing the TRIPS Agreement.

50. The representative of Costa Rica said that the successful performance of the Salvadoran economy was due in large measure to El Salvador's open trade regime and the reforms introduced in recent years. The economy had grown steadily despite the natural disasters which the country had endured. Costa Rica was pleased to note that El Salvador's economic growth had had the effect of helping to reduce poverty. The speaker said that the steps taken to modernize the State, in particular in the area of government procurement, would be of great benefit to the country. El Salvador had also made considerable progress in improving and modernizing the public infrastructure, as well as in

education and health. These efforts, combined with the creation of the National Investment Office, the National Commission for the Promotion of Investment and the promulgation of a new Investment Law would help to improve the climate for investors and the living standards of the Salvadoran people. Costa Rica welcomed the positive results of the Salvadoran initiatives to diversify exports and facilitate trade, as well as the results of fiscal reform which had reduced the importance of receipts from customs duties as a source of tax revenue.

51. The representative of Guatemala recalled that his country was El Salvador's second trading partner. One of the problems faced by both countries was the dramatic fall in world coffee prices. The speaker noted that the dollarisation of the Salvadoran economy, which extended to almost 90 per cent of economic activity, had been carried out with great care, thereby winning the trust of national foreign economic operators, as reflected in the behaviour of the sovereign debt. Macroeconomic stability and the progress made so far had been translated into increased savings, a gradual reduction in interest rates, more investment, and the progressive diversification of production and exports, all of which would have a favourable effect on future rates of economic growth. Thus, El Salvador had laid the foundations for reducing its dependence on family remittances and *maquila* exports.

52. The representative of India said that the structural adjustment programme carried out by El Salvador had injected strength and institutional stability into the country's economy. However, the natural disasters which El Salvador had suffered had restricted economic growth. He urged El Salvador to press ahead with its programme of economic reform aimed at boosting the economic growth rate, since some 40 per cent of the population was still living in poverty. El Salvador was an active participant in the multilateral trading system and had an extremely liberal trade regime. The importance of trade could be judged from the large contribution of imports and exports to GDP. El Salvador also attached importance to regional initiatives, as evidenced by its participation in the Central American Common Market and the FTAs with Mexico, the Dominican Republic, Panama and Chile, as well as by the negotiations with Canada and the United States and in connection with the FTAA. India trusted that all these regional agreements were consistent with WTO disciplines. The representative expressed confidence that his country's economic and trade relations with El Salvador would become closer and more extensive in the years to come.

53. The representative of Kenya noted that the reforms carried out by El Salvador so far had brought stability to the macroeconomic environment, thereby favouring increased investment and economic growth. Kenya congratulated El Salvador on its bilateral, regional and multilateral trade liberalization initiatives aimed at increasing market access opportunities for its exports. However, in order to benefit fully from the opportunities afforded by these initiatives, El Salvador had to improve its productive capacity and take the measures necessary to encourage export diversification. The representative noted the statement in the Secretariat report concerning the decline in the relative importance of the agricultural sector for the Salvadoran economy since 1996. Kenya urged El Salvador to increase and intensify its efforts to revitalize agriculture, a sector which accounted for more than 35 per cent of the labour force and could play a very important part in reducing poverty. In the multilateral context, the speaker praised El Salvador for its active participation in the work of the WTO and noted that El Salvador had submitted a series of proposals in areas such as agriculture in which Kenya had similar concerns. The speaker said that El Salvador's active participation in the WTO was partly the result of a sound national consultative process which set a good example for many other Members.

54. The representative of Honduras stressed El Salvador's commitment to an open and market-oriented economic regime. Economic openness and deregulation had been constant features of the economic reform process aimed at achieving higher levels of economic growth, which El Salvador regarded as the fundamental variable for combating poverty. This growth could only be achieved by policies that ensured the better allocation of resources, the creation and development of opportunities, and greater private initiative. He congratulated El Salvador on its huge efforts to adapt itself to a new model that rejected every kind of protectionist policy; on supporting and strengthening Central

American integration; on undertaking new multilateral commitments; and on promoting closer integration with its strategic trading partners.

55. The representative of Nicaragua noted that the significant efforts made by El Salvador to modernize its economy, mainly in the telecommunications, banking, energy, investment, ports and other services sectors, were based, *inter alia*, on the provisions that governed international trade and the WTO. He said that it was indispensable to achieve real and genuine trade openness and the rapid elimination of agricultural subsidies and other barriers to trade in order that open countries such as El Salvador could enjoy improved access to international markets, especially those of the developed countries. In the expectation and belief that bilateral and regional FTAs would bring development and job creation, El Salvador and the Central American countries had concluded FTAs with Mexico, Chile, the Dominican Republic and Panama and were negotiating with Canada and the United States. As the representative of El Salvador had said in his initial statement, closer cooperation was needed to consolidate a highly democratic and institutional process of economic reform and elimination of corruption such as that carried out by El Salvador and Nicaragua. Cooperation would ensure that the efforts to achieve economic and political reform were translated into tangible benefits for the population.

56. The representative of Norway said that his delegation had great respect for the efforts made by El Salvador to strengthen its economy and institutions, liberalize its trade and diversify its productive base in adverse circumstances. Norway agreed with El Salvador's aim of seeking free trade agreements with neighbouring countries and hoped that these initiatives would provide opportunities for small enterprises to participate in international trade. He asked the authorities for their opinion on how quickly the Salvadoran market should be opened up to international competition under the FTAA. Moreover, in view of the differences between the bilateral and regional agreements and WTO disciplines, the representative requested information about the ability of a developing country such as El Salvador to maintain several foreign trade systems simultaneously and formulate different policies for each. The speaker noted the difference between El Salvador's applied and bound rates and asked whether El Salvador was intending to bind its applied tariffs within the framework of the current WTO negotiations with a view to increasing the transparency of its foreign trade regime. Although the trade relations between Norway and El Salvador were limited, Norway saw opportunities for increasing economic cooperation between the two countries, for example, in electricity generation.

57. The representative of Uruguay noted that El Salvador had continued liberalizing and modernizing its trade and investment regimes in a context of institutional stability and steady economic growth. He recognized El Salvador's very active participation in all areas of the WTO and its firm commitment to the multilateral trading system. El Salvador was participating very actively in the current WTO negotiations, especially in the agricultural negotiations, in which it had argued that agricultural trade should be subject of the same rules as those that governed trade in other goods.

58. The representative of the Dominican Republic said that the Investment Law, the Law on Trademarks and Other Distinctive Signs and the trade initiatives with various countries of the Latin American region had established the basis for promoting the growth of the Salvadoran economy. With the signature of the FTA between the Dominican Republic and El Salvador in 1998 the trade flows between the two countries had increased, making El Salvador an important trading partner for the Dominican Republic.

59. The representative of Mexico recalled the FTA between his country and El Salvador and said that trade between the two countries was increasing substantially. Within the framework of the FTA, the two countries had found a means of communicating and settling their differences. El Salvador was engaged in a very ambitious process of structural reform aimed at modernizing the country's economic structure through the adoption of new legislation in the areas of investment, intellectual property and transport, a system of FTAs with neighbouring countries and very active participation in

the multilateral negotiations. Mexico was pleased to note that, as a result, El Salvador had converted its foreign trade into an engine of economic growth and development. The countries of the region needed to continue the process of structural adjustment and modernization. In this connection, Mexico welcomed the example provided by the Salvadoran experiment.

V. REPLIES FROM THE REPRESENTATIVE OF EL SALVADOR AND ADDITIONAL COMMENTS

60. The Chairperson invited the representative of El Salvador to focus his responses on three main themes: (a) the economic environment; (b) trade measures and policies; and (c) sectoral policies.

(a) Economic environment

61. The representative of El Salvador noted that his country's macroeconomic performance had been positive in recent years. The ratio of public debt to GDP was fairly low as compared with most other countries in the region. Two earthquakes had left El Salvador still solvent despite the fact that dealing with the consequences of these natural disasters had cost the country approximately three-quarters of its annual budget. The recently recorded reduction in current expenditure was the first in the country's history and had been accompanied by an increase in social expenditure, particularly in health and education. This had enabled the country to reduce poverty. Where monetary policy was concerned, the adoption of the dollar as legal tender had led to sharply reduced domestic interest rates and longer-term loans, which had given Salvadorans easier access to housing. Moreover, the adoption of the dollar had enabled El Salvador to maintain its policy of low inflation. The greater certainty which dollarisation meant for investors had been reinforced by the modernization of the investment regime through the promulgation of the Investment Law, which offered investors broad guarantees, including national treatment, and eliminated performance requirements. In addition, the National Investment Office (ONI) had been established, reforms had been introduced in order drastically to reduce the time needed to complete investment formalities, and an investment promotion agency had been created.

62. The representative confirmed El Salvador's belief in economic freedom and openness as two of the best means of achieving a higher standard of living for the population and strengthening the democratic system. In this respect, the WTO constituted El Salvador's trade policy framework and its principal tool for economic liberalization. Membership of the WTO was locking in the national reforms by making it possible to translate government policy into State policy. At the same time, it was necessary to continue improving the system of multilateral trade rules so that Members, in particular the small economies, could appreciate the advantages of the WTO. The WTO system had served as a basis for the bilateral and regional agreements that El Salvador had been negotiating. In their turn, these agreements constituted important precedents that could facilitate and give fresh impetus to the WTO negotiations, since they would help other countries to appreciate the benefits of trade liberalization in general and of integration between economies of different sizes and levels of development in particular. The representative noted that the preferential agreements were enabling his country to proceed more rapidly with the liberalization of trade and the consolidation of economic freedoms. In a forum such as the WTO, which had more than 140 Members, it was not always possible to advance at the speed which suited countries such as El Salvador. On the other hand, being WTO-based, the preferential agreements were similar to each other, which made them easier to administer. The FTAs were creating opportunities for domestic investors and foreign investors located in El Salvador, especially those active in the textile and made-up clothing, food and non-traditional agricultural sectors, by facilitating access to new and larger markets. As a result of these agreements El Salvador had succeeded in doubling its exports to Mexico and the Dominican Republic and was close to doubling its exports to Panama and Chile.

63. The representative stressed the need for support mechanisms so that countries such as El Salvador could take advantage of the opportunities offered by free trade. In countries such as El Salvador the average citizen was generally unaware of the link between trade liberalization and his own welfare; it was therefore imperative to take concrete action in the area of cooperation in order to develop the productive capacity of the small enterprise and the small farmer. In this connection, El Salvador had recently installed an integrated system designed to give the small enterprise easier

access to information, advice, training and financing. There were other areas requiring attention in order to ensure that El Salvador could take full advantage of the opportunities offered by organizations such as the WTO, in particular the development of human resources through vocational, technical and managerial training and the development of an innovation and technology system.

64. The representative noted that the Government of El Salvador was communicating and consulting closely with various sectors in formulating its trade policy.

65. The discussant was pleased to note that the Salvadoran authorities had managed the dollarisation of the economy with considerable skill. During the years in which El Salvador had maintained a fixed exchange rate, it had escaped the problems of currency revaluation experienced by other countries. At the same time, the discussant congratulated the authorities on having pursued a prudent fiscal policy, despite the natural disasters which the country had had to confront.

66. The discussant stressed El Salvador's low levels of investment which were partly attributable to the perceptions of investors resulting from the long internal conflict through which the country had passed. Nevertheless, it was important to consider how investment could be encouraged so as to achieve growth rates of more than 5 per cent. In this connection, the discussant welcomed the efforts which the Salvadoran authorities had been making to promote investment and growth in the small enterprise sector which was having difficulty in accessing the financial markets and marketing its products abroad. He noted that another issue which had been discussed was that of promoting investment by Salvadorans established abroad, given their knowledge of the domestic market and local contacts.

(b) Trade measures and policies

67. The representative of El Salvador said that his country had made great progress in the customs field. It had adopted the Central American Uniform Customs Code, which had harmonized the customs legislation of the countries making up the CACM and had expedited the movement of goods across El Salvador's borders. The El Salvador was applying the WTO Agreement on Customs Valuation. As regards the application of minimum values to clothing, El Salvador was using minimum values only for second-hand clothing imports. Once the period authorized by the WTO for the use of minimum values had ended, El Salvador would apply the provisions of the Customs Valuation Agreement in full. Meanwhile, since 1999 it had been implementing the *Teledespacho* system which had considerably facilitated import operations.

68. With respect to import licences, El Salvador was complying with its WTO commitments. Import licences were being applied only to imports of milk and milk derivatives and products subject to quotas aimed at promoting the integration of production chains. At the same time, El Salvador was maintaining an under-supply quota system under which quotas at below-MFN tariffs could be opened for quantities which could not be covered by domestic agricultural producers. These quotas were to ensure the integration of production chains.

69. As far as technical regulations and sanitary and phytosanitary measures were concerned, El Salvador was conforming strictly with WTO provisions. In the field of government procurement, El Salvador had introduced new legislation which was being applied uniformly to all government entities, including municipalities. The law established the principles of transparency and non-discrimination between domestic and foreign suppliers. Moreover, it laid down uniform procedures for all the entities subject to the legislation, established specific amounts for each mode of procurement, created a register of suppliers and provided legal remedies for settling bidding disputes. El Salvador had not yet decided whether to accede to the WTO Plurilateral Agreement on Government Procurement.

70. The representative of El Salvador noted that the WTO had recently authorized an extension in connection with the Law for the Reactivation of Exports, which allowed enterprises to draw back 6 per cent of the f.o.b. value of their exports outside Central America. Coffee and sugar exports which did not incorporate at least 30 per cent of national value added did not benefit from the provisions of the Law.

71. With respect to intellectual property rights, El Salvador had recently promulgated the Law on Trademarks and Other Distinctive Signs and had voluntarily submitted to a review of its legislation by the WTO. The legislation, which regulated and protected all categories of intellectual property, was fully consistent with the provisions of the WTO's TRIPS Agreement. Pharmaceutical products and all patents enjoyed 20 years of protection, without exception. Compulsory licences were issued only in cases of emergency or for reasons of national security. El Salvador was maintaining a special unit in the Office of the Attorney General of the Republic for dealing promptly with complaints concerning infringements of the provisions relating to intellectual property rights. In 2001, it had handled 120 cases, in 3 of which the offenders had been sentenced to between one and three years' imprisonment. The rest had been settled out of court. El Salvador's efforts to combat software piracy had been recognized by the Business Software Alliance which, in November 2002, had granted the country the Cyber Champion Award.

72. The discussant referred to the matter of tariff escalation. It was possible that the high levels of effective protection derived from tariff escalation observable in certain sectors important for export performance, including textiles and processed foods, were creating a bias against investment in exports.

(c) Sectoral policies

73. The representative of El Salvador said that his country had not yet completed an analysis to determine the measures that would have to be adopted once the extension granted in connection with the free zone regime ran out, since until recently El Salvador's efforts had been concentrated on obtaining that extension. Although in some cases the free zone regime had been called into question because of its limited linkages with the national economy and its restricted capacity for generating high levels of value added, the representative pointed out that the free trade zones were important sources of employment, especially for poor women. These jobs gave access to home loans and the health system, as well as increasing the opportunities for the children of free zone employees to attend school. The jobs offered by the free zones were ideal for new entrants to the labour market and appropriate to the current level of development of human resources in El Salvador. Moreover, the free zones generated significant levels of value added.

74. In the telecommunications sector, El Salvador had carried out a number of important reforms and had entered into commitments under the GATS that provided certainty for investors. The Salvadoran measures in this sector did not discriminate between domestic and foreign service operators.

75. The discussant acknowledged the importance of El Salvador's free trade zones for job creation. However, it would not be possible to maintain the incentives granted under the free zone schemes once the extension granted by the WTO had expired. It was necessary to design alternative formulas not only to ensure that the investments operating under these schemes remained in the country but also to attract new investment that would result in higher levels of value added. In this way, it would be possible to prevent the elimination of the free zone regimes within the period allowed by the WTO from resulting in job losses.

76. The discussant said that it was necessary to connect the opening-up process with the activities of the urban and rural small producers so that the latter could benefit from international trade. In this respect, financing mechanisms and marketing support could help to ensure that these small producers

did not perceive trade liberalization as a threat. To achieve these objectives, many governments would have to make tremendous efforts and would require cooperation.

VI. CONCLUDING REMARKS BY THE CHAIRPERSON

77. This second Trade Policy Review of El Salvador has done much to improve our understanding of its trade and investment policies and of the context within which they are being formulated and applied. We owe this in large measure to the active participation of the Salvadoran delegation led by Minister Lacayo, Vice-Minister Ayala and Ambassador Lima.

78. First of all, I should draw attention to the support which Members have expressed for El Salvador's current efforts at modernization and their recognition of the progress El Salvador has made since the end of the civil war some ten years ago. Members praised El Salvador for the success of its efforts to restructure and stabilize the economy, especially the autonomous, regional and multilateral initiatives aimed at liberalizing trade and investment.

79. Economic growth has been steady, though modest, partly as a result of natural disasters, and the alleviation of poverty continues to be a serious problem. Members suggested that to achieve higher growth rates it was necessary to redouble efforts to promote investment. The adoption of the US dollar as legal tender was considered to be a step in this direction. Salvadorans living abroad could perhaps give a further boost to investment through their remittances.

80. Salvador was encouraged to diversify its export base, in terms of markets as well as products, in order to achieve closer and more balanced integration in the world economy. Members noted that at present exports consist of just a few products, mainly clothing, from the EPZs. On the other hand, traditional agricultural exports have lost ground and it was considered important to reverse this trend.

81. Members praised El Salvador for its trade regime, which was generally open; for the measures adopted to comply with the obligations assumed as a result of its joining the WTO; and for its active participation in the multilateral trading system. Members noted El Salvador's steadily increasing participation in preferential trade agreements and expressed the hope that those agreements would supplement the multilateral liberalization process. They expressed concern about El Salvador's administrative capacity to participate effectively in several different regional initiatives at the same time.

82. El Salvador was praised for its trade facilitation initiatives and for applying the WTO Customs Valuation Agreement. Some Members requested clarification with regard to certain aspects of the customs administration and the use of minimum values and reference prices. In the interests of greater transparency, El Salvador was invited to send the WTO additional notifications on the granting of import licences.

83. Members congratulated El Salvador on the low level of its tariffs and on the full binding commitments it had made. However, El Salvador was encouraged to reduce tariff rates and tariff escalation and improve predictability by eliminating the disparity between applied and bound tariffs within the context of the Doha Development Agenda. Comments were made concerning the administration of tariff quotas and the consistency of the "under-supply quotas" with WTO principles.

84. Some Members expressed concern about the effect on trade of certain sanitary measures and about the compulsory application of rules on government procurement. Nevertheless, Members welcomed El Salvador's adoption of a new law on public administration procurement and requested further details of this regime. One Member suggested that El Salvador might accede to the Plurilateral Agreement on Government Procurement.

85. Where sectoral policies are concerned, the *maquila* industry received special attention. Members recognized that the EPZs had performed an important function in promoting El Salvador's integration in the world economy, by creating jobs and attracting investment. However, attention was also drawn to the structural distortions to which they give rise, the lack of linkages between the EPZs

and the national economy, and the export subsidies which they entail. These characteristics, though perhaps necessary in the present phase, might reduce the opportunities for future growth. Some Members raised the question of the progressive elimination of the EPZ regime and the reconciliation of the programme with WTO rules once the transition period granted by Ministers in Doha had expired.

86. Members praised the liberalization and opening-up of El Salvador's services sector, in particular in the areas of financial services and telecommunications, as well as in the electricity industry. It was noted that, partly due to this, the current openness of the sector was not reflected in the commitments assumed under the GATS. The extension of El Salvador's multilateral commitments during the services negotiations in progress would necessarily improve the predictability of its trade and investment regime.

87. Members also asked for clarification on a number of specific points, including:

- the import licensing regime for sugar;
- the regulatory framework for telecommunications;
- the ratification of the Agreement on Information Technology; and
- the protection of intellectual property rights.

88. The delegation of El Salvador responded orally and in writing to the questions formulated during the review. The replies provided made a considerable contribution to the review and Members clearly appreciated them.

89. This brings us to the end of the second review of El Salvador. Clearly, El Salvador has made much progress in building an efficient market economy in a relatively short period of time, starting from particularly difficult beginnings. I am particularly encouraged by El Salvador's declared belief that market liberalization is fundamental to its development strategy. I am convinced that, as a small economy, El Salvador still has much to gain by applying this strategy multilaterally. The strengthening of the multilateral trading system within the framework of the Doha Development Agenda could provide a sounder foundation on which to base the additional internal reforms necessary to obtain the improvements in growth rates and living standards which El Salvador is seeking and, it seems to me, will undoubtedly achieve.
