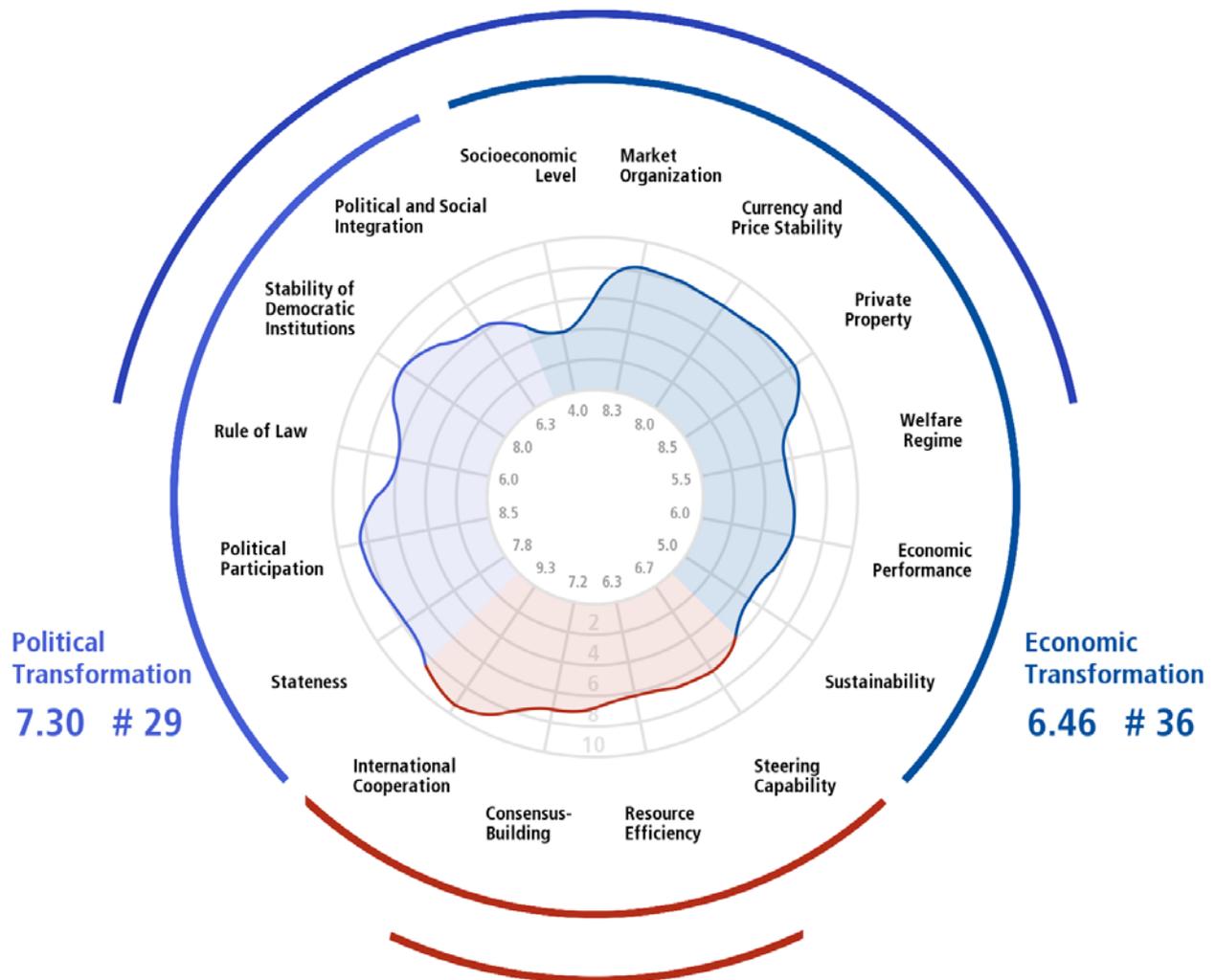


El Salvador

Status Index

6.88 # 28

on 1-10 scale out of 129



Governance Index

6.57 # 14

on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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Key Indicators

Population	M	6.3	HDI	0.680	GDP p.c., PPP \$	8619
Pop. growth ¹	% p.a.	0.5	HDI rank of 188	117	Gini Index	40.8
Life expectancy	years	73.0	UN Education Index	0.620	Poverty ³	% 9.8
Urban population	%	67.2	Gender inequality ²	0.384	Aid per capita \$	14.0

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

The government of El Salvador is currently in the hands of the FMLN, a leftist political party rooted in the civil war of the 1980s. Its main opposition is ARENA, a party of the right that was also born in the 1980s. Today they are adversaries in the political arena and compete for political power through the ballot box. Legislative elections were held in 2015 but failed to produce a majority, which has resulted in delays in reaching agreement on key pieces of legislation.

As befits representative governments, public policies have reflected the concerns of the people. Salvadoran governments must also listen to foreign governments and international aid agencies given the importance of the country's ties with the outside world. From this combination of internal and external political concerns emerges a set of public policies that center on social, economic and security issues. These are the immediate problems that voters and government officials feel they must address in the short term.

Social policy is primarily focused on education and health, as reflected in the two largest budget items over the last years. The impact of government efforts in these fields can be gauged by the increase of life expectancy and education achievement levels. However, both health care and education are below the standards expected by many inside and outside the country. Spending on education is still considerably below the 6% of GDP that is considered a desirable level for successful development.

Increased spending and investment in social policies are constrained by sluggish economic growth, a feature of the last ten years at least. Public debt and deficit financing are nearing their limits. Investment in productive enterprises is held back by a number of problems, including low educational levels and resource scarcity. However, an immediate concern is the current wave of social and criminal violence which disrupts normal life and places a great strain on both government and private companies.

Most recent responses to violence involve increasing the number of police officers and private security guards. This would be an understandable approach were it not for the large numbers involved in violent actions, including tens of thousands of young people who belong to gangs. It would also be understandable if police actions were sufficiently effective to identify and prosecute those who commit violent crimes. As things stand now, both the levels of violence and the methods chosen to try to curb it through repression are unacceptable.

The most powerful tool that those concerned about the country's future have at their disposal is the democratic political system that allows for free debate and consultation about the problems that society faces. However, it is unclear whether there is sufficient time for democracy to successfully address these enormous challenges, for which there are few precedents and resources (both human and financial) in the country and abroad.

History and Characteristics of Transformation

El Salvador's authoritarian political system began to unravel in the 1970s when civil disobedience reached levels that made the country ungovernable. The military, which had run the country for nearly half a century, attempted to install a new governing coalition of reformist army officers and civilian politicians, but the country descended into civil war before a political solution to the crisis could be found. The war that ensued lasted until 1992, when peace accords were signed and a new political system came into existence based on political and civil rights, as well as an economic system framed in terms of private enterprise.

The confrontation of the civil war carried over into the post-war political system, albeit in the political arena: the ARENA party became the main force on the right, while the FMLN represented the left. However, they both realize that they must collaborate in order to be effective. ARENA has become the mainstay of private enterprise and government fiscal responsibility. Its candidates won the four presidential elections since 1989 and it occupied the executive branch of government until 2009. During ARENA's tenure, the country experienced an initial period of rapid economic growth and customs duties were lowered in response to a big increase in local demand, resulting primarily from remittance flows. ARENA also presided over the dollarization of the economy in 2001.

After 2000 economic growth was less pronounced and practically stalled during the 2008 world economic recession. Since then, it has been very modest. In 2009, the FMLN's candidate won the presidential election and there were concerns that the new government would undercut the free-market policies of the ARENA years. Instead, what has characterized the FMLN governments up to the present is a commitment to the poorer sectors of the population via increased spending in education and health, putting pressure on government finances.

Low economic growth and increases in budgetary outlays are a formula for political confrontation: ARENA demands more fiscal responsibility and the FMLN insists on the need to address the

country's social problems. To this must be added the explosion of criminal violence in the last decade for which the government's institutions were wholly unprepared. Past studies have estimated that the yearly cost of violence and criminality might be as high as 12% of GDP.

Perhaps the most intense and acrimonious political debate over the last five years has centered on how to address social and criminal violence. The general consensus is that social and economic exclusion are the root problem, aggravated by a large number of children and young people who have been left to fend for themselves after their caregivers (parents mostly) have emigrated in search of better opportunities abroad. Remittances sent back by those who have left offer economic support for some of those left behind but are no substitute for parental figures of authority and a stable family structure.

In addition to this relatively recent issue of violence can be added a number of others that have accumulated over the years. El Salvador is one of the most environmentally degraded nations on the continent, the result of high levels of population density, combined with non-sustainable farming practices (peasant farming on slopes and chemically-intensive cotton production, for example). Water shortages are expected to increase as urban populations grow unabatedly, while reliance on food imports is very high.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

The state's monopoly on the use of force covers the entire territory of El Salvador. Since the end of the civil war in 1992, no irregular armed group threatens the state's ultimate control of any region of the country. However, there are particular pockets where crime levels are persistently high enough to suggest a significant loss of state control over population and territory and its ability to guarantee basic civil and human rights.

Scholars and policymakers alike associate high rates of crime and violence with the presence of gangs that fight over control of territory from which they extract resources through protection rackets and small-scale drug sales. Gangs also are becoming an issue for state monopoly of the use of force to the extent that they have acquired military-grade weapons and on occasion confront the security forces directly. In 2015, a total of 61 police officers were killed in action or on leave; in 2016, 44 police officers and approximately 20 military personnel died under similar circumstances. The state has attempted to reduce crime and violence by implementing a number of repressive policies, both legal and administrative, and by involving regular army troops in public security functions. However, this has neither curtailed gang activity nor dismantled the gang's territorial organization. Hidden political violence is also used to counter gangs and everyday crime, through social cleansings and the supposed rise of death squads.

El Salvador has one of the highest murder rates in the world (although the 2016 rate decreased from the previous year).

According to the constitution, all Salvadorans over the age of 18 are considered citizens of the state. Nobody is formally denied citizenship on the grounds of religious or political preferences, for belonging to any ethnic groups, or because of gender or sexual orientation. However, de facto discrimination and socially embedded violations of civic rights of members of certain groups, including women,

Question
Score

Monopoly on the
use of force

6

'06 '18 10



1

State identity

9

homosexuals, and indigenous and disabled persons, frequently go unpunished or are ignored by state authorities.



There have been notable developments regarding the protection of civic and gender rights, such as the work of advocacy groups and legislative initiatives, but these remain largely formal and do not touch on the more deeply rooted social and cultural drivers of diverse forms of discrimination. Still, the spaces for advocacy are sufficiently respected to allow for a healthy, albeit restricted, debate on a number of socially contentious issues.



The constitution explicitly recognizes the juridical status of the Catholic Church but also recognizes the right of all other churches to be similarly recognized when they so choose. These constitutional religious rights can be observed in the rising numbers of non-Catholic denominations: in 2014, 50% of the population identified as Roman Catholics, 38% as evangelical, 3% other denominations, and 9% had no affiliation.

No interference of religious dogmas
10

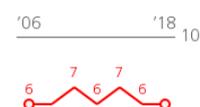


While religious beliefs can be freely expressed, the constitution specifically prohibits persons who hold positions of religious authority from joining political parties or running for public office. Thus, the law sets the foundations for a secular state, but religious groups frequently express their views on political issues such as abortion, reproductive and gender rights, and sex education in public schools.



Most government institutions charged with providing basic social and economic services have been in place since at least the mid-twentieth century, but they have always faced the challenges of a rapidly growing population and shifts in demographics as well as political contention. However, population growth today is fairly low due to emigration and a declining fertility rate. This means that pressure on the state to provide basic social services in education is declining, but increasing life expectancy means that health services will face greater demand from an aging population with special needs.

Basic administration
6



Access to primary education is provided throughout the country. To improve school attendance, the government has distributed school uniforms and shoes to all primary school students as well as providing school meals. Other programs have distributed computers to school children. Still, total government spending on education has not surpassed 3.5% of GDP; authorities themselves and international aid agencies suggest it should be nearer to 6% in order to improve coverage and quality.



Provision of health services by the government is the responsibility of the Ministry of Health and the Social Security Institute. The former administers free health clinics and hospitals, while the latter is restricted to those who are formally employed. Private medical services are a third option used mainly by the middle and upper class. In general, improvements in the provision of health services are reflected in an overall life expectancy of 73.5 years in 2015 (66.8 years for men and 77.9 for women).

One important contributing factor to improved health is the provision of potable water. Most surface water is today contaminated beyond the capacity of treatment possibilities and no city has a functioning waste water treatment plant. A national law to regulate and conserve water resources has been held up in the legislature for some time now.

The country's communications infrastructure is adequate in general terms. The government's port authority administers the national airport and the main seaport. El Salvador has an extensive highway network that is in urgent need of repair and improvement to handle both increased freight and passenger traffic.

The security sector (law, police, prisons) has absorbed around 1.5% of GDP in the last five years. This has allowed the government to employ around 22,000 police officers, but there has been no sustainable reduction in levels of violence and crime. In addition, the prison population has grown dramatically: as of January 2017 it stands at around 37,000 inmates in 19 prison installations designed originally for around 8,000 individuals.

2 | Political Participation

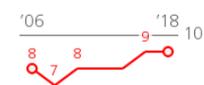
The constitution of the Republic and secondary legislation guarantee free, direct and transparent elections. The last presidential election (2014) was decided in a second round, which the FMLN candidate won by a mere 6,364 votes out of a total of nearly three million cast. The losing ARENA party denounced the results but was unable to prove that fraud had been committed. Elections were held in 2015 for the national legislature and local governments. Less than half of registered voters bothered to participate, with ARENA receiving the most votes (39% of total), followed by the FMLN (37%) and three small, splinter parties sharing the rest.

Public funding for electoral activities is provided in proportion to the number of votes received in previous elections. However, the largest parties have considerably more resources available. On the other hand, some smaller parties are able to elect a number of legislators out of proportion with their electoral strength due to provisions in the electoral law that allow them to consolidate results from a number of disparate electoral districts.

Overall, election results are accepted even though the results of the last legislative elections in 2015 were extensively delayed. Photographs of the candidates are now on the ballots to help voters recognize their choice. Voting has also been extended to Salvadorans abroad but relatively few participate because of logistical problems.

Free and fair elections

9



1

Since the successful exclusion of the military from politics after the 1992 peace accords, there are no overt veto powers or political constraints on elected government officials. Business interests, both national and multinational, continue to exercise strong political influence, mainly through financing of party activities and their direct links to elected officials.

A more difficult problem for governance is the make-up of the legislative branch of government which has not had an absolute single party majority since the 1990s. As a result, the party that controls the executive branch needs to make deals with some of the smaller parties in the legislature in order to achieve a working majority, but this comes at a political cost that involves turning over certain government offices to minority party control and supporting certain legislative initiatives in exchange for others. For example, the approval of the state budget each year has become a time-consuming exercise in under-the-table political deals.

The constitution establishes the right of independent political and civic groups to associate and assemble freely within the law. The main concern of human rights organizations at present is the excessive use of force by police forces engaged in persecuting gangs. Even the government-appointed human rights advocate (ombudsman) has expressed concern about extrajudicial executions supposedly committed by police forces. In addition, civil society organizations focused on youth rehabilitation and the prevention of violence have seen their work impeded by the radical application of the anti-gang law, which allows the government to arrest any person who works with youths suspected of belonging to a gang.

Organizations which work to defend the rights of specific social groups (gender equality, labor unions) also face threats and actual physical violence from those opposed to their activities. Still, their vocal presence would suggest that greater openness and tolerance are possible and are not subject to government restrictions as official policy. Nevertheless, social attitudes remain entrenched.

Freedom of speech and of the press are guaranteed under the constitution and generally respected in practice. Books can be freely printed and imported free of duties. The mainstream media (newspapers, radio, television) are owned by private interests, some of which pursue a very clear editorial line. There is also a small but active group of Internet news sites which specialize in investigative reporting that try to maintain their independence through alternative financing (crowd funding, international donors). International media can operate freely in El Salvador and access to the Internet is not restricted, including foreign news services.

El Salvador remains one of the best-performing Central American countries in terms of media freedom. Nonetheless, Reporters without Borders ranks it number 58 out of 180 countries worldwide in its 2016 Press Freedom Index, a drop from 2015 when it was ranked 45th. This deterioration of press freedom was mostly ascribed to harassment of journalists by government officials and to problems accessing

Effective power to govern



1

Association / assembly rights



1

Freedom of expression



1

information in the public domain. The law currently establishes that most government documents are in the public domain and can be accessed freely; however, some requests for documentation have been denied, ignored or explained away by officials stating that such documents have been lost or do not exist.

3 | Rule of Law

The separation of powers in El Salvador is formally recognized, but continues to be constrained in practice due to persistent structural deficiencies in the judiciary branch and a legislative branch that suffers from inefficiency and a lack of willingness and capacity to exercise its oversight role.

One of the most positive changes is an increasingly autonomous Supreme Court which in July 2016 overturned the 1993 amnesty law that essentially pardoned all those involved in war crimes during the 1980s. The Supreme Court ruled (over the objections of the two main political parties in the legislature and the executive branch) that crimes against humanity could not be put aside and all those accused should stand trial.

The judiciary's independence is constitutionally recognized, but persistent dysfunctions impair its impartiality and effectiveness in practice. Serious problems remain in terms of coverage and access, especially in rural areas. Inefficiency and corruption within El Salvador's justice system are widespread and contribute to a high level of impunity. Judicial delays, inadequate government funding for the police, and the failure to remove under-qualified and corrupt judges continue to undermine the public's respect for the justice system.

The judiciary must also deal with the limited investigative capacities of the prosecutor's office and the police. Many cases are eventually thrown out for lack of evidence or procedural problems that tend to add to the already considerable backlog.

The reform of the judicial system after the 1992 peace accords raised the academic requirements for judges but did not necessarily improve their qualifications. In addition, judges are subject to undue pressures from interested parties and might even feel threatened by violence-prone individuals and groups if a verdict is not in their favor.

Although El Salvador has low levels of corruption overall in comparison with other Latin American countries, reports have cited persistent patterns of both petty and grand corruption – often linked to organized drug trade and money laundering – within state agencies, in particular within the judiciary and the police and in contracts involving public works and purchases. A significant step to address these problems was the replacement of the previous attorney general who had been accused of manipulating investigations to favor certain business people and acquaintances. The

Separation of powers

7

'06 '18 10



1

Independent judiciary

6

'06 '18 10



1

Prosecution of office abuse

6

new attorney general took office in January 2016 after his election by the legislature and reopened a number of cases which had been shelved by his predecessor.

Up to the present, three presidents of the Republic have been accused of embezzlement; one has died before the conclusion of the proceedings, another fled the country, and a third is behind bars. All are accused of using their office to channel public funds into their own pockets and to diverse individual and institutional associates. All of these cases have attracted widespread media attention and investigation. Other public officials linked to corruption have been mentioned but legal action against them is still pending.

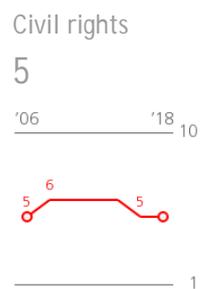
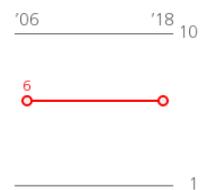
In addition to public censure, international actors – foreign governments and international aid agencies – have expressed concern about corruption as an obstacle to development. Their voice carries particular weight in a country highly reliant on international partners.

Civil rights are constitutionally protected. However, they are not respected uniformly in society. Discrimination against women, homosexuals, indigenous people and persons with disabilities, as well as stigmatization of youth as a security threat are widespread. Civil rights violations have been dealt with inadequately or not at all. Problems with access to justice and due process constitute one of the most important civil rights violations in the country.

Two of the main perpetrators of civil rights violations are the police and the army, especially in applying the anti-gang law under which masses of youths are arrested without any clear charges. Gangs have also been involved directly in violations of civil rights when they practice extortion and limit the free movement of people in communities and neighborhoods. Cases of people abandoning their homes due to threats and actual physical injury by gang members are not infrequent.

Impunity goes hand in hand with violations of civil rights. Cases of extrajudicial executions have been investigated and documented by the media and denounced by the human rights ombudsman but with few results.

In summary, high levels of violence and crime does not bode well for the proper respect and defense of civil rights and places great strains on government and political parties that must answer to an electorate and public opinion which generally approve of repressive measures as a means to improve security and public safety.



4 | Stability of Democratic Institutions

Functioning democratic institutions are a relative novelty in El Salvador, having only been in existence since the end of the civil war in 1992. Today, multiple political parties and a decentralized system of government mean more public initiatives as well as increased opportunities for inefficiency and corruption.

The problem is not with the institutions themselves but the new responsibilities they have acquired. For example, municipal authorities are now freely elected and are subject to social demands that they perform adequately, but their resources are insufficient and not always well administered. The government's audit office has never been up to the task; instead, it has become a reward for political allies of the party in power and overlooks cases of corruption (some massive). The legislature is mainly concerned with discussing and approving new laws but does little in terms of oversight.

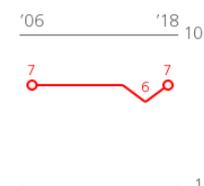
Thus, the fragility of institutions is partly the result of limited economic resources but even more so of inadequate political leadership. The executive branch of government has discretionary funds which it is not required to account for. Power struggles in the legislative branch determine the allocation of resources to other institutions, including the judiciary. Even if few people are calling for a reorganization of the state, many voices are demanding increased oversight, transparency and accountability.

All relevant actors formally accept democratic institutions and procedures although many people in society complain about their operation due to administrative inefficiency and corruption. Representative and plural democracy in El Salvador is not in question although attempts to reform the system and improve accountability are confronted by a party leadership that is mostly concerned about the next election cycle.

Having said this, it should be remembered that El Salvador's democracy is still nascent and strongly endorsed from abroad as a way out of the civil war of the 1980s. Thus, "relevant" actors must include a number of governments and international organizations that have a stake in the political development of the country. Until now, these actors have generally been supportive of democratic practice but there is no absolute guarantee that this might be the case in the future, which might allow anti-democracy movements to gain strength.

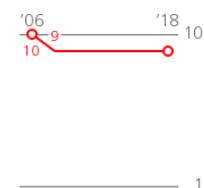
Performance of democratic institutions

7



Commitment to democratic institutions

9



5 | Political and Social Integration

The political scene has been dominated by two parties since the end of the civil war in 1992: ARENA on the right and the FMLN on the left. Both have a core of committed voters which alone are insufficient to assure absolute majorities in elections. Thus, minority parties have acquired an importance that is much greater than their real electoral strength.

It is difficult to gauge the level of patronage in determining political outcomes but election campaigns are heavily reliant on distribution of goods to influence voters. Public service posts are also handed out as rewards for political support, but these are generally considered inevitable albeit criticized.

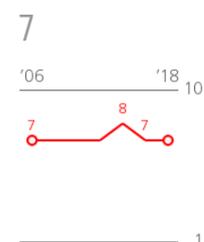
The party system has fragmented more as a result of divisions in the two major parties than due to the emergence of new political or ideological movements. These divisions have exacerbated political polarization but have also forced political actors to reach agreements on key issues (approval of state budgets, for example). In January 2017, in fact, the government and the political opposition announced that the United Nations has appointed a mediator to help reach agreements on the most important issues affecting the country, including public finance and social and criminal violence.

Numerous interest groups and NGOs with diverse societal agendas operate in El Salvador and generally coexist peacefully despite competing programs. Groups deal with a wide range of concerns including political accountability and gender and environmental issues. Organizations that work to prevent violence and crime must operate somewhat cautiously due to repressive laws that punish any association with youth gangs. The existence of a large network of hometown associations comprising migrants in the United States is also important given the weight of monetary remittances in the Salvadoran economy.

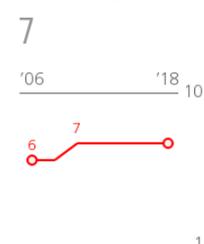
Broader community organizations remain relatively weak, as do unions and other labor organizations. By contrast, business associations such as the National Association of Private Enterprise (ANEP) have high levels of political influence since most economic and fiscal policies (including tax reform) must take business interests into account.

In general, democratic norms and practices have weathered the difficult years the country has faced since the end of the civil war in 1992. According to a LAPOP 2014 survey, support for democracy remained strong in El Salvador with about 76% citing democracy as the best political regime, compared to about 13% who preferred an authoritarian government. These results are essentially identical to a survey carried out by the Central American University (UCA) of San Salvador in December 2016

Party system



Interest groups



Approval of democracy

6

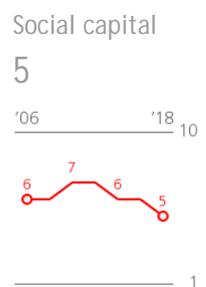
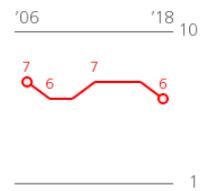
in which 76.4% of respondents agreed that democracy was the best form of government regardless of its shortcomings.

Support for democracy is not the same as support for government institutions or outcomes. There are significant levels of disenchantment with the workings of government institutions. The December 2016 UCA survey found that over four-fifths of those interviewed would approve of a new constitution to revamp the political system. A Latinobarómetro survey in 2016 found that only 36% of respondents in El Salvador thought that democracy was preferable to any other political system. These results suggest that the performance of governments will determine to a great extent the future of democratic practice in El Salvador.

The network of autonomous, voluntary organizations has weakened in recent years. After the civil war there was strong international interest in supporting local NGOs with monies and technical support as part of post-war reconstruction efforts but more recently this interest has waned. Some local funding sources have tried to compensate in part for this shortfall but this cannot make up for monies previously received from abroad. As the country's problems with violence and unemployment have increased, efforts by civic-oriented voluntary associations are increasingly marginal. Instead, there has been a considerable increase in attendance at churches of a revivalist nature that encourage people to turn to faith-based conversion in order to overcome personal and social problems.

It should be said that some religious denominations have become committed to important social work, particularly in the area of preventing violence and crime through job training, education, sports and social rehabilitation. Some of these organizations, including the Catholic Church, often act as a substitute for effective state institutions. In some rural areas, local initiatives to promote sustainable agriculture and protect the environment have endured since the 1990s, but with only modest results.

Adverse economic conditions, crime and insecurity have undermined interpersonal trust. According to data from a 2014 LAPOP survey, 45% of residents have little or no trust in their neighbors and only 35% have some trust. Participation in community activities is also low; in 2014 only 16% of survey respondents said they had participated in the solution of a problem faced by the community.



II. Economic Transformation

6 | Level of Socioeconomic Development

Persistently high levels of poverty, long-term ingrained socioeconomic inequalities and social exclusion are among the greatest challenges to the country's socioeconomic development. In 2015, El Salvador ranked 116 out of 188 countries on the Human Development Index with a value of 0.666, making it a country of medium human development.

In 2013, the overall poverty rate stood at 29.6% of households, rising to 31.8% in 2014 and to 34.9% in 2015. The rate had declined between 2010 and 2013 as a result of increased public spending on social policies and the flow of remittances from abroad. In 2015, the “extreme poverty rate” – those households that cannot purchase even basic required foodstuffs – stood at 8.1% and the “relative poverty rate” – those households that can purchase up to twice the minimum required foodstuffs – stood at 26.8%.

The Gini inequality coefficient in El Salvador declined from 0.48 in 2010 to 0.38 in 2014 and to 0.37 in 2015. However, there are still marked differences between average income in the urban and rural areas; for example, the overall poverty rate for rural areas in 2015 was nearly 39%, compared to 33% in urban areas.

The overall unemployment rate rose slightly from 5.6% in 2013 to 5.9% in 2014 and to 7% in 2015. However, this data does not take account of underemployment, which is considerable given the size of the informal sector of the economy. Nor does it address the marked difference in employment rates among women in relation to men. According to ILO data (Panorama Laboral 2016), in 2015, the labor force participation rate for women was 46.7% and for men 80.2% (overall: 62.1%).

Using the 2015 gender inequality index, the World Economic Forum placed El Salvador 62 out of a total of 145 countries, similar to Ghana and Lesotho. However, life expectancy for women is markedly higher than that for men: 77.4 years compared to 68.3.

Question
Score

Socioeconomic
barriers

4

'06 '18 10

4

1

Economic indicators		2013	2014	2015	2016
GDP	\$ M	24350.9	25054.2	26052.3	26797.5
GDP growth	%	1.8	1.4	2.3	2.4
Inflation (CPI)	%	0.8	-	-	0.6
Unemployment	%	5.9	5.9	6.2	6.3
Foreign direct investment	% of GDP	1.0	2.0	1.9	1.8
Export growth	%	4.8	-0.6	2.2	-0.3
Import growth	%	4.5	-2.5	3.9	-2.2
Current account balance	\$ M	-1585.6	-1211.5	-925.7	-530.6
Public debt	% of GDP	55.3	57.1	58.3	59.5
External debt	\$ M	13539.2	14532.7	14913.0	15424.9
Total debt service	\$ M	1110.2	1246.6	1214.9	1351.2
Net lending/borrowing	% of GDP	-1.4	-2.1	-1.2	-
Tax revenue	% of GDP	15.4	15.1	15.1	-
Government consumption	% of GDP	11.6	11.5	12.1	12.1
Public education spending	% of GDP	3.4	3.4	3.5	-
Public health spending	% of GDP	4.6	4.5	-	-
R&D expenditure	% of GDP	0.1	0.1	0.1	-
Military expenditure	% of GDP	1.0	0.9	1.0	0.9

Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

In principle, the rules for market competition are well established and guaranteed by the Salvadoran state and its constitution, which contains articles that specifically guarantee economic freedom and prohibit monopolistic practices. The governments of the left-wing FMLN, which still has not given up socialism as a goal, have not noticeably altered the free-market system since 2009. However, this framework has become more fragile during the past few years, above all due to some institutional weaknesses, relatively weak judicial independence, and a degree of government interference in the private sector. There are no controls on prices except liquefied

Market-based
competition

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propane gas, public transportation and electric energy, all of which are subsidized by the state. There are no restrictions on using or transferring profits. The 1999 Investment Law grants equal treatment to foreign and domestic investors and establishes procedures to settle disputes between foreign investors and the government.

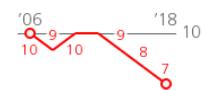
However, the informal economy is estimated to be very large, comprising about two-thirds of the (non-agricultural) labor force according to ILO, which points to an inappropriate institutional framework of economic policy (though it is not necessarily an indicator “of extensively regulated markets,” apart from labor markets). According to a 2016 Central American University poll, about 40% of Salvadorans intend to leave the country soon.

El Salvador is listed as a moderately free country in the 2017 Heritage Index of Economic Freedom, with an overall ranking of 66 out of 178 and a score of 64.1 (slightly above the regional and global averages of 60.0 and 60.9, respectively). However, despite the establishment of a generally appropriate and efficient institutional economic policy framework, domestic and international observers identify high crime rates, deficiencies in the Salvadoran judicial system, and comparatively low workforce education levels as key hindrances to market-based competition, as they constrain business activities and deter investment. The considerable weight of remittances in the economy of El Salvador means less poverty in the short run, but it also finances high levels of imports that local producers struggle to compete with.

Certain sectors of the economy are dominated by a small number of companies and holdings such as urban development, retail sales, agroindustry and beverages. However, to the extent that the country has an open economy, competition also involves foreign producers and retailers.

A new competition law took effect in 2006, with the explicit aim of enhancing economic efficiency and consumer welfare. In addition to prohibiting anti-competitive practices such as rigged bids and dominant illegal market positions, this law also established the Superintendence of Competition (SC), which seeks to abolish monopolistic practices and render the economy more efficient and competitive. In 2007, competition law was amended to set higher maximum fines for especially harmful conduct and enable stricter enforcement by the Superintendent’s office.

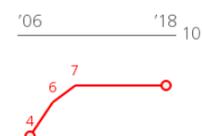
International observers including the OECD and WTO have praised El Salvador’s competition policy for being generally sound, and have commended the country for making considerable progress in recent years. The OECD in particular describes El Salvador as a model for other countries seeking to implement a competition policy, citing the comprehensive regulatory framework provided in the Competition Law as well as the broad political consensus on which it was built. A specific government



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Anti-monopoly
policy

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initiative has lowered the prices of medicines by setting benchmarks for certain pharmaceuticals that are widely consumed.

Notwithstanding the many advances, the chief economist of SC, Marlene Tobar, recently pointed to persisting weaknesses of El Salvador's anti-monopoly regime, some of which are considered structural. She highlights the "completely asymmetric general industry structure," with a high share of micro and small firms (representing 85% of total firms but generating only 8% of the country's wealth) and few large firms (representing 3% of total firms but generating around 77% of national wealth). According to Tobar, in 2014 the Salvadorian economy's Herfindahl-Hirschman Index (HHI) was around 3,567 points, indicating "oligopolistic markets with the presence of agents with considerable market power." This is also reflected in the lack of a competition culture in a country "where many of the most important participants had not gained their current status exclusively on the grounds of their own merits."

Finally, Tobar states that though the Superintendence's budget and staff have been strengthened lately, they remain insufficient when compared to the great workload that the institution faces. In 2016, the IMF recommended that El Salvador improve the effectiveness of the Competition Agency and more thoroughly curb anti-competitive practices in key sectors of the economy.

The Global Competitiveness Report 2016-17 of the World Economic Forum ranks El Salvador overall as 105th out of 138 countries, but 53rd in terms of "intensity of economic competition."

Foreign trade is mostly liberalized. The average tariff rate is 2.4%. El Salvador is a member of the Central American Free Trade Agreement (CAFTA) with the United States and also participated (as a member of the Central American region) in the negotiation of a trade agreement with the European Union during 2007 to 2010. Specific trade policy objectives of the Salvadoran government include the promotion of foreign investment in export-generating production areas in order to reduce the country's trade deficit, as well as export-market diversification intended to lower El Salvador's vulnerability to negative demand shocks.

El Salvador's export earnings declined slightly from \$5.5 billion in 2013 to \$5.3 billion in 2014, before rising to \$5.5 billion in 2015. Imports totaled \$10.8 billion in 2013, dropping to \$10.5 billion in 2014 and to \$10.4 billion in 2015. Exports from the maquila (offshore assembly for re-export) sector represented nearly 21.1% of export value in 2013.

International observers commend the openness of El Salvador's trade and investment regime, as well as the consistency with which both current and previous governments have followed their trade liberalization strategies. El Salvador is a member of the WTO.

Liberalization of
foreign trade

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The Salvadoran banking system has undergone important changes in the last few years. It was privatized in 1992 following over ten years of state ownership and operation in the 1980s. The Salvadoran owners of banks subsequently sold off the most important of them to foreign concerns after the dollar was introduced as legal tender in the country in 2001. Some economists argue that foreign ownership of the most important banks was necessary after dollarization to the extent that the country's central bank no longer established monetary policy, nor did it have the authority or the means to back up a private bank that faced liquidity problems. Thus, international banking corporations were better prepared to support their Salvadoran branches should the need arise.

The Salvadoran banking system is one of the most stable in the region. According to a January 2015 IMF report, banking indicators are sound due to prudent supervision and regulation. The five leading private banks (all foreign owned) account for approximately 95% of the Salvadoran banking sector. In a 2016 report, however, the IMF pointed to a “dichotomy” between this well-established banking sector and an under-developed capital market, despite government-directed equity investments. Despite developed institutions, the IMF maintains that “access to financial services by households is weak even as enterprises have ready access.”

Liquidity and capital ratios remain comparatively high in the country's banking system. Banking problems are related to an overall lack of economic dynamism rather than the structure of the banking system. The bank capital-to-assets ratio has steadily risen during the past decade, reaching a satisfactory rate of 13.9% in 2015. Non-performing loans decreased to 2.1% in November 2016, from 2.4 % a year before.

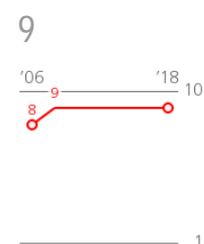
Oversight of the financial system is provided by the Superintendence of the Financial System. According to law, financial institutions are required to report suspicious transactions to the office of the Attorney General and the Superintendence of the Financial System, as well as publish their yearly financial statements.

8 | Currency and Price Stability

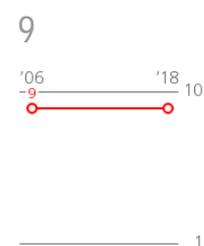
The passage of the Monetary Integration Law in November 2000 established the U.S. dollar as legal tender in El Salvador. Strictly speaking, Dollarization did not abolish the old Salvadoran “colon” but replaced it with a “bimonetary” monetary system. Some shops still price their products for sale in dollars and colones but for all practical purposes the economy is fully dollarized as no colones are in circulation.

According to the IMF, the dollarization of El Salvador's economy – although preventing authorities from using monetary or exchange rate policy to mitigate external shocks – has played a key role in preserving macroeconomic stability. The inflation that does exist generally reflects the purchasing power of the dollar; it has been the lowest in Latin America and the Caribbean during 2012 to 2015 (2012: 1.7; 2013: 0.8; 2014: 1.1; 2015: -0.7).

Banking system



Anti-inflation /
forex policy



Dollarization has helped to keep inflationary pressures in check but Salvadoran economic growth has been slow: in 2012 it grew by 1.7% and in 2013 by 1.9%, the lowest in the Central American region. However, growth reached 2.0% in 2014 and 2.5% in 2015 and is expected to have been around 2.2% in 2016.

However, these statistics must be adjusted after a report prepared by the IMF in June 2016 claimed that Salvadoran economic data has been inflated for at least the last ten years; according to the IMF, real GDP is currently about 14% lower than the official data suggests. The consequences of this revelation are serious: the relation of government debt to GDP will rise, bond credit ratings will fall, and the government will have to pay more for loans.

Spending pressures have resulted in a chronic fiscal deficit and rising public debt. El Salvador's tax revenue represented 15.2% of GDP in 2014 and 15.4% in 2016, but continues to lag behind regional peers in this regard. The overall fiscal deficit is a problem: over 4% of GDP since 2013 and about 4.6% in 2016. Public sector debt has continuously risen, reaching about 63.9% of GDP by the end of 2016. In sum, economic stagnation in El Salvador continues, although the economic institutional framework of the country has been strengthened.

The current debate over the government's fiscal solvency revolves around a reform of the tax base. In 2016, VAT represented 43.5% of government revenue, income taxes represented another 35.3%, while customs duties made up only 4%, a reflection of liberal trade policies. Other revenue stood at 5.2%. Since the early 1990s, property taxes have been non-existent and proposals to reinstate them have failed.

9 | Private Property

Property rights and the regulation of property acquisition are well defined and moderately well protected. El Salvador is a signatory of most relevant international treaties on the protection of property rights. There are restrictions on land ownership and the exploitation of underground resources. All mineral resources belong to the state and concessions for mining are compulsory. With respect to land ownership, a maximum of 245 hectares per individual is mandated by the constitution. State authorities are permitted to expropriate private property for reasons of public utility and social interest upon prompt payment of compensation at market value; there have been no recent cases of direct expropriation.

El Salvador was ranked 79 out of 128 countries according to the International Property Rights Index for 2014. El Salvador still has one of the highest piracy rates in Latin America. According to the Business Software Alliance's Global Software Survey for 2015, El Salvador's piracy rate has remained at about 80% of installed software since 2009, meaning that the use of illegal software is widespread in homes, education centers, non-governmental organizations and businesses. Piracy of music

Macrostability

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Property rights

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and movies is part of the extended informal economy in the country. This represents a challenge for a Salvadoran government facing considerable international pressure on the issue.

Private companies are the basis of the Salvadoran formal economy. The privatization of state enterprise began with the banking sector in 1989, while other public services such as electrical energy distribution, telecommunications and pension funds followed in the 1990s.

The FMLN governments of presidents Funes and Sánchez Cerén have guaranteed and strengthened private business in El Salvador. The FMLN government has promised not to reverse the privatization processes conducted by its ARENA-controlled predecessors (1989-2009). At present, the only important remaining state-owned economic enterprises are the national airport, the seaports, three hydroelectric dams, and the national waterworks (potable water and sewage).

In 2013, the Public-Private Partnerships Law was passed with the aim of strengthening public-private investments in the areas of infrastructure, health, education and public security. One of the prime projects under this law is the concession of the container port of La Unión, in the east of the country, but problems of access to the port by large container ships that requires significant dredging have delayed successful concession and operation of the facility.

10 | Welfare Regime

The FMLN governments since 2009 have underlined public spending in social programs as their main contribution to reducing social inequalities and expanding opportunities for individual improvement. Budgetary allocations devoted to health and education have both increased. Education expenditure increased from 2.8% of GDP in 2008 to 3.5% in 2015 but still falls well below the 6% target figure proposed by the current government for 2019. Public health expenditure increased from 3.7% of GDP in 2008 to 4.3% in 2013. The government considers access to free or inexpensive health and education a direct subsidy to family budgets.

According to Social Watch, educational and health social programs have definitely improved lives among the poorest sectors of the Salvadoran population. However, the current programs place strong demand on a state with limited financial resources which might render them ultimately unsustainable. Structural socioeconomic changes are needed in order to mitigate the effects of a lack of social services.

Migrants' remittances are an especially important contribution to the social safety net. Most remittances are employed to cover medical, educational, housing and living expenses. On the other hand, volatility of remittance flows means that they alone cannot effectively address structural social and economic problems in the long term.

Private enterprise
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Social safety nets
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The pension system has both a public and a private component. The national social security institute (created in the 1950s) provided medical services and retirement plans to formally employed workers until 1998, when a new law allowed private companies to administer retirement funds while the government's social security institute was essentially limited to providing medical services to insured workers and employees.

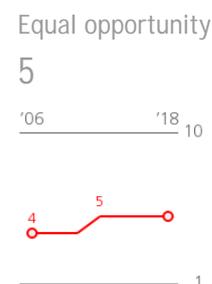
By 2014, approximately 630,000 individuals employed in the private sector were paying into the national social security (health care) institute, as well as 159,000 employed by the public sector. An additional 638,000 spouses and children under 12 years of age are also covered. 143,000 retirees are still covered by the social security institute. Thus, a grand total of 1.6 million individuals – about a quarter of the population – are covered by some form of safety net under the government's social security program.

In 2013, there were a total of nearly 2.5 million individuals who had enrolled in one of the three pension funds companies, but only 657,000 were actually paying into the system. In January 2016, the government proposed a reform of the pension system that included the creation of a national retirement fund administered by the government; it would be funded in part by transferring monies from the private retirement fund companies. A strong debate ensued and the proposal was shelved. Whatever the outcome, the social safety net is clearly weak and insufficient both in terms of coverage and sustainability.

Salvadoran governments have made significant efforts to expand social, political and economic opportunities for all Salvadorans. These efforts have included a presidential decree issued in 2010 against discrimination on the basis of gender and sexual orientation in the public services. In 2011, the legislature unanimously approved a set of regulations that improves the judicial framework for the protection of women's rights. This was strongly supported by Salvadoran women's organizations, as well as U.N. Women's Fund for Gender Equality.

To date, however, the impact of these measures in terms of ensuring equal opportunity to all members of society has been relatively small overall. According to the 2015 Human Development Report of the UNDP, only 48% of the country's women participate in the labor force (versus 81% of the men) and their earnings represent only 85% of men's. Reports of discriminatory practices towards homosexuals, persons with disabilities, women and indigenous people are still widespread.

El Salvador was ranked 62 out of 145 countries worldwide in the 2015 Global Gender Gap Report published by the World Economic Forum, which is a significant improvement over its position of 84 out of 142 countries in 2014. It performs somewhat worse (111 out of 145) in women's labor force participation and wage



equality (118 out of 145). However, political empowerment is much more positive, with an overall country ranking of 30 for women in parliament.

Perhaps the best efforts to overcome gender inequality are in the field of education. For example, literacy among young people (ages 15-24) is practically universal: 97% in 2013 with little difference between women and men (compared to 87% for the total population above 15 years old). Literacy has risen primarily as a result of continuing efforts to increase school attendance. In 2013, net enrollment in primary level schools was 95%, with 70% at the secondary level. There were no significant differences between girls and boys, although school attendance is higher in urban areas than in rural ones.

11 | Economic Performance

Economic activity recovered modestly in 2010 from the global economic downturn and grew slowly during 2012 (1.9%) and 2013 (1.7%). Growth rates dropped to 1.4% in 2014, but recovered noticeably in 2015 to 2.5% and are forecast to be similar for 2016. However, all of these figures must be considered tentative until the central bank of El Salvador sets down proper guidelines for estimating correct GDP, after the IMF published a report on inaccurate estimates in mid-2016.

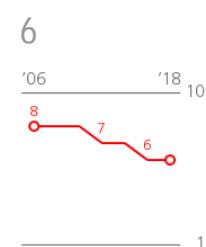
Available figures put GDP for the years since 2010 at: \$21.4 billion for 2010; \$23.1 billion for 2011; \$23.8 billion for 2012; \$24.4 billion for 2013; \$25.1 billion for 2014; and \$25.9 billion for 2015. If the IMF estimates of data inflation are correct, these numbers will need to be revised down by some 10-15%. This situation is particularly worrisome given the relatively high levels of public debt that the government has accumulated over the last years. In the years up to 2008, the relation between public debt and GDP remained below 40% but thereafter has climbed steadily and in 2016 reached 63.9%. Moody's lowered the country rating to B3 in mid-2016.

The economy's slow recovery after 2010 was driven by improved export demand and remittance figures. Remittances amounted to \$3.54 billion in 2010 and have risen steadily every year to reach \$4.27 billion in 2015. Preliminary data for 2016 puts remittances at \$4.58 billion. It is estimated that remittances are received by about a third of all households in the country and are crucial to covering the chronic current account and trade deficit.

Unemployment has hovered between 6% and 7% since 2004, but these numbers are not very meaningful given the huge informal sector. Foreign direct investment has risen slowly during most years after 2010, when it stood at \$7.2 billion. It reached \$8.5 billion in the first quarter of 2015.

The World Bank and the IMF estimate that tax revenue increased from 13.5% of GDP in 2010 to 15.2% in 2015. Due to comparatively low levels of domestic demand,

Output strength



inflation rates have been low and stable despite rather high international commodity prices and supply-side disruptions. The price inflation rate has been around 2% since 2014.

Overall, the Salvadoran economy has undergone a shift in focus from production to services. In 2015, the service sector represented 62% of GDP, while manufacturing represented 21% and agriculture 11%. In general, high levels of imports are essential to keep the service sector in operation, which would be impossible without a continuing high flow of remittances.

12 | Sustainability

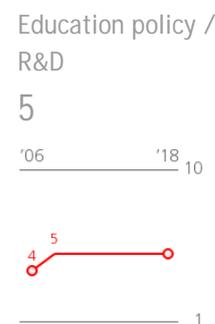
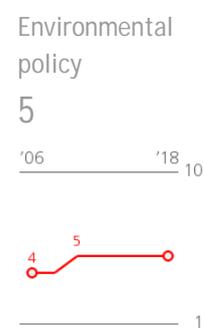
Environmental concerns were largely subordinated to growth efforts in the 1990s and 2000s. With the continent's highest population density and a history of intensive agriculture, both for internal consumption and export, it is estimated that 80% of El Salvador's territory has been deforested. Soil erosion has been a very serious problem too, and the country is also highly vulnerable to powerful earthquakes, floods, and landslides.

A Ministry of the Environment and Natural Resources (MARN) has existed since the 1990s but its size and budget is hardly commensurate with the environmental problems the country faces; its budget for 2016 was around \$25 million (of a total government budget of over \$4.4 billion). Nor have effective environmental policies been devised or put into operation. A law to regulate water use has been held up in the legislature since presented in 2012, even in the face of continuing emergency situations of water extraction and distribution and increasing levels of pollution of surface waters. No measures have been taken to improve air quality in the main cities.

Energy production has become increasingly reliant on non-renewables (46% fossil fuels in 2015), as compared to 28.5% hydro, 12.3% geothermal, and 13.6 biomass. Wind and solar power have been severely underexploited so far even though fiscal incentives exist for private investment in renewable energy production.

Education has been a high priority of all governments since the middle of the last century. Public spending on education reached a high of 4.0% of GDP in 2009, but since then has settled at around 3.5%. The current government has previously spoken of spending 6% of GDP on education by the end of its term in office in 2019 but this objective seems unattainable at the moment.

Primary school attendance is practically universal but access to secondary and higher education is restricted. According to UNESCO, the gross enrollment ratio for secondary education was 72.0% in 2015. Higher education enrollment rates are significantly lower: 28.9% in 2014.



The constant expansion of primary school coverage has translated into a significant increase in literacy rates. Literacy among youth (15-24 years) in 2015 was 97.7% but somewhat lower for adults (25-64 years) at 87.5%. For those above 65 years it was 63.4%.

Public schools cover about 90% of enrollment at the primary level and 80% of the secondary level. Higher education is divided between private institutions (approximately two-thirds) and public institutions (approximately one-third).

Given the low levels of spending on education in general, support for research and development (R&D) in El Salvador is very low. There is a national council for science and technology concerned mainly with supporting educational initiatives. Private universities spend very little or nothing on research. The national university still maintains faculties in the sciences (physics, biology, medicine, chemistry) but assigns few resources for research because its main concern, as with all other universities, is teaching. According to UNESCO, El Salvador spent only 0.08% of its GDP on research and development in 2014.

Governance

I. Level of Difficulty

Ever since the 1950s, Salvadoran governments have been concerned about development. Leaving aside concerns that require immediate responses, the country's leadership has had to confront structural and external problems that constrain its capacity to govern effectively, namely: population growth, the natural resource base, external economic shocks, and natural catastrophes.

Population growth was extremely high from 1950 to 1970, peaking at yearly rates of 3.5% in the 1960s. Since the end of the war, population growth has slowed considerably as a result of declining fertility and massive emigration. At present, yearly growth is less than 1% and continues to slow.

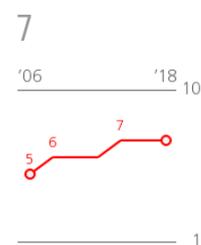
The country resource base is limited to soils, water (rainfall), and sunlight. There are no significant mineral or energy deposits. Thus, agriculture was the main economic activity up until the 1970s in terms of exports, employment, and food production. The war years produced widespread population displacements and contributed to processes of rapid urbanization.

The country is today much more integrated into the globalized economy than ever before. Its traditional agricultural exports have declined dramatically while its open foreign trade policies have allowed imported food products in volumes and prices that compete strongly with local producers. To that must be added massive emigration, a large part of it originating in rural areas. The country is today about two-thirds urban and one-third rural, a relationship which was the polar opposite half a century ago.

Finally, natural catastrophes have had a significant impact on the country's efforts to develop. The country receives abundant rainfall that can lead to flooding and landslides. More serious are periodic earthquakes that can affect large sections of the country. Powerful earthquakes hit the country in 1986 and 2001 with the loss of thousands of lives and extensive destruction of infrastructure.

In addition to long-term structural constraints, a number of existing conditions must also be addressed. A country that seeks to engage more intensely with the world needs to improve the quality of its human resource base above all else. Poverty levels are

Structural
constraints



high: about a third of all households live in poverty. These proportions vary across the country; poverty is higher in rural areas (about 38%) but less so in urban ones (29%). Malnutrition goes hand in hand with poverty: according to the World Food Programme (2015), 17% of children under the age of five suffer from chronic malnutrition and in some rural areas the percentage can be as high as 40%. Anemia from lack of iron affects 51% of rural children.

Average schooling levels are only 6.7 years nationally, but drop to 4.9 in rural areas. However, when schooling data is broken down by age the results reflect positively on recent and ongoing efforts: 9.7 years of schooling among those aged 18-29. Still, the challenges faced by youth are considerable: a recent household survey (2014) indicates that a little over a quarter of all individuals between 15-24 years of age neither work nor study.

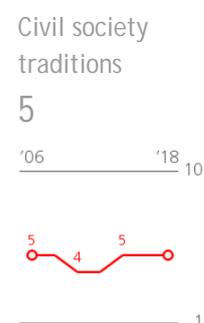
Economic growth has been sluggish since 2010 which has led to: a) unabated emigration, especially toward the United States; and b) the growth of the informal sector. The informal sector currently comprises about one-half of all employment.

There are also additional problems of drug-trafficking, high rates of crime and violence.

Civil society traditions in El Salvador are not strong. For many years the country lived under military governments which rarely tolerated dissenting viewpoints. For a few years after the peace accords of 1992, civil society was a relevant political actor but subsequently lost prominence before starting to grow again after 2000. By the end of 2016, nearly 3,000 civil society organizations with diverse societal or political agendas were registered in El Salvador according to the International Center for Not-for-Profit Law.

Nevertheless, conditions for greater civic participation are not encouraging. According to the 2013 Latinobarómetro survey, only 17.2% of those interviewed in El Salvador believed they could trust other people. High levels of violence have created an environment of distrust among many in the country. (83% of those interviewed believed the country was becoming less safe.) Only 12.7% said it was important to participate in civil society organizations in order to be a good citizen, although 57% thought that voting was necessary.

It should be mentioned that most civil society organizations emerged from the left of the political spectrum in response to many years of political exclusion by governments on the right. Once leftist political parties were allowed to function and compete openly after the peace accords in 1992, many of those involved in civil society organizations found other channels to express their political and social concerns.

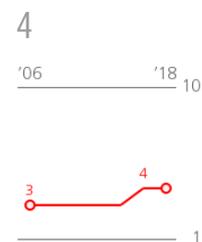


The intensity of open conflict among political actors is moderate to low as all understand that they will have to reach agreements on key issues such as budgets, taxes and social rights. Citizen mobilization occurs mostly during election campaigns; in the interim, various groups demonstrate and march for different causes but with limited participation as the issues are quite specific such as: opposition to dams and mining, provision of public services, payment of veterans' bonuses, and various political initiatives.

Religious cleavages are not an issue in El Salvador. Proselytizing is quite strong but respectful. The growth of Protestant churches is clear evidence that religious freedom and tolerance is the norm. Salvadoran society remains deeply divided by conditions of economic and social inequality, which are the main underlying drivers of crime and violence.

The most frequent expressions of violence in recent years have involved youth gangs and police forces. Some analysts have even suggested that gangs are a political force insofar as they exert control over certain territories and populations and have even engaged in informal or indirect conversations with representatives of political parties to discuss electoral support in exchange for certain concessions.

Conflict intensity



II. Governance Performance

14 | Steering Capability

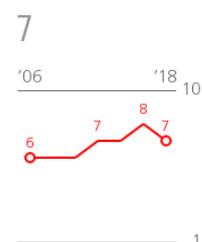
El Salvador experienced an important change of government when the left-leaning FMLN assumed the presidency of the Republic in 2009. However, there has been much more continuity than change as all involved in government have agreed that the protection of constitutional democracy and a socially responsible market economy are the state's most important strategic long-term aims, together with measures that will reduce the extremely high levels of social and criminal violence.

In 2014, the government began a national consultation process via the newly-created National Security Council to devise a policy to improve security and combat crime. The five-year plan the Council proposed has received support from the international community and civil society organizations but projected costs are high, especially with regards to prevention and rehabilitation.

An alternative approach that was tried with some success in 2012 to 2013 was dialogue with and among gangs to reduce the levels of violence. However, the political costs of this type of engagement proved too high and the government's

Question
Score

Prioritization



response - largely supported by public opinion - has been to continue to repress and persecute irrespective of the cost in lives and resources.

The international community is very much aware and concerned about the levels of violence and crime and has provided support. However, efforts to develop alternative responses have been mostly on a small-scale, trial basis. The position of the United States, the country's most important trade and political partner, will be key in determining a viable outcome. The United States is the main international actor involved in large-scale projects aimed at stimulating public-private partnerships and strengthening social policy in El Salvador, especially in the area of security.

Most other long-term government social policies and programs have widespread support but are hampered by limited financial resources. Fiscal reform to provide more income has involved rather modest tax increases on digital communications and gasoline sales, but the main fiscal unbalance remains unresolved, all of which forces the government to seek legislative authorization to issue treasury bonds. It is these authorizations which produce some of the more acrimonious political debate because they require a two-thirds majority of votes in the legislature, which the governing party does not have.

The current government's main areas of concern are social policy and security, which are in line with its electoral promises. Accomplishments during the period under review include an expansion of educational and health services and a number of infrastructure projects inherited from previous governments.

In addition to limited financial resources, the government faces difficulties in implementing its own policies due to shortcomings in the organization of government offices and a lack of qualified personnel. Insufficient oversight has led to levels of corruption, improvisation, and incompetence that tarnish the image of the government. The 2015 Latinobarómetro survey found that around 80% of Salvadorans have little or no trust in the executive branch of government, in the legislature, judiciary and police force.

On the other hand, the government has received support from international partners, including representatives of the IMF and the World Bank, who have commended El Salvador's government for making good use of international and domestic support in order to achieve its policy goals.

If anything, the last two Salvadoran governments have learned that representative democracy requires considerable compromise, transparency and accountability. The current government requires its cabinet-level officials to broadcast their yearly reports over digital media. The government has also set up an office to handle access to public documents; there are currently 183 government institutions whose documents can be consulted, including full budgetary records of the ministry of finance, arguably the most important government agency.

Implementation

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Policy learning

6



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One of the government's concerns is the investigation and punishment of corruption, especially after one former president was imprisoned for embezzling tens of millions of dollars during his term in office and another sought asylum in a neighboring country to evade arrest and prosecution for similar – albeit less serious – offenses. The former attorney general was also arrested and jailed for miscarriages of justice.

A lesson which has yet to be learned is that the government's auditing office is useless and part of the system of institutionalized corruption when it concludes satisfactory audits of departing government officials. It is further suspect in that it has not allowed its own operations to be audited.

Other lessons that need to be learned involve the police, which have a very inconsistent record of investigating crime. Less than five percent of all homicides, for example, are successfully investigated and result in a sentence. Overall however, it would seem that the government is aware of the need for transparency that, in turn, will put pressure on government officials to be more efficient and responsive.

The government's initiatives to promote efficiency and transparency have been aided by the use of digital information technologies. The national office for registering property and businesses has become completely digital and relatively immune from corruption as in the past. Tax collection procedures have also become fully compatible with digital technology. However, corrupt practices are far from eradicated. Just recently it became publicly known that government ministers were receiving substantial bonuses in cash that were not declared for tax purposes. A number of legislators have also been involved in corrupt practices.

15 | Resource Efficiency

It is difficult to assess the efficiency of government operations aside from cases of corruption and wasteful investments in some public works. Those government entities charged with oversight of public expenditures (legislature, government accounting office) are generally inoperative and there are none that assess the quality of government services.

The government's total budget has increased every year since 2010. The 2016 budget totaled a little over \$4.9 billion, of which 61% was assigned to current expenses (salaries, goods and services, overhead), 15% to investments in infrastructure, while 18.4% was set aside for debt payment. Salaries totaled \$1.7 billion, which represent 35.8% of total government outlay and reflect the government's commitment to provide greater social services that rely heavily on human resources. (Education and health account for a little over a third of total government outlays.)

Stability of government employees is largely assured under law. The government hires more people every year and some offices and departments are clearly bloated

Efficient use of assets

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while others are understaffed. Although difficult to demonstrate, party affiliation appears to influence hiring for government posts. There are also issues with the distribution of budgetary resources. For example, the ministry of the environment was assigned only 0.5% of the budget in 2016, while defense was allocated 3%.

Government income still relies heavily on indirect taxation. The VAT is currently 13% and contributed 43.5% of total government income in 2016. Income taxes represented another 35.5%. The budget is consistently unbalanced and the difference covered by borrowing, the only recourse in a dollarized economy where monetary policy is not under government control. Constant borrowing means that public debt as a proportion of GDP has risen steadily: in 2015 it was 61.9% and El Salvador's credit ratings have been downgraded accordingly.

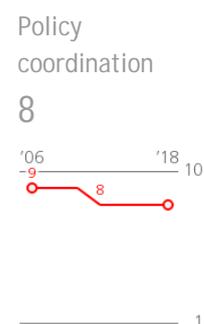
The dollarization of the economy, a solid banking system, and comparatively low taxes and tariffs contribute to a generally favorable business climate but economic growth has remained low. High levels of crime and violence and a workforce with limited education levels are additional problems that have yet to be addressed.

The government generally coordinates conflicting objectives effectively and acts in a coherent manner, although significant tensions between key political actors have occasionally emerged, along with pressures and demands from civil society. The executive branch of government is currently under the direction of a leftist, nominally socialist political party (the FMLN). However, the legislative branch is clearly under the control of parties on the right with demands of their own.

The differences between the executive and legislative branches are most visible when the national budget must be approved. It is to the credit of all involved that budgetary differences are eventually resolved. However, legislative disagreements over authorizing increases of public debt to cover shortfalls in the 2016 budget have required the involvement of the IMF to provide advice on ways to move forward.

Within the executive branch, the principle means of coordination is the council of ministers, which meets under the president's direction and decides on policy matters. Policy is strongly influenced by the availability of resources and budgetary allocations; a majority of negotiations involve the distribution of fiscal resources, with the finance minister playing a very important role. Specific areas of policy might be handled by a smaller group of ministers.

In general, the government's organization is highly centralized under the president and coordination is sometimes accomplished through personal contacts. Some government offices, such as the ports and hydroelectric authorities, operate autonomously.



Corruption has become a headline topic in recent years, especially because three former presidents have been implicated in cases of corruption. Since both major political parties are involved, it has not been easy to get to resolve these cases even though everyone agrees on the need to curb corruption.

There are institutional problems too. The national auditing office is ineffective and highly politicized in its composition. Until recently, the attorney general's office covered up corrupt practices instead of prosecuting them. Various legislators have faced public criticism of their expenses. Municipal authorities from all political parties have also been criticized for authorizing contracts to private companies without going through the requisite steps.

There are no studies on the magnitude of the costs of corruption although the latest cases of corruption in the presidential offices run into the hundreds of millions of dollars. While there is no easy solution to this problem, a first step undoubtedly is the creation of a well-funded and well-staffed national accounting and auditing office, but this is still not a priority. Instead, the new attorney general's office is going after notorious individual cases, which is good but insufficient.

16 | Consensus-Building

There is basic agreement among all major political actors that safeguarding democracy is a long-term strategic aim. The presidential elections in 2014 demonstrated the stability of the Salvadoran electoral system in the face of the very close win of the current president. The 2015 legislative elections were held normally, even though the final results were announced after considerable delay, fueling rumors of foul play in the counting.

All political parties are run by their leadership groups with little dissent among their supporters. This facilitates agreement among political elites but does not promote democratic practices and procedures within the parties themselves. More importantly, it indicates that while safeguarding democracy is a long-term goal, deepening democracy is seemingly not on the agenda.

The two presidents of the leftist FMLN have been consistent in promoting a free-market system, with the aim of stimulating the vulnerable Salvadoran economy. They have maintained previous governments' privatization and liberalization policies, while increasing social spending in an attempt to reduce poverty and socioeconomic inequalities. Their governments have also strengthened policies recommended by the Inter-American Development Bank (IDB), the IMF and the World Bank. The country's participation in programs financed by the United States seeks to strengthen the relationship between the government and the private sector.

Anti-corruption policy

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Consensus on goals

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A case can be made that there has been a gradual meeting of political minds in the center of the political spectrum. The left has accepted the importance of a healthy business sector and has decided to address its electoral constituency by improving the government's role in social development via taxation. The right, in turn, has accepted an important role for government in creating a healthy environment for business, and is willing to agree with the left on the need to strengthen government finances in exchange for more efficient and accountable government spending.

Nonetheless, there are also important factions of the left and the right which diverge more strongly on the appropriate path to a consolidated liberal market economic system that is socially balanced.

Though at present highly unlikely, it is still possible that possible future governments of the FMLN might take a more hard-line approach to private enterprise.

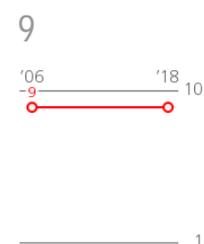
There are no significant anti-democratic actors in El Salvador as in the past (such as the military or powerful opposition groups). Organized crime remains a latent threat, though its current strategy is to bypass the democratic state rather than confronting it directly. The main concern of those who fear a weakening of democratic values and practices is the existence, on the one hand, of groups inside and outside the police engaged in extrajudicial executions and, on the other, of gangs controlling and terrorizing entire neighborhoods. These two factors have convinced some organizations in the social sector that undemocratic systems of government are better because they are the only way to address violence and criminality.

The most evident cleavage in Salvadoran society is class as determined by income distribution: in 2012, the wealthiest 20% of the population received 42% of national income, while the poorest 20% received 8.3%. Inequality in the medium term appears to be gradually declining: the Gini index has declined from 0.51 in 2000 to 0.41 in 2012. There are no visible or formal barriers (ethnic, religious) that keep people from moving along the social scale.

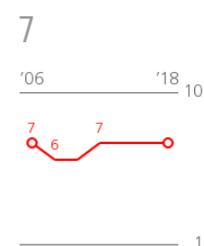
The political system has opened up avenues for social advancement and change in a country which is now mostly urban and, therefore, more heterogeneous. The 2015 Latinobarómetro survey found that 88% of Salvadoran respondents did not feel that they belonged to a group that was actively discriminated against in society, but 72% felt that income was unjustly or very unjustly distributed. Slightly fewer thought that the country was being run for the benefit of only a few powerful groups. The high level of violence is at least indirectly related to inequality, and no government has yet been able to contain.

In the face of these realities and perceptions, the country's political leadership must be careful to not promise too much nor engage in aggressive language, especially given the very recent experience of a terrible civil war. All sides of the political

Anti-democratic actors



Cleavage / conflict management



spectrum and its leadership are committed to democratic (i.e. negotiated) resolution to all important social issues.

Up to now, calls for understanding and unity have proved stronger than divisive discourses and the party system has become less polarized as political leaderships have moderated their language and their electoral promises.

Since 2010 at least, governments have been making significant efforts to draw civil society organizations into the political process – albeit with some ambiguity. In one sense, the objective is to create a sense of empowerment and shared responsibility for outcomes. In another, it simply aims at gaining support for policy measures that face obstacles in the legislature.

The most important examples of this participation of civil society include the creation of a national council for security that includes civil society groups and international community observers, including the UNDP. This council has discussed a five-year national plan to overcome the current wave of violence and provide educational and economic opportunities for young people.

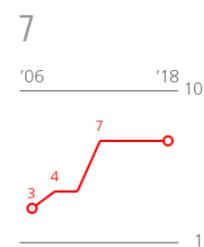
Another initiative established a national council charged with reaching agreements that seek to improve teaching methods and educational coverage. This council brings together individuals from educational institutions, think tanks, teacher unions and NGOs, as well as political parties, churches, and business interests. It presented its first policy proposal in June 2016.

Salvadoran civil society groups also play an active role in migratory issues through a large number of migrant associations, most of which are based in the United States with counterparts in El Salvador. In addition to funding local development projects, these associations lobby for greater political rights for expatriates. In January 2013, after years of discussion, the legislature passed a law that allows for out-of-country voting. However, this has only led to minor participation in subsequent presidential elections.

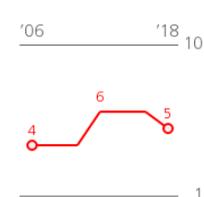
El Salvador's political leadership made significant progress in bringing about processes of reconciliation during the Funes administration. In a speech in October 2010 he became the first president to publicly apologize for violent crimes perpetrated against indigenous people; he also asked for forgiveness on behalf of the Salvadoran state from the families of the hundreds of victims killed by Salvadoran security forces in El Mozote in 1981 at the beginning of the civil war.

Since then other massacres committed during the civil war have come to light but little progress has been made in investigating and bringing to justice those responsible for human rights violations. An important obstacle in this respect was the 1993 general amnesty law, but in 2016 the Supreme Court decided that the law was unconstitutional because it denied the aggrieved the right to seek justice and

Civil society participation



Reconciliation



reparation. This decision was criticized by parties on both the right and left because they felt that their members and associates might be prosecuted legally.

In general, the political leadership is loath to talk about the past even though it is abundantly clear that many people in the country are still very traumatized by the suffering they experienced during the civil war.

17 | International Cooperation

The Salvadoran government is committed to making efficient use of international assistance either in the form of loans, grants or technical assistance. It is party to international agreements that commit it to ensure the highest levels of efficiency and positive results in foreign aid programs.

Its stated development priorities are education, health and security, for which it seeks assistance from both international aid agencies and individual foreign governments. For example, the Salvadoran government signed an agreement with the European Union in November 2014 worth \$200 million for youth violence prevention and reactivation of the productive sector. The USAID current aid priorities (\$332 million in aid for fiscal year 2015) are in education, infrastructure and economic growth.

The World Bank and a host of other development agencies (e.g., USAID, EU, JICA, IDB) will assist El Salvador over the period 2016 to 2020 in two main areas: inclusive economic growth (safer communities, youth education and vocational training) and support for sustainability and resilience (greater efficiency in public spending and capacity-building to handle disasters and environmental challenges).

Recent calls from foreign donors have underlined the need to root out corruption and improve administrative efficiency in order to secure continued support from foreign aid donors. The Salvadoran government is keenly attuned to these concerns given the enormous importance of monies received from abroad that keep the country's economy afloat and underpin its political and social stability.

El Salvador's participation in economic and trade agreements such as CAFTA-DR and the Association Agreement with the EU have established the country as a credible and reliable partner within the international community. In addition, ties with the United States remain strong, especially after the successful implementation of the Fomilenio I and II aid programs.

Two aspects of Salvadoran reality are prominently featured in the news and affect its capacity to interact with international actors. One is the level of violence which makes it difficult to attract foreign investment and tourism, and leaves a mark on the country's record of respect for human rights. The second is migration and the defense of its citizens abroad, either in their new country of residence or during the trip to their destination. Salvadoran governments have sought international assistance

Effective use of support

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Credibility

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precisely to improve security and employment opportunities so that emigration becomes a less attractive option than staying in the country. The problem, of course, is that much improvement still needs to be made on both fronts.

El Salvador is a signatory to the majority of important international treaties on human rights, the Millennium Development Goals, climate change and trade (it is a signatory to the WTO). A total of 53 international aid agencies are registered in the country, including big players such as USAID, the EU, the Japanese aid agency (JICA), the principal United Nations agencies (World Bank, FAO, UNDP, UNICEF, WHO, UNESCO), the IDB, and the Organization of American States (OAS).

El Salvador has long been a proponent of closer regional ties. The Salvadoran government promotes and maintains stable economic and political relations with neighboring countries within the framework of several trade agreements such as CAFTA-DR, as well as participating in international organizations such as the Central American Parliament (PARLACEN), the Central American Integration System (SICA).

El Salvador's relations with its immediate neighbors – Honduras and Guatemala - are good. There are some minor territorial disputes with Honduras while relations with Guatemala are particularly close given the intense commercial exchange between the two. Following promises made during President Funes' electoral campaign, the government restored full diplomatic ties with Cuba.

El Salvador and Mexico maintain close diplomatic ties that reflect growing levels of commercial exchange and the presence of large numbers of Salvadoran migrants that pass through Mexican territory on their way north to the United States.

Regional
cooperation

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Strategic Outlook

A number of inevitable long-term trends will define the country's future. One is population growth, which has been slowing over the last 30 years as a result of declining fecundity. Women today have fewer than three children on average and projections envision a stabilized population around mid-century with a smaller proportion of children but more senior citizens. The country can begin to prepare for this already by reallocating resources in education and health.

A second is emigration, which for the last 30 years has been the solution that many individuals – potentially in excess of two million – have resorted to in the absence of employment and education opportunities in El Salvador. For those who remain, remittances have been a godsend and have propped up the entire economy. Most emigrants head for the United States after a difficult journey and those who are turned back often try again. However, the recent upsurge in anti-immigrant sentiment in the United States that will be translated into stronger border protection measures means that emigration will become more difficult and less frequent. Reduced emigration will have a negative impact on remittance flows as second and third generations Salvadoran living abroad tend to send less money back to their ancestral country.

A third trend is resource depletion or scarcity. As the country becomes less reliant on agriculture for food production, it is possible that soils will stabilize and erosion will slow down as forest cover increases, but urban populations will inevitably demand more water, a resource which is already in short supply. The country needs to invest urgently in both sustainable water extraction and sewage treatment plants.

The above three trends must be addressed with economic resources and technical expertise, both of which are lacking at present. The country's educational system is still largely oriented toward the humanities and business careers, and economic growth has been weak over the last decade. More resources need to be invested in improving education and stimulating the economy, but it remains unclear where the funds could be drawn from.

Valuable resources are currently being spent on security and violence prevention. Nobody would object to this but these efforts have failed to deliver visible results in terms of declining levels of social and criminal violence. In addition, it is unquestionable that these resources could be employed in job-creation, education, and protection of the environment, all of which offer better long-term guarantees for a small country that has few natural resources and limited space for its population. Resources are also available from international aid agencies and banks, but the country is fast approaching its debt limit.

The challenge, in the end, falls to the country's leaders, both political and entrepreneurial. For 25 years politics has allowed for understanding around key issues, albeit interrupted by the usual political confrontations of a functioning democracy. But politicians tend to be short-sighted, looking ahead to the next election cycle. Entrepreneurs, too, in environments perceived as hostile are prone to seek short-term returns on their investments. Without a change in perspective among both, El Salvador will face a difficult future.