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**Trade Policy Review Body**

# TRADE POLICY REVIEW

## Report by the Secretariat

## EL SALVADOR

This report, prepared for the third Trade Policy Review of El Salvador, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from El Salvador on its trade policies and practices.

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Document WT/TPR/G/226 contains the policy statement submitted by El Salvador.

Note: This report is subject to restricted circulation and press embargo until the end of the first session of the meeting of the Trade Policy Review Body on El Salvador.

**CONTENTS**

## TABLES

## APPENDIX TABLES

## SUMMARY OBSERVATIONS

1. Trade and Investment play an important role in El Salvador's economy, reflecting in part the openness of its trade and investment regime. The trade policy regime of El Salvador has been further liberalized since El Salvador's previous Trade Policy Review in 2003. Progress has been made in modernizing customs, eliminating unnecessary licensing requirements, enhancing the transparency of technical regulations and SPS measures, and strengthening the institutional framework on competition policy and government procurement. As part of its liberalization efforts, El Salvador has entered as well into three new preferential trade agreements (with Chinese Taipei, Panama, and the United States), and continued to assign high priority to deepening Central American integration. El Salvador has also maintained its long-standing strategy of granting exporters refunds as well as fiscal privileges through free-trade zones (FTZs), which result in subsidies and tax breaks that distort economic incentives.

### (1) ECONOMIC ENVIRONMENT

2. Over the period 2003-2008, El Salvador's real GDP rose at an average rate of 3.1 per cent per year, supported mainly by strong domestic demand underpinned to a large extent by remittances. From the second half of 2008 onwards, there was a marked slowdown in growth because of the international economic crisis, which resulted in a decrease in investment, exports, and remittances from Salvadoran workers abroad. In 2009, GDP is estimated to have contracted by 2.5 per cent. El Salvador is a dollarized economy, having introduced the US dollar as legal tender in 2001.

3. The balance-of-payments current account was in deficit between 2003 and 2008, reaching 7.6 per cent of GDP in 2008. This reflects traditional deficits in both the balance of trade in goods and in services, which have more than offset high current transfers, mostly in the form of remittances from Salvadorans living abroad (representing 17.1 per cent of GDP in 2008). The current account deficit has been financed by capital inflows, principally in the form of foreign direct investment and official debt. El Salvador has also obtained the support of international financial organizations.

4. Trade in goods and services plays an important role in El Salvador's economy, representing some 73.6 per cent of GDP in 2008. For trade in goods (imports and exports including maquila), El Salvador's leading trading partners are the United States and the other Central American Common Market (CACM) countries. Manufactures are still the major export category but their share in total trade has contracted due mostly to lower exports of textiles and clothing. In contrast, exports of agricultural and other primary products have increased considerably. Manufactures still account for the largest share of imports, although the value of imports of primary products increased substantially reflecting higher fuel prices.

### (2) TRADE AND INVESTMENT POLICY FRAMEWORK

5. The trade policy objectives of El Salvador's new administration are to: reduce the trade gap by supporting foreign investment in export-generating production; contribute to export market diversification; improve domestic production capacity by making it more competitive *vis-à-vis* imports, in order to lessen El Salvador's vulnerability to changes in the world economy; and to promote job-creating and productivity-improving external trade.

6. El Salvador has been a Member of the WTO since May 1995 and takes an active part in negotiations and in the regular work of the WTO. It has made a large number of notifications, but at end 2009 some were pending, including those concerning State-trading enterprises, import licensing and customs valuation. El Salvador has accepted the Fourth and Fifth Protocols to the GATS.

7. El Salvador does most of its trade with trading partners with which it has preferential agreements. In 2008, such partners accounted for almost 90 per cent of total exports, and some two thirds of imports. El Salvador is a member of the CACM, and has free trade agreements with Chile, the United States (CAFTA-DR), Mexico, Panama, Chinese Taipei and the Dominican Republic. Of the three agreements that entered into force since the last Review of El Salvador, CAFTA-DR is of particular significance given the close economic links between El Salvador and the United States. Together with the other members of the CACM, El Salvador is negotiating association agreements with the European Union and free trade agreements with Canada and CARICOM.

8. El Salvador's foreign investment legislation guarantees freedom to invest and national treatment for foreign investors, except in those areas where other laws impose restrictions. This includes the supply of "small-scale" services, which are the prerogative of Salvadoran citizens by birth or nationals of other Central American countries, and the ownership of rural real estate, which may not be bought by foreigners from countries that do not give Salvadoran citizens equal rights.

### (3) MEASURES AFFECTING IMPORTS

9. Since its last Review, El Salvador has continued to adopt measures to modernize customs by implementing risk management techniques, broadening the use of information technology, and creating a single window for importers. As a result, customs clearance times have fallen below the OECD average. El Salvador applied minimum values on imports of certain categories of used goods until the expiration of WTO waivers in 2003 and 2005.

10. The average applied MFN tariff rate has fallen slightly since the last Review of El Salvador, to 6.3 per cent in 2009. This reflects the reduction to 5.2 per cent of the average applied MFN rate on non-agricultural goods, in turn the result of tariff decreases for textiles and clothing. At the same time, the average applied MFN rate on agricultural goods (WTO definition) has risen by approximately one percentage point, to 12.9 per cent, reflecting higher tariffs on certain chicken products. In 2007, El Salvador renegotiated the bindings applicable to some of these products in accordance with Article XXVIII of GATT 1994. The tariff comprises 11 rates of between 0 and 164 per cent. All tariffs are bound, at an average rate of 37 per cent, thus affording certainty to MFN traders. In spite of this, and the stability of the tariff regime in practice, certainty could be enhanced by reducing bound rates.

11. El Salvador imposes prohibitions and licensing requirements on certain imports to safeguard national security, public morals, health, and the environment. In mid-2008, El Salvador abolished the only licensing requirement (on imports of coarse fibre sacks) explicitly maintained to protect domestic producers. However, prior authorization from the Economics Ministry is still required to import sugar. El Salvador has reduced the number of goods subject to import visas, which are applied on some 1,000 tariff lines; eliminating this requirement for additional categories of goods whenever possible would further facilitate trade.

12. El Salvador has not applied any contingency measures during the period under review. CACM members and, under certain conditions, other preferential trading partners are exempt from the application of safeguards.

13. Since its last Review, El Salvador has pursued efforts to ensure greater transparency in the formulation and implementation of technical regulations and sanitary and phytosanitary measures. With few exceptions, its WTO notifications on both types of measures provide for multilaterally recommended comment periods.

### (4) Other Measures Affecting Trade

14. El Salvador restricts exports of certain goods, including liquefied petroleum gas and sugar, to ensure domestic availability. Remaining export restrictions generally reflect international commitments.

15. Exporters continue to be entitled to a refund amounting to 6 per cent of the f.o.b. value of their exports. The law that authorizes this measure was not modified during the period under review. In addition, El Salvador grants tariff and tax concessions, including an income tax exemption, under its free trade zone (FTZ) scheme. El Salvador notified both the 6 per cent refund and the FTZ schemes as providing export subsidies. During the period under review, El Salvador introduced domestic content requirements for FTZ exports of textiles and clothing to the domestic market. El Salvador also introduced tariff and tax concessions for firms exporting services and for tourism projects.

16. Since its last Review, El Salvador has established export credit and guarantee programmes through its national development bank. El Salvador has also reorganized the institutional structure underpinning its official export promotion activities. In addition to export promotion incentives, El Salvador has programmes to grant support to micro and small enterprises, transfer of technology, and programmes to attract investment.

17. Since the previous Review, El Salvador has strengthened the legislative and the institutional framework governing competition policy. This is important because the Salvadoran market, like other small markets, tends to be concentrated and competition to be limited. El Salvador has also made considerable progress in modernizing the legislative and institutional frameworks for government procurement. Its legislation does not contain provisions giving preferences for Salvadoran or foreign goods, services or public works, unless bids are for an equal amount.

18. All the aspects covered by the TRIPS Agreement are regulated in El Salvador. During the period under review, El Salvador extended the term of copyright protection from 50 to 70 years, as well as the term of patent protection for pharmaceuticals, and amended its legislation to bring it into line with its international commitments.

### (5) Sectoral Policies

19. The agricultural sector has performed strongly since El Salvador's last review, increasing its share in GDP and exports. The sector is supported by above-average tariffs and marketing and guarantee programmes. El Salvador applies tariff quotas on imports of cheddar cheese, maize, sorghum, rice, and pig meat, pursuant to its WTO commitments or marketing arrangements between agricultural producers and processors. Access to in-quota volumes under these tariff quotas is limited to processors who have purchased certain domestic inputs. El Salvador maintains a system of production quotas for sugar, and sugar imports are subject to prior authorization. Marketing arrangements for rice and productions quotas for sugar have been found to limit competition and increase domestic prices.

20. Manufacturing largely takes place in FTZs. Despite the fiscal privileges offered by this scheme, the performance of FTZ firms has been below expectations and, compared with the principal manufacturing sectors outside FTZs, their linkages to the rest of the domestic economy remain weak. Moreover, FTZ tax breaks place producers outside these zones at a comparative disadvantage. These shortcomings raise doubts about the effectiveness and overall benefits of El Salvador's export strategy, highlighting the need for the gradual introduction of a more neutral trade regime.

21. The electricity sector is open to private, including foreign, participation. Private operators are responsible for most generation and all distribution, while a State-owned enterprise is in charge of

transmission. Competition has been hindered by the dominant position of some distribution companies. During the period under review, El Salvador strengthened its legal framework governing the electricity sector and introduced tax incentives to promote investment in renewable energy. El Salvador also subsidized the consumption of electricity and liquefied petroleum gas.

22. The financial services sector in El Salvador is relatively open. For both banks and insurance companies, national treatment is guaranteed by law and there are no barriers to establishment other than prudential ones. However, foreign insurance companies and banks from countries outside Central America must be classified as first-line corporations by internationally recognized risk-rating agencies and recognized as such by the Superintendence of the Financial System. During the review period legal reforms were introduced to modify the rules on bank secrecy and the form and content of insurance policies.

23. The regulatory framework for telecommunications was reformed during the period under review to consolidate the liberalization initiated in previous years. In order to enhance competition, it has been recommended that regulations on interconnection be adopted and rates for calls from fixed to mobile networks be controlled. The legislation does not lay down any requirements regarding the origin of operators' capital, except for free-to-air or subscription broadcasting services, which must be provided by Salvadoran citizens. A special tax applies to telephone calls from abroad.

24. There are no restrictions to foreign investment in Salvadoran airlines, nor on market access through commercial presence. El Salvador's single international airport and its maritime port are both managed by a State entity. The building of a second commercial port was completed in December 2008, but it is not expected to start operating until mid-2010. El Salvador does not have its own merchant fleet. The law allows foreign vessels to provide national cabotage services.

25. Membership of an association is not compulsory to exercise a profession. However, it is necessary to be a Salvadoran national in order to act as a lawyer or chartered accountant.