

## II. TRADE POLICY REGIME: FRAMEWORK AND OBJECTIVES

### (1) Trade Policy

#### (i) Trade policy objectives

1. El Salvador's trade policy is a core element of the overall structural adjustment programme, begun in 1989, to move from a highly regulated economy to an economic system which combines the principle of freedom on the market with that of social balance. The programme has entailed: (i) the deregulation of the economy; (ii) the elimination of distortions caused by State intervention; (iii) the guarantee of private ownership and freedom of contracts; (iv) the application of economic policy measures that conform to the requirements of the market; (v) the creation of a State apparatus that is supportive of the market system; (vi) the establishment of a monetary framework that secures the stability of the value of money; (vii) the elaboration of labour regulations that protect employees; and (viii) the creation of a financial structure regulating the income and consumption of the State (e.g., tax legislation).

2. Since 1989 El Salvador has moved from inward orientation in its trade policy, designed to protect import-substitution industries within El Salvador and other Central American countries, to one of much greater outward orientation, intended to allow the country to achieve further integration into the world economy. Thus, trade policy has been based on the liberalization of the import régime; the reduction of the anti-export bias caused by that régime; the expansion of the export base; the modernization of trade laws and regulations; the strengthening of ties with trade partners; and negotiating better market access for its goods and services complemented by the establishment of an appropriate environment for investment.

3. Since the reforms began, El Salvador has eliminated most non-tariff barriers and price controls, as well as agricultural marketing boards; it has also reduced and rationalized import duties which were fully bound in the Uruguay Round, albeit at rates substantially higher than those currently being applied.

4. According to the authorities, no specific sectoral policy is to be implemented, since the purpose is to achieve a more neutral environment without granting preferences to any sector. However, in order to promote the production of non-traditional exports for extra-regional markets, a duty drawback system has been established as well as a series of tax incentives for exporters. Production of exportables has been further enhanced by recent improvements to the free-zone and tax-free area régimes.

5. Since 1994, El Salvador has put special emphasis on strengthening the process of integration in Central America, in particular, through the General Treaty for Central American Economic Integration, usually known as the Central American Common Market (CACM). This has entailed the revision of the regional legislation regarding: rules of origin, trade disputes, safeguards, unfair trade practices, phyto- and zoo-sanitary regulations, and technical standards.<sup>1</sup> The Central American Common Tariff (*Sistema Arancelario Centroamericano*, SAC) is also being updated to align it with the new version of the Harmonized System. In addition, El Salvador would like to renegotiate the 1970 free-trade agreement with Panama. However, this process has not started.

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<sup>1</sup>*Protocolo al Tratado General de Integración Económica Centroamericana (Protocolo de Guatemala)*, 29 October 1993.

6. To achieve further integration into the world economy, the authorities have been actively engaged in negotiations of regional, bilateral and multilateral agreements. El Salvador acceded to the GATT in May 1991 and to the WTO in May 1995. At present, El Salvador, together with Guatemala and Honduras, is engaged in the negotiation of a free-trade agreement with Mexico and is actively involved in the negotiations to establish the Free Trade Area of the Americas (FTAA).

(ii) Institutional and legal framework

7. The Government is divided into three independent branches: executive, legislative and judicial. The Executive Branch comprises the President, who is directly elected by the people every five years. The President appoints a Cabinet, consisting of Ministers and Vice-Ministers of State. The executive branch is, *inter alia*, responsible for the budget, the security forces and foreign relations. The Legislative Branch consists of an Assembly of 84 members elected every three years by the people, in proportion to the number of inhabitants of each of the departments into which the country is divided. The legislative branch must ratify treaties signed by the executive and approve the budget. To carry out its work, the Legislative Assembly meets in specialized commissions; the pertinent commission must approve a draft law before it is read by the full house. Draft laws have to undergo at least one reading for approval. The Judicial Branch consists of the Supreme Court of Justice, courts of second instance and other courts of justice. Members of the Supreme Court are elected by the Legislative Assembly. There is also an Office of the Attorney-General consisting of the Attorney-General and the Government Procurator of the Republic. The Constitution guarantees the independence of local municipalities.<sup>2</sup>

8. According to the Constitution, the hierarchy of the national legislation is as follows: the Constitution, international treaties, secondary laws and regulations. Secondary laws include legislative decrees (*Decretos Legislativos*), executive decrees (*Decretos Ejecutivos*), executive agreements (*Acuerdos Ejecutivos*), and executive resolutions (*Resoluciones Ejecutivas*). Laws are referred to as legislative decrees. Executive decrees, agreements and resolutions need only be approved by the Executive Branch.

9. A draft bill can be submitted to the Legislative Assembly for approval by: its members, the President through the Ministers, the Supreme Court, and/or the municipal councils. The draft law is first discussed and approved by a specialized commission in Congress and then passed to the full house. Once the draft has been discussed and ratified it is submitted to the President for his sanction. The law has to be published in the official gazette (*Diario Oficial*) within 15 days of the President's sanction and it enters into force eight days after its publication in the official gazette.

10. International treaties become national laws once they are ratified by Legislative Assembly, the procedure followed for the WTO Agreement. A secondary law cannot modify a treaty, and, in case of a conflict, the treaty would prevail. Since all ratified treaties are national laws, any person can invoke their provisions in the national courts.

(iii) Trade policy formulation

11. The Ministry of Economy, which in 1989 absorbed the Ministry of Trade (*Ministerio de Comercio Exterior*), is, in first instance, accountable for the formulation of trade policy, and is in charge of its implementation. However, the approval of policies is undertaken by the Economic Committee (*Comité Económico*, COE), formed by the President, the Vice-president, the Minister of Foreign Affairs (*Ministerio de Relaciones Exteriores*), the Minister of Economy (*Ministerio de Economía*), the Minister

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<sup>2</sup>Provisional Accession of El Salvador, GATT document L/6391.

of Agriculture and Livestock (*Ministerio de Agricultura y Ganadería*), the Minister of Finance (*Ministerio de Hacienda*), the President of the Central Reserve Bank (*Presidente del Banco Central de Reserva*), and the Presidential Commissioner for the Reform of the State (*Comisionado Presidencial para la Reforma del Estado*).

12. The Trade Policy Directorate (*Dirección de Política Comercial*), created in 1994 within the Ministry of Economy, is responsible for formulating, implementing and reviewing trade policy, as well as negotiating trade agreements at the regional, hemispheric and multilateral level. However, several public entities participate in the process of formulating trade policy and negotiations of trade agreements. For example, the Ministry of Economy discusses trade policy proposals with the Ministry of Foreign Affairs and the Ministry of Health (*Ministerio de Salud*) prior to their submission to the COE for approval. The COE approves the proposal by issuing a Ministerial Agreement. Should a new law be required, this would follow the normal process for a draft law, discussed earlier.

13. As part of the reform of the State, the rôle of the Ministry of Foreign Affairs, which in December of 1995 absorbed the Ministry of Co-ordination of Economic and Social Development (*Ministerio de Coordinación Económica y Desarrollo Social*), has changed. This Ministry now has greater economic responsibilities in the international arena, and the execution of these functions has to be co-ordinated with the Ministry of Economy and the private sector. The rôle of the Ministry of Health in the design of trade policy is to establish health standards or regulations. The Ministry of Agriculture and Livestock is in charge of establishing phyto- and zoo-sanitary standards.

14. There is no independent review body to provide the Government with formal, public advice on general economic policies, including trade policies. However, the private sector participates in the design of trade policy in an informal way, since the authorities hold periodic consultations with producers and exporters associations such as the Salvadorean Association of Industrialists (*Asociación Salvadoreña de Industriales*, ASI), the Chamber of Commerce and Industry of El Salvador (*Cámara de Comercio e Industria de El Salvador*), the National Association of Private Enterprises (*Asociación Nacional de la Empresa Privada*, ANEP), and the Salvadorean Exporters Corporation (*Corporación de Exportadores de El Salvador*, COEXPORT) among other groups. Specialized commissions such as the Commission for the Development of the Sugar Sector (*Comisión de Desarrollo Azucarero*, CDA), the Commission on Textiles (*Comisión de Textiles*) and the Salvadorean Coffee Council (*Consejo Salvadoreño del Café*, CSC) also advise the Government regarding trade policy. In addition, the Salvadorean Foundation for Economic and Social Development (*Fundación Salvadoreña para el Desarrollo Económico y Social*, FUSADES), a private research think tank, and other research institutions provides advice to the Government on economic policy matters.

15. The approval of trade policy within the Central American framework is different. The Council of Ministers of Economic Integration (*Consejo de Ministros Responsables de la Integración Económica*) examines proposals for the implementation of Central American integration policy and approves the instruments of implementation; these have then to be ratified by the national Legislative Assembly or by the Executive Branch, as appropriate.<sup>3</sup> In El Salvador, the Legislative Assembly has to approve: (i) modifications to the General Treaty of Central American Economic Integration; (ii) modifications to the Central American Tariff Code (*Convenio Arancelario Centroamericano*); and (iii) modifications to any code that requires the approval of three Member countries to enter into force, as well as any change in the tariff rates in Part III of the SAC.

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<sup>3</sup>*Protocolo al Tratado General de Integración Económica Centroamericana (Protocolo de Guatemala)*, 29 October 1993.

(iv) Trade laws and regulations

16. Table II.1 provides an overview of El Salvador's main legislation in trade-related areas. However, the Salvadorian trade laws and regulations are currently being reviewed by the relevant ministries to assess any incompatibility between the existing legislation and the WTO Agreement<sup>4</sup> and the need to repeal incompatible legislation or legislation that may have fallen into desuetude.

17. Central American legislation has also been reviewed and new legislation is being contemplated. For instance, in order to update the regional legislation, new directives regarding unfair trade practices, safeguards and rules of origin have been approved.<sup>5</sup> In addition, new regulations regarding trade in services, investment, sanitary and phytosanitary measures and dispute settlement are under study.

(v) Trade relations

(a) World Trade Organization

18. El Salvador acceded to the GATT in May 1991, following ratification by the Legislative Assembly in April 1991. El Salvador was not party to any of the Tokyo Round Agreements. El Salvador signed the Final Act of the Uruguay Round and the Marrakesh Agreement establishing the World Trade Organization in May 1995. Accession to the WTO was ratified in March 1995. Under the Single Undertaking, all Uruguay Round Agreements, except the four Plurilateral Agreements, became binding on El Salvador. El Salvador has no plans to sign any of the Plurilateral Agreements.

19. While autonomous liberalization has reduced tariffs to below bound levels, adherence to the GATT/WTO provides the discipline and security of access that lend support to the reform process. On the other hand, much of El Salvador's trade takes place within preferential agreements or within Central America so that the improvements in access to other markets as a result of the Uruguay Round will not have a major short-term impact on El Salvador's exports. In particular, the authorities are disappointed with the implementation of the WTO Agreement on Textiles and Clothing, and are particularly concerned that some developed country importers have resorted to the transitional mechanism without adequate justification.

20. Tables II.2 and II.3 show the notifications made by El Salvador under the obligations of different WTO Agreements as well as a list of notification obligations where there is no record of notification by El Salvador of a measure or the absence of a measure by June 1996.

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<sup>4</sup>However, in case of a conflict between the WTO Agreement and the national legislation, the international agreement would prevail.

<sup>5</sup>Central American Regulation on Unfair Trade Practices (*Reglamento Centroamericano sobre Prácticas Desleales de Comercio*), Agreement No.808, *Diario Oficial* No. 237, 21 December 1995; Central American Regulation on Safeguards (*Reglamento Centroamericano sobre Medidas de Salvaguardia*); Agreement No. 213, *Diario Oficial* No. 110, 14 June 1996; and Central American Regulation on the Origin of Goods (*Reglamento Centroamericano sobre el Origen de las Mercancías*); Agreement No. 799, *Diario Oficial* No. 329, 21 December 1995.

Table II.1

## Trade-related legislation in El Salvador

Area	Law
Rules of Origin:	Central America Regulations on the Origin of Goods ( <i>Reglamento de Origen Centroamericano de las Mercancías</i> ) (1995).
Customs Tariffs	Central American Tariff System ( <i>Sistema Arancelario Centroamericano, SAC</i> ) (1993)
Customs Valuation:	Annex B to the Agreement on the Central American Tariff and Customs Régime: Central American Legislation on Customs Valuation ( <i>Anexo B del Convenio sobre el Régimen Arancelario y Aduanero Centroamericano: Legislación Centroamericana sobre el Valor Aduanero de las Mercancías</i> ) (1986)
Preferential Agreements:	Central American General Treaty of Economic Integration ( <i>Tratado General de Integración Económica Centroamericana</i> ) (1961) Free Trade and Preferential Exchange Treaty with Panama ( <i>Tratado de Libre Comercio y de Intercambio Preferencial con Panamá</i> ) (1970)
Levies and Charges:	Tax on jute sacks (1993) Decree No. 495 on VAT (1993). Law on the Tax on the Transfer of Goods and Services ( <i>Ley de Impuesto a la Tránsito de Bienes Muebles y a la Prestación de Servicios</i> ) (1992). Law on the Tax on Sweetened and Unsweetened Soft Drinks ( <i>Ley de Impuesto sobre las Bebidas Gaseosas Simples o Endulzadas</i> ) (1996). Instruction No. 2093 of the Ministry of Finance (1996) Decree No. 385 Abolishing duty and tax concessions (1989)
Import Regulations:	Annex A to the Central America General Treaty of Economic Integration (Agreement No. 577, 1995). Decree No. 647 (import prohibitions and import restrictions) (1990) Law Regulating the Production and Commercialization of Alcohol and Alcoholic Beverages ( <i>Ley Reguladora de la Producción y Comercialización del Alcohol y de las Bebidas Alcohólicas</i> ) (1996) Import restriction on jute sacks (1953) Law to Promote the Sanitary Production of Milk and Dairy Products and the Regulation of Retailing ( <i>Ley de Fomento de Producción Higiénica de la Leche y Productos Lácteos y de Regulación de su Expendio</i> ) (1960) Agreement No. 277 on import liberalization (1993)
Export Regulations:	Coffee Retention Scheme, Decree No. 414 (1995)
Barter and Countertrade:	Law for the Reactivation of Exports ( <i>Ley de Reactivación de las Exportaciones</i> ) (1990)
Export Promotion:	Law for the Reactivation of Exports ( <i>Ley de Reactivación de las Exportaciones</i> ) (1990) Law on the Régime on Free Zones and Tax-free Areas ( <i>Ley del Régimen de Zonas Francas y Recintos Fiscales</i> ) (1990)
Standards and Regulations:	Law on the Enrichment of Sugar with Vitamin A ( <i>Ley de Fortificación del Azúcar con Vitamina "A"</i> ) (1994) Law on the Iodization of Salt ( <i>Ley de Yodación de Sal</i> ) (1993)
Sanitary and Phytosanitary: <sup>a</sup>	Decree No. 647 Sanitary and Phytosanitary (1990) Law Regulating the Production and Commercialization of Alcohol and Alcoholic Beverages ( <i>Ley Reguladora de la Producción y Comercialización del Alcohol y de las Bebidas Alcohólicas</i> ) (1996) Health Code (1988) Plant and Animal Health Law (1988)
Marketing and Labelling:	Law for Consumer Protection ( <i>Ley de Protección al Consumidor</i> ) (1996) Decree No. 647 (labelling). (1990)
Government Procurement:	General Budget Law ( <i>Ley General del Presupuesto</i> ) Procurement Law ( <i>Ley de Suministro</i> ) (1946) Instruction 6023 A ( <i>Instructivo 6023 A</i> ) (1994)

Table II.1 (cont'd)

Area	Law
Anti-dumping and Countervailing and Safeguard Measures:	Central American Regulations on Unfair Trade Practices ( <i>Reglamento Centroamericano sobre Prácticas Desleales de Comercio</i> ) (1995) Central American Regulations on Safeguard Measures ( <i>Reglamento Centroamericano sobre Medidas de Salvaguardia</i> ) (1996) Central American Agreement on Tariff and Customs ( <i>Convenio sobre el Régimen Arancelario y Aduanero Centroamericano</i> ) Art. 25 and 26 (1993).
Pricing and Marketing Arrangements:	Law for Consumer Protection ( <i>Ley de Protección al Consumidor</i> ) (1996) Agreement No. 46 Wholesale Pricing for petroleum (1995) Agreement No. 463 Retail Pricing for petroleum (1995)
Competition Law:	Law for Consumer Protection ( <i>Ley de Protección al Consumidor</i> ) (1996) Art. 110 of the Constitution (1983)
Intellectual Property:	Law to Promote and Protect Intellectual Property Rights ( <i>Ley de Fomento y Protección a la Propiedad Intelectual</i> ) (1993)
Foreign Investment:	Law to Promote and Guarantee Foreign Investment ( <i>Ley de Fomento y Garantía de la Inversión Extranjera</i> ) (1988)

a For a complete list of sanitary and phytosanitary regulations refer to Table III.2.

Source: Compiled by the WTO Secretariat.

**Table II.2**  
Notifications made by El Salvador under the WTO Agreement, September 1996

Agreement	Subject	Document symbol	Type of measure
GATS Article VII:4	Trade in services	S/C/N17 (18/06/96)	Recognition agreements/arrangements; autonomous recognition measures (agreements, arrangements or autonomous measures recognizing education, experience, licences or certification granted in a particular country).
Agreement on Technical Barriers to Trade (Art.2:10)	Technical barriers to trade	G/TBT/NOTIF.95.324 (09/11/95) and G/TBT/NOTIF.95.324/Add.1 (6/12/95)	Characteristics and specifications to be satisfied for wheat flour.
Agreement on Implementation of Article VI of GATT 1994 (Art.18.5)	Anti-dumping	G/ADP/N/SLV/1 (24/03/95)	Laws/regulations (and changes thereto, including changes in the administration of such laws).
Agreement on Implementation of Article VI of GATT 1994 (Art.16.4)	Anti-dumping actions (taken within the preceding 6 months)	G/ADP/N/2/Add.1/Rev.1 (28/08/95) G/ADP/N/4/Add.1/Rev.4 forthcoming G/ADP/N/9/Add.1/Rev.2 forthcoming	No actions taken, Jul-Dec 94. No actions taken, Jan-Jun 95. No actions taken, Jul-Dec 95.
Agreement on Subsidies and Countervailing Measures (Art.32:6)	Countervailing measures; subsidies	G/SCM/N/1/SLV/1 (27/03/95)	Laws/regulations (and changes thereto, including changes in the administration of such laws).
Agreement on Subsidies and Countervailing Measures (Art. 25:11 - semi-annual)	Countervailing duty actions (taken within the preceding 6 months)	G/SCM/N4/Add.1 (14/07/95)	No actions taken.

Table II.2 (cont'd)

Agreement	Subject	Document symbol	Type of measure
Agreement on Safeguards (Art. 12:6)	Safeguards	G/SG/N/1/SLV/1 (27/03/95) G/SG/N/1/SLV/2 (02/09/96)	Laws/regulations and administrative arrangements (and changes thereto), or absence thereof.
Agreement on Textiles and Clothing (Art. 2:7)	Textiles/clothing	G/TMB/N/52 (28/04/95)	Integration Programme (first stage) Articles 2.6 & 2.7: List of products for first integration into GATT, i.e., 16 per cent of total volume of 1990 imports of products in Annex.
Agreement on Textiles and Clothing (Art. 6:1)	Textiles and clothing (safeguard measures)	G/TMB/N/8 (01/03/95)	Article 6.1: Decision whether or not Member wishes to retain the right to use the provisions of the special safeguard in ATC Article 6.
Agreement on Import Licensing Procedures (Footnote 5 to Art. 2.2)	Import licences	G/LIC/I (24/04/95)	Delay of application of sub-paragraphs (a)(ii) and (a)(iii) by 2 years from date of entry to force of the WTO Agreement.
Agreement on Implementation of Article VII of GATT 1994 (Annex III) (Art. 20.2) (Art. 4) Art. 5.2)	Customs valuation	WT/LET/1/Rev.2 22/05/95 G/VAL/2 (28/04/95) G/VAL/2/Rev.1 (13/10/95)	Article 20.1 (delayed application of the provisions of the Agreement), Article 20.2 (delayed application of the computed value method), paragraph 2 of Annex III (reservation concerning minimum values), paragraph 3 of Annex III (reservation concerning reversal of sequential order of Articles 5 and 6), and paragraph 4 of Annex III (reservation concerning application of Article 5.2, whether or not the importer so requests).
Agreement on Rules of Origin (Article 5 and Paragraph 4 of Annex II)	Rules of Origin	G/RO/N/10 (10/08/96)	El Salvador does not have or apply any non-preferential rules of origin.

Source: WTO Central Registry of Notifications.

Table II.3

Notification obligations under the WTO Agreement where no notification of measures or the absence of measures has been received by September 1996

Agreement	Subject	Note
Agreement on Agriculture: Article 18:2	- - - -	Volume of imports under tariff and other quota commitments Annual use of the special safeguard provisions Domestic support
Agreement on Agriculture: Article 10 and 18:2	- -	Export subsidies Food aid in the context of export subsidies
Agreement on Agriculture: Article 16:2	-	Decision on measures concerning the possible negative effects of the reform programme on least-developed and net food-importing developing countries
TRIPS Agreement Article 63.2 and Decisions TRIPS Council of 21 November 1995 (IP/C/2)	-	Relating to Articles 3, 4 and 5  Article 65 requires all Members to comply with Articles 3, 4 and 5 of the TRIPS Agreement as of 1 January 1996. According to paragraph 2.1 of the Decision of the Council for TRIPS of 21 November 1995 (IP/C/2), relevant legislation has to be notified to the Council without delay after that date. 1 January 1996 (see IP/C/M/3, paragraph 27)
TRIPS Agreement Article 69		
Agreement on Import Licensing Procedures Article 7.3		
Agreement on Import Licensing Procedures Article 1.4(a) and/or 8.2(b)		
Decision on Notification Procedures for Quantitative Restrictions (G/L/59)		Biennial.
Agreement on Preshipment Inspection Article 5		First time.
Agreement on Subsidies and Countervailing Measures Article 25.1 - GATT 1994 Article XVI:1		
Agreement on Subsidies and Countervailing Measures Article 25.11 GATT 1994 Article XVII:4(a) - Understanding on the Interpretation of Article XVII		Semi-annual: period January-June 1995, period July-December 1995. Full notification was due on 30 June 1995.
GATS Article III:4 and/or IV:2 (optional) (for all Members)		Each Member should notify the establishment of its enquiry/contact points by 31 December 1996.

Source: WTO Central Registry of Notifications.

21. El Salvador has no legislation to solve trade disputes with its trading partners, thus GATT/WTO provisions would be used, if required. Within the CACM, trade consultations and dispute settlement among members are covered in a first instance at the meetings of Directors of Integration and, as a last resort, at the meetings of Ministers in charge of Integration (*Ministros Encargados de la Integración Centroamericana*).



22. In 1993, within the framework of the dispute settlement provisions of GATT 1947, El Salvador was involved as a complainant in a dispute under GATT Article XXIII which led to a panel. The dispute was in relation to the United States' introduction of legislation restraining imports of tobacco, which according to the complainants and the panel conclusions violated Article III:5 and other relevant provisions of the GATT.<sup>6</sup>

(b) Regional Agreements

Central American Common Market (CACM)

23. El Salvador has been a member of the CACM since 1961 when the General Treaty of Central American Economic Integration (*Tratado General de Integración Económica de Centroamérica*) of 1960 entered into force.<sup>7</sup> The Salvadorian authorities consider that this integration scheme is of primary importance for the country and could provide a sound base for the integration of Central America into the world economy - hence the effort made by the Salvadorian Government to enhance the process of integration.

24. The CACM was created mainly to promote trade and the development of the industrial sector in the member countries; sectors such as agriculture and services were given little importance. A strategy of import substitution industrialization (ISI) was adopted, since it was considered that the agricultural sector was not sufficiently dynamic to generate desired rates of growth and provide employment for a growing population. While providing support to industry geared to supplying the national and Central American markets, the protectionism implicit in this strategy also effectively taxed the export sector. The strategy led to a distorted distribution of resources and to the development of an inefficient industrial sector. Initially, the programme was successful in boosting intra-regional trade, but was much less successful in promoting exports towards third markets. Until recent reforms, only exports such as coffee with high comparative advantage were able to compete for scarce resources with the protected sectors.

25. In recent years the process of integration has been given a new impetus. In 1987, growth in intra-regional trade again began to grow strongly, and this trend gained momentum through 1995. Since 1993, trade levels have consecutively surpassed historic highs. Intra-regional trade grew 22 per cent in 1995 to reach US\$ 1.5 billion.<sup>8</sup>

26. In 1990, the CACM members started negotiations to restructure the programme of economic integration. The new process of integration is based on outward orientation, and the production of tradeable goods is a fundamental element. This new scheme was to be designed within the framework of the structural adjustment programmes that are being implemented by several of the CACM members. Thus, the new framework of integration is characterized by less interventionist policies and lower rates of protection in order to achieve a more efficient allocation of resources. The regional market will be protected by a moderate common external tariff.

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<sup>6</sup>For more information see GATT documents: DS44/1, 7 September 1994; DS44/5, 7 December 1993; DS44/5/Corr.1, 15 February 1994; DS44/9, 15 February; DS44/9/Rev.1, 28 February 1994; DS44/R, 12 August 1994.

<sup>7</sup>This Treaty was signed by Guatemala, El Salvador, Honduras and Nicaragua in December 1960 and entered into force for these countries in June 1961. Costa Rica signed the Treaty in November 1962.

<sup>8</sup>Inter-American Development Bank (1996).

27. In 1993, there was a shift from the common tariff nomenclature, NAUCA II, based on the CCCN, to the Central American Common Tariff (*Sistema Arancelario Centroamericano*, SAC), based on the Harmonized System. While the nomenclature is the same for all members, the SAC cannot yet be considered a common external tariff, since rates applied by each member are still in the process of harmonization.

28. The SAC is divided into three Parts; the average tariff rate for Parts I and II is 20 per cent and 30 per cent for Part III. Tariff rates for goods included in the three Parts of the SAC can be changed unilaterally. However, any unilateral changes in tariff rates of Parts I and II can only be temporary emergency measures, as established in Article XXVI of the Central American Tariff and Customs Agreement (*Convenio Arancelario y Aduanero Centroamericano*) (Chapter III). Changes in these tariffs have to be approved by the Ministers in Charge of Integration who have 30 days to examine each case and make a decision. Tariff rates for Part III can be modified by the Legislative Assembly of each Central American country, without the approval of the Ministerial Meeting. Definitive modification in the tariff rates of Parts I and II can only be done at the Council of Ministers Responsible for Integration (*Consejo de Ministros Responsables de la Integración*).

29. The Salvadorian authorities are undergoing a revision of the regional legal instruments to ensure accordance with the WTO Agreements, some new regulations have already been drafted and re-negotiated. For instance, new legislation on rules of origin and safeguards has been approved at the Central American level.

30. In 1995, substantial changes were made to the CACM legal framework. First, the Protocol of Tegucigalpa<sup>9</sup>, which created the Central American Integration System (*Sistema de Integración Centroamericana*, SICA), was signed and ratified by the six countries of the Isthmus. The system establishes an economic community in which the member countries would harmonize economic policies, agree on common external tariff and allow mobility of factors of production such as capital and labour. In the longer run, the aim is that the Members specialize in the production of those products in which each Member enjoys a comparative advantage. Second, the Protocol of Guatemala entered into force with its ratification by Nicaragua, Honduras and El Salvador. This Protocol reformed the General Treaty on the Economic Integration of Central America and strengthened the juridical framework of the Central American Secretariat for Economic Integration (*Secretaría para la integración Económica de Centroamérica*, SIECA). These new instruments strive at establishing an economic area whose economic legislation and regulatory framework is harmonized so as to facilitate private sector activities and contribute to a more effective integration of Central America into the international market.

31. According to the Protocol of Guatemala (Article 6), individual members of the CACM can progress at their own pace. This is the basis on which, in 1992, the Presidents of El Salvador, Guatemala and Honduras signed an agreement to strengthen the process of integration by creating the so-called "*Triángulo del Norte*".<sup>10</sup> The agreement provided for the free movement of labour and capital among the three countries. However, this agreement has never become a law per se at the national level.

32. On February 1993, El Salvador together with the other Central American countries signed a Trade and Investment Agreement with Venezuela and Colombia. The agreement was to eliminate

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<sup>9</sup>The full name of the Protocol of Tegucigalpa is *Protocolo de Tegucigalpa a la Carta de la Organización de Estados Centroamericanos* (ODECA), in Legislative Decree No. 222, *Diario Oficial* No. 93, 22 May 1992.

<sup>10</sup>*Acuerdo de Nueva Ocotepeque*, 12 May 1992.

both tariff and non-tariff barriers and increase the investment flows amongst the member countries.<sup>11</sup> However, negotiations were not successful and were suspended in the same year.

33. El Salvador, together with Guatemala and Honduras, is at present negotiating a free-trade agreement with Mexico and is actively engaged in the negotiations for the creation of the Free-Trade Area of the Americas (FTAA).

(c) Preferences

34. El Salvador is a beneficiary of the Caribbean Basin Initiative(CBI) and also benefits from the Generalized System of Preferences (GSP) schemes of the United States, Canada, Switzerland and the European Union (EU). In addition, Mexico, Venezuela and Colombia grant preferential treatment to some Salvadorian products.

35. According to the authorities, the United States' CBI and GSP programmes are the most important of these preferential schemes. Salvadorian exports under the CBI amounted in 1994 to US\$26.5 million and increased to US\$41 million in 1995, while exports under the United States' GSP amounted to US\$37.6 million in 1994.<sup>12</sup> However, these data do not agree with figures in Table II.4 which suggest that the EU GSP is the most important preferential régime.

**Table II.4**  
**Exports benefiting from unilateral trade preferences, 1991-95**  
(US\$ million; and percentage)

Country	1991	1992	1993	1994	1995
<b>Value</b>					
Total exports	633.6	795.5	1032.1	1294.3	1661.3
United States	41.3	32.5	26.7	22.8	56.4
Canada	5.6	3.9	4.7	12.4	14.7
EU15	122.7	72	101.4	178.2	308.2
Switzerland	0.3	0.2	0.2	0.0	3.2
USA (CBI)	112.0	119.5	123.0	94.2	92.2
<b>Share of Total Exports</b>					
United States	6.5	4.1	2.6	1.8	3.4
Canada	0.9	0.5	0.5	1.0	0.9
EU15	19.4	9.1	9.8	14.3	18.6
Switzerland	0.0	0.0	0.0	0.0	0.2
USA (CBI)	17.7	15.0	11.9	7.5	5.5

Source: Government of El Salvador.

<sup>11</sup>Norton et al. (1994).

<sup>12</sup>Information provided by the authorities.

36. Most of the products benefiting from the United States' CBI and GSP schemes are traditional agricultural products such as coffee and sugar; non-traditional products such as shrimp, melons and pineapples are also exported under these régimes. These agricultural products are labour-intensive and the schemes therefore have a positive impact upon employment.<sup>13</sup>

37. Exports under the Canadian GSP have also gained in importance since the number of products allowed to enter under this régime has been broadened, even though some important manufactured products, such as some textiles and shoes, have been excluded. In 1991, 54 different products were exported under the régime, while in 1994 the number of products increased to 70; the most important exports are coffee, cotton thread (*hilaza de algodón*), raw sugar, sesame seeds, beans and knitted blouses.

(2) Investment Policy

(i) Investment policy objectives

38. Foreign direct investment (FDI) has become a key element in the reconstruction and modernization of infrastructure, as well as for increasing productivity through technology transfer and know-how. Thus, since 1989, the promotion of FDI has been an important component of Salvadorian economic policy. The authorities have aimed at eliminating all restrictions applied to foreign investors, at setting the same rules for national and foreign investors and at guaranteeing all investments and respecting private property.

39. Policies in support of efforts to attract greater FDI include the liberalization of the foreign exchange market, the reform of the trade régime and the revision of the legal framework. Thus:

- the foreign exchange market was liberalized in 1991 eliminating all restrictions and controls. The price of the currency is set by the market, and there are no controls on acquiring or selling foreign exchange;
- the rationalization of tariffs and the elimination of most non-tariff barriers begun in 1989 aims at promoting the efficiency of the productive sector and at adding transparency to the trade régime by reducing discretionality; and
- an improved legal framework has given national and foreign investors a clear picture of the rules and regulations under which they would operate and has re-established investor confidence. To this end, three laws have been approved: the Law to Promote and Guarantee Foreign Investment (*Ley de Fomento y Garantía a la Inversión Extranjera*), the law for the Reactivation of Exports (*Ley de Reactivación de las Exportaciones*), and the Law on the Régime for Free Zones and Tax-free Areas (*Ley del Régimen de Zonas Francas y Recintos Fiscales*), (Chapter III).

40. Additional legal and institutional reforms have also contributed to the creation of an environment more attractive to foreign investment. These include the deregulation and privatization of the banking sector and the design of a plan to privatize other institutions; the elimination of trade monopolies; the reform of the State; and the establishment of a legal framework to strengthen the functioning of the market.

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<sup>13</sup>Norton et al. (1994).

41. The process of registration and legalization of foreign and national investment has been centralized through the establishment of the single-window for investment formalities (*Ventanilla Única de Trámites de Inversiones*) in 1994. However, despite the streamlining of formalities, the process is still bureaucratic; the authorities aim to introduce a single application form and to establish the National Investment Office (*Oficina Nacional de Inversiones*, ONI) as a one-step investment window similar to Centrex. (Chapter III).

42. In addition, the Salvadorian business community has founded a private institution, PRIDEX, to aid foreign investors. PRIDEX, El Salvador's trade and investment service centre, is part of the Salvadorian Foundation for Economic and Social Development (*Fundación Salvadoreña para el Desarrollo*, FUSADES), and specializes in assisting international companies in setting up manufacturing operations, for exporting to markets outside the Central American region.

43. In order to promote and protect investment El Salvador has also signed bilateral agreements with Ecuador, France, Switzerland and Spain. Similar agreements with Argentina and Peru are to be ratified, while negotiations with Chile have been concluded. Agreements are being negotiated with Korea, the Netherlands, Russia, Chinese Taipei and the United States. El Salvador has also signed bilateral investment guarantee agreements with Chile, the United States and Spain.<sup>14</sup>

44. El Salvador is a member of the Multilateral Investment Guarantee Agency (MIGA) and of the Overseas Private Investment Corporation.

(ii) Legal framework

45. The main FDI law in El Salvador is the Law to Promote and Guarantee Foreign Direct Investment and its Regulation.<sup>15</sup> However, FDI is also covered by the Constitution, the Banking and Financial Law (*Ley de Bancos y Financieras*), the General Law on Fishing (*Ley General de Actividades Pesqueras*) and the Law Regulating Commerce (*Ley Reguladora del Ejercicio del Comercio*); several other laws also touch on investment-related issues.

46. The FDI law grants a series of incentives to foreign capital duly registered at the Ministry of Economy. The law allows: (i) operations under 100 per cent foreign ownership; (ii) unrestricted remittance of net profits of investment in industrial activities; (iii) remittances of up to 50 per cent of net profits per year of investment in commercial and service oriented activities;<sup>16</sup> (iv) free repatriation of funds obtained from the liquidation of foreign investment; (v) no restrictions on foreign capital transactions; (vi) access to domestic credit; and (vii) fiscal credit on income tax. In addition, the incentives provided to national investors under the free-zone and the tax-free areas régimes are also available to foreign investors (Chapter III).

47. The FDI law was passed to safeguard the rights of foreign investors, but the benefits apply only to registered foreign capital. Nevertheless, the registration of foreign capital is not a legal requirement, and, at present, there is no incentive to register this capital, since foreign exchange controls

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<sup>14</sup>Data supplied by the Government of El Salvador.

<sup>15</sup>Decree No 960, *Ley de Fomento y Garantía de la Inversión Extranjera*, *Diario Oficial* No. 85, 9 May 1988 and Decree No. 1, *Reglamento de la Ley de Fomento y Garantía de la Inversión Extranjera*, 9 January 1990.

<sup>16</sup>This restriction cannot be enforced since the capital account has been liberalized.

and restrictions on capital movement, which existed when this law was issued, have been abolished.<sup>17</sup> Nevertheless, given the existence of the law, the registration of foreign capital is recommended since it would protect investors in the event that restrictive policies were re-instituted.

48. As shown in Table II.5, FDI is limited in very few areas. Small-scale commerce, industry and services are the only areas which are totally restricted to foreign investors, and even this limitation is not binding. First, the definition of small-scale investment renders this restriction ineffective.<sup>18</sup> Second, the Commerce Code (*Código de Comercio*) allows for exceptions to these restrictions when domestic capital is not available.

49. Foreigners benefit from national treatment at the time of the approval of the investment. However, the formal registration ("*legalización*") of foreign investment has certain additional requirements to those for nationals. Foreigners are also required to obtain a commerce and industry "patent" (*patente de industria y comercio*). Foreign branches require an additional authorization (preliminary authorization, *autorización previa*) that has to be issued before they apply for the other permits. Once all these permits are granted and the investment is approved the company can be "legalized".

50. However, these procedures are to be simplified under a proposal that is currently being discussed. The proposal includes the elimination of the preliminary permit and the substitution of a single permit for the patent and the commercial licence. It is also envisaged to establish the National Investment Office (*Oficina Nacional de Inversiones*, ONI) as a one-step window in charge of all these procedures. Moreover, according to the authorities, the FDI law will also be revised to simplify the process of registration and legalization of foreign investment.

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<sup>17</sup>Foreign exchange controls were relaxed in 1991; therefore, it is not feasible to restrict capital repatriation, since technically today all capital could be repatriated.

<sup>18</sup>Small-scale commerce is defined as an operation holding less than C 100,000 (US\$11,428.57), and small-scale industry and services are defined as operations holding less than C 50,000 (US\$5,714.28). (Decree No.9, *Reglamento a la Ley Reguladora del Ejercicio del Comercio e Industria*, *Diario Oficial* No. 23, 4 February 1970 (Article 20)).

Table II.5

Areas in which FDI and national investment are limited

Activity	Law
<b>A. Sectors in which FDI and national investment are limited</b>	
1. In order to exploit the subsoil the Government may grant a concession.	Constitution <sup>a</sup> (Art. 103, 3)
2. Concessions to use piers, trains, channels or other public infrastructure are granted for a limited period of time.	Constitution (Art. 120)
3. Properties of rural areas are limited to 245 hectares both for nationals and for foreigners.	Constitution (Art. 105,2)
4. The amount of shares that can be owned in a financial institution is limited to 5 per cent of the total capital both for nationals and foreigners.	The Banking and Financial Law ( <i>Ley de Bancos y Financieras</i> ) <sup>b</sup> (Art. 9)
5. The possession, production, importation, exportation and commerce of weapons, ammunition, explosives and similar goods can only take place under the direct supervision of the Ministry of Defence and Security ( <i>Ministerio de Defensa y Seguridad</i> ).	Constitution (Art. 217)
<b>B. Sectors reserved only for the State</b>	
1. Issuance of money.	Constitution (Art. 111, inc 1)
<b>C. Sectors in which foreign direct investment is prohibited, restricted or limited</b>	
(a) FDI prohibited.	
1. Small-scale commerce, industry and services.	Law to Promote and Guarantee Foreign Investment ( <i>Ley de Fomento y Garantía de la Inversión Extranjera</i> ) (Art. 5) <sup>c</sup> Constitution (Article 115)
2. Small-scale fishing or coastal fishing. <sup>d</sup>	Law to Promote and Guarantee Foreign Investment ( <i>Ley de Fomento y Garantía de la Inversión Extranjera</i> ) (Art. 5) The General Law on Fishing ( <i>Ley General de Actividades Pesqueras</i> ) (Art. 25 literal a.) <sup>e</sup>
(b) Sectors or activities in which FDI is limited or restricted.	
1. FDI is restricted to a maximum of 50 per cent in mechanized coastal fishing of pelagic and demersal species and deep-sea fishing.	The General Law on Fishing ( <i>Ley General de Actividades Pesqueras</i> ) (Art. 26)
2. FDI in banks and financial institutions is limited to 50 per cent of the total capital.	The Banking and Financial Law ( <i>Ley de Bancos y Financieras</i> ) (Art. 9)
3. There are limitations on the amount of capital that is invested by foreigners in commerce, industry and services. <sup>f</sup> Investment in a one-man commerce company: liquid assets must amount to at least C 100,000. Investment in a one-man industrial company: liquid assets must amount to at least C 50,000. Investment in a society: liquid assets must double the above-mentioned amounts.	The Law Regulating Commerce ( <i>Ley Reguladora del Ejercicio del Comercio</i> ) (Art. 3) <sup>g</sup>
4. Rural land can be purchased by foreigners only if there is reciprocity, unless land is for industrial use.	Constitution (Art. 109)

a Constitution of El Salvador, 16 December 1983.

b *Ley de Bancos y Financieras*, *Diario Oficial* No. 92, 22 May 1991.c *Ley de Fomento y Garantía de la Inversión Extranjera*, *Diario Oficial* No. 85, 9 May 1988.

d Coastal fishing - 12 marine miles measured from the lowest tide; deep-sea fishing - the area from 12 marine miles up to 200 marine miles.

e *Ley General de Actividades Pesqueras*, Decree No. 799, *Diario Oficial* No. 169, 14 September 1981.

f Services are considered an industry for the purpose of these restrictions.

g *Ley reguladora del Ejercicio del Comercio e Industria*, Decree No. 279, 27 March 1969.

Source: Compiled by the WTO Secretariat.