International Monetary Fund

El Salvador and the IMF

Press Release:
IMF Executive Board Approves US$790 Million Stand-By Arrangement for El Salvador
March 19, 2010

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

El Salvador: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

March 1, 2010

The following item is a Letter of Intent of the government of El Salvador, which describes the policies that El Salvador intends to implement in the context of its request for financial support from the IMF. The document, which is the property of El Salvador, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

THE AUTHORITIES' LETTER OF INTENT

San Salvador, March 1, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C., 20431

Dear Mr. Strauss-Kahn:

1. El Salvador's economy performed strongly in the years prior to the world financial and economic crisis of 2008–09. Sound macroeconomic policies and structural reforms delivered buoyant economic growth, a declining public debt-to-GDP ratio, and low and stable inflation. The global slowdown caused by the world financial crisis, however, has severely affected El Salvador's economy. International trade flows and remittances have declined, and foreign financing has become scarce. In addition, in November 2009, the country was hit by Hurricane Ida. These developments took a heavy toll on domestic economic activity and tax collections during 2009. The Government of El Salvador, with the support of the International Monetary Fund (IMF) and other multilaterals, has tried to shield the domestic economy—especially the most vulnerable sectors—from the impact of the crisis and the hurricane, while, at the same time, adhering to macroeconomic policies that safeguard fiscal and financial sustainability in El Salvador's dollarized economy.

2. The recent period of macroeconomic stability, structural reforms and relatively high growth carried many benefits, but did not result in the desired improvement in income distribution and poverty reduction. From 2006 to 2008 the number of households living below the poverty line increased by almost 10 percentage points, reaching a level of 40 percent by end-2008 and reversing progress achieved up to 2006. The Government of El Salvador reiterates its firm commitment to improving social conditions through the expansion of poverty-reducing programs and improved targeting of critical government expenditure, within a policy framework that safeguards macroeconomic stability.

3. The attached Memorandum of Economic and Financial Policies (MEFP) presents the plans and policies of the Government of El Salvador for 2010–12. In support of our economic program, we request the cancellation of the Stand-By Arrangement (SBA) with the IMF approved on January 16, 2009—which achieved its broad objective of helping to maintain macroeconomic and financial sector stability in the run-up to the presidential election and the follow-up transitional period—and the approval of a new SBA totaling SDR 513.9 million (300 percent of quota), covering the period through March 16, 2013. In line with the previous SBA, our intention is to treat the new arrangement as precautionary. We believe that the new SBA will provide critical support for our commitment to continued sound macroeconomic policies, help anchor the confidence of depositors, investors, and

creditors (including multilaterals), and provide potential access to liquidity support for the financial system, if the need were to arise.

4. We believe that the policies described in the attached MEFP are sufficient to meet the objectives of our program and we stand ready to take additional measures that may be needed for this purpose. We will consult with the Fund in advance of any revisions to the policies described in the MEFP, as well as the adoption of additional measures, in accordance with IMF policies on such consultations. Consultations with Fund staff would also occur in the event of a significant decline in the sum of private sector deposits and short-term external liabilities of the banking system, or if the need were to arise to change reserve requirements or liquid asset requirements for the banking system. We will continue our close dialogue with IMF staff on our economic policies after the expiration of the arrangement, for as long as there are any outstanding purchases in the upper credit tranches. During the program, we will continue to comply with all obligations of Article VIII of the IMF's Articles of Agreement.

5. Program implementation will be monitored through semi-annual reviews, with the first review to be completed on or after September 15, 2010. The performance criteria and structural benchmarks under the program are set out in Tables 2 and 3 of the attached MEFP.

6. We authorize the IMF to publish this Letter of Intent and its attachments, and the related staff report.

Sincerely yours,

/s/

Carlos Cáceres
Minister of Finance

/s/

Carlos Acevedo
President, Central Reserve Bank of El Salvador

Attachments

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES OF THE GOVERNMENT OF EL SALVADOR

I. BACKGROUND AND PROGRAM OBJECTIVES

1. The global financial crisis severely affected the performance of the Salvadoran economy in 2009 through a sharp fall in proceeds from exports and remittances, and lower private capital inflows. As a result, real GDP is estimated to have fallen by 3.3 percent during the year, annual inflation declined to around zero, and the external current account deficit is estimated to have narrowed to 1.6 percent of GDP (from over 7½ percent in 2008). Measures taken in recent years to strengthen our banking system, together with the credibility-enhancing effects of the IMF's Stand-By Arrangement (SBA) approved in January of last year, helped maintain stability and left our banks liquid and well capitalized. However, our domestic financial system was affected; bank deposits and credit growth stalled, and interest rates remained high.

2. The larger-than-expected fall in economic activity resulted in a sharp decline in government revenue and a higher public sector deficit than was projected under the January 2009 program. Total revenues and grants fell by 9.8 percent compared with 2008, a shortfall of more than US$650 million with respect to the revenue forecast under the program, despite measures taken to minimize the revenue loss. Austerity and expenditure restraining measures taken by the Government were effective in keeping total government spending more than US$150 million below that envisaged in the program. Nonetheless, the effects of the slowdown on revenue and nominal GDP resulted in an increase in the nonfinancial public sector (NFPS) deficit to 5.4 percent of GDP, higher than the deficit target under the program of 2.8 percent of GDP.

3. Our economic priorities going forward will be to preserve financial stability, foster economic recovery, bring down poverty, and gradually reduce the public sector deficit and debt to ensure fiscal sustainability. To this effect, our economic program aims at: (i) bolstering confidence in the government's commitment to macroeconomic stability; (ii) strengthening the fiscal position and placing public sector debt on a firm downward path; (iii) increasing the scope and efficiency of social programs; and (iv) maintaining the liquidity buffers of the financial system.

4. Our program will be anchored on strict adherence to official dollarization and a prudent fiscal policy. For 2010, we envisage a reduction of almost 1 percent of GDP in the NFPS deficit from its level in 2009. This decline will help signal that fiscal consolidation is underway and, at the same time, allow fiscal support for the incipient economic recovery. Furthermore, we are putting in place measures that will help strengthen the fiscal position as

the economy approaches its potential, shifting spending toward social programs and other high-priority sectors, and enhancing the financial system's resilience.

5. A significant measure to reduce the NFPS deficit was taken last year when congress approved (in December) a set of revenue measures expected to yield at least 0.5 percent of GDP on an annual basis. The measures include: (i) an increase in excise taxes on alcoholic and non-alcoholic beverages and tobacco; (ii) a widening of the tax base on beverages to include non-carbonated products; (iii) the introduction of a tax on the registration of new vehicles; (iv) taxation of interest income of banks licensed abroad (putting this income source on an equal footing with banks licensed domestically); and (v) the introduction of a tax on the interest income of individuals. Approval by congress of this legislation is a prior action for the program.

6. We are committed to improving our debt management practices. As a first step in this regard, in November 2009 we placed successfully a 10-year Eurobond for US$800 million. The proceeds are being used mainly to redeem short-term domestic debt as it falls due and improve the maturity structure of our public debt.

II. Economic and Financial Policies for 2010–2012

A. Fiscal Policy

7. Fiscal policy is aimed at reducing the NFPS deficit to no more than US$1,047 million (4.7 percent of GDP) in 2010, while protecting spending on social programs and investment in key sectors, as well as accommodating reconstruction costs related to Hurricane Ida (of about 0.4 percent of GDP). The proposed deficit targets from 2010–12 (including Ida-related spending), against the backdrop of a slow recovery of economic activity, will take the overall public debt-to-GDP ratio (after netting out government deposits at the central bank and commercial banks) to just under 50 percent by end-2011 (and the non-financial public sector debt ratio to 47.5 percent of GDP); thereafter, the ratio is expected to decline steadily. Key elements of our fiscal strategy include the following:

- ***Congressional approval of a budget for 2010 consistent with the NFPS deficit under the program***, which is a prior action for the program.

- ***Improvements in tax administration***, which are expected to yield about 0.4 percent of GDP on an annual basis. In addition, we are adopting strategic planning processes at the Domestic Tax Administration Directorate (DGII) and the Customs Administration Directorate (DGA), and are preparing modernization strategies and action plans for both agencies. These plans will define steps to enhance coordination in the tax collection process across agencies; strengthen the large taxpayers unit at the DGII; consolidate the authority of the audit department at the DGII and improve its auditing capacity (including by refining the risk-management approach of taxpayer selection for audits); and include measures to reduce fiscal fraud by reforming the tax and penal codes. We will monitor progress on these fronts through structural benchmarks under the program (see ¶10 of the attached Technical Memorandum of Understanding, TMU).

- ***Better targeting of subsidies***. With subsidies costing over 1 percent of GDP in 2009, we have placed a high priority on implementing a broad-based reform of all such expenditures. In 2010, we intend to bring liquid propane gas prices closer to market rates, while still protecting the most vulnerable through a consumption subsidy (see TMU ¶11). We will also finalize plans to improve the targeting of the remaining electricity subsidy, which, complemented with a campaign to reduce electricity usage, should bring additional savings (see TMU ¶11). We have implemented a new tariff structure for water utilities, which will help target better the current water subsidy. These reforms are expected to generate savings of about 0.4 percent of GDP in 2010 that would be redirected toward other social spending, and will build on progress already achieved last year. For example, the subsidy to public transportation operators was reduced by 40 percent in 2009, bringing its costs fully in line with receipts from dedicated revenue sources; control over outlays for this subsidy has been strengthened through a special unified account at the Treasury.

- ***Strict control of current expenditure***. Our austerity policy (in place since June 2009) will be maintained in 2010. It has been effective in controlling expenditure by reducing non-priority outlays, mainly on purchases of goods and services by public ministries and institutions.

- ***Increased spending on social programs***. The anti-crisis plan that we have adopted since June 2009 is helping to mitigate the effects of the economic slowdown on the most vulnerable sectors and will be maintained. Total spending on the plan is expected to reach US$575 million, about 1 percent of GDP on an annual basis through 2011. Key components of the program include: a system of loan guarantees for construction of low-cost housing; a temporary employment program; elimination of co-payments for services and medicines at public medical facilities; and provision of school uniforms and meals to low-income students.

- ***Saving of revenue over-performance***. Our fiscal program is based on conservative projections for output and revenue growth. If tax revenues were to exceed those projected under the program in 2010, we will use up to 50 percent of the excess revenue to increase spending on the social programs listed above, with the remainder allocated to meet the adjusted performance criterion on the overall balance of the non-financial public sector (as detailed in TMU ¶7).

- ***Medium-term fiscal strategy***. We plan to improve the transparency and planning of government operations by implementing a multi-year fiscal strategy starting with the publication of our 2010–15 government program. This publication will have a five-year macroeconomic framework, including a medium-term fiscal framework consistent with the SBA and our medium-term objectives of reducing the combined public sector deficit and debt to sustainable levels. Key to this effort will be the implementation of a fiscal pact arrived at (by end-June 2012) through consultation with a broad range of stakeholders that will aim to increase government revenues over the medium term, on the order of 1.5 to 3 percent of GDP. Beginning with the 2011 budget, we will introduce a multi-year budget framework that will ensure consistency between short-term and medium-term objectives.

8. ***Financing***. The government expects to cover the bulk of its financing needs during 2010–12 with external resources of relatively long maturity. We have firm commitments from the World Bank and IADB for more than US$1,100 million of gross disbursements, and we are discussing with the Central American Bank for Economic Integration possible loans for about US$240 million. Following the large but transitory increase in net public debt from 37.8 percent to under 50 percent of GDP in 2011, our fiscal consolidation strategy will yield a declining debt path in the medium term, with our public debt falling to less than 45 percent of GDP by 2015.

B. Financial System Policies

9. The government is committed to preserving and protecting the soundness and stability of the Salvadoran banking system and plans to adopt reforms to enhance its resilience and increase the efficiency of financial intermediation.

10. We regard the current level of liquidity coverage at banks as broadly adequate, and therefore plan to maintain reserve requirements and liquid asset requirements at their present level (detailed in TMU ¶9) during the program period. However, if we were to consider it necessary to modify either of those requirements, we would consult with IMF staff on such a change. In addition, if at any point during the program period we were to observe a significant decline in the sum of external short-term liabilities of banks and total private sector deposits held in the banking system (as defined in TMU ¶8), we would evaluate the appropriate policy response in consultation with IMF staff.

11. We will seek congressional approval in the coming months of the Financial Sector Supervision and Regulation Law (a structural benchmark under the program and described in TMU ¶12). The bill strengthens financial sector supervision by merging the supervisory entities for banks, pensions, and the stock market; enhances the autonomy of the merged institution; empowers the Central Reserve Bank of El Salvador (BCR) to be the sole regulator of the financial system; and provides legal protection for supervisors. In addition, the bill bolsters cross-border consolidated supervision by permitting the financial system superintendency to share information on local operations with foreign supervisors.

12. We will also seek congressional approval during 2010 of the Investment Funds Law (a structural benchmark under the program and described in TMU ¶13). The law aims at facilitating financial intermediation by creating a clear framework for investment funds,

specifying accounting and asset valuation rules, and setting the terms for investor entry and exit.

13. Given the significant changes that have taken place in the Salvadoran financial system in recent years (including the sale of the majority of domestic banks to foreign-owned institutions), we have requested a second update of the Financial Sector Assessment Program (FSAP; the first update was completed in 2004). In addition, we are considering requesting technical assistance, including from the IMF, on the following: financial system regulation and supervision, the bank resolution framework, mechanisms of parent-subsidiary support within international financial conglomerates, and steps for bolstering the BCR’s lender-of-last-resort capabilities. The FSAP update, together with technical assistance, will help us shape our financial sector reform agenda for the coming years.

III. Safeguards Assessment Update

14. We recognize the importance of evaluating progress made by the BCR on the recommendations contained in the safeguards assessment performed under the January 2009 SBA. We have authorized the central bank’s external auditors to provide IMF staff with all necessary information and to discuss directly with them any issues relevant to this process. The safeguards assessment update should be completed by the time of the first review of the SBA (September 15, 2010).

IV. Program Monitoring

15. The program will cover economic policies from March 2010 through end-2012, will be monitored through semi-annual reviews, and will contain quarterly and continuous quantitative performance criteria, structural benchmarks, and consultation clauses. The phasing of access under the arrangement and the schedule of reviews are set out in Table 1 of this memorandum; the quantitative targets and performance criteria through September 30, 2010 and indicative targets through December 31, 2012 are set out in Table 2; while the prior actions and structural benchmarks through June 30, 2012 are set out in Table 3. The definitions of the prior actions, quantitative performance criteria, structural benchmarks, and consultation clauses described in Tables 2 and 3 are further specified in the accompanying TMU.

Table 1. El Salvador: Purchase Schedule and Terms Under the Stand-By Arrangement

Date	Conditions for purchase	Purchase			
		Million SDR	Million US$ 1/	Percent of Quota	Percent of Total Access
March 17, 2010	Board approval of the SBA	171.30	261.17	100.00	33.33
May 17, 2010	Performance criteria based on end-March 2010	21.41	32.65	12.50	4.17
September 15, 2010	First review, based on end-June 2010 performance criteria	107.06	163.23	62.50	20.83
November 15, 2010	Performance criteria based on end-September 2010	21.41	32.65	12.50	4.17
March 15, 2011	Second review, based on end-December 2010 performance criteria	21.41	32.65	12.50	4.17
May 16, 2011	Performance criteria based on end-March 2011	21.41	32.65	12.50	4.17
September 15, 2011	Third review, based on end-June 2011 performance criteria	21.41	32.65	12.50	4.17
November 15, 2011	Performance criteria based on end-September 2011	21.41	32.65	12.50	4.17
March 15, 2012	Fourth review, based on end-December 2011 performance criteria	21.41	32.65	12.50	4.17
May 15, 2012	Performance criteria based on end-March 2012	21.41	32.65	12.50	4.17
September 17, 2012	Fifth review, based on end-June 2012 performance criteria	21.41	32.65	12.50	4.17
November 15, 2012	Performance criteria based on end-September 2012	21.41	32.65	12.50	4.17
March 8, 2013	Sixth review, based on end-December 2012 performance criteria	21.41	32.65	12.50	4.17
Total 2/		513.90	783.51	300.00	100.00

Source: Fund staff estimates.

1/ SDR/US$ exchange rate of 0.655892 as of February 19, 2010.
2/ May not reflect the sum of individual lines because of rounding.

Table 2. El Salvador: Quantitative Performance Measures

(in millions of U.S. dollars)

	2009	2010				2011	2012
	Estimated					Indicative	
	end-Dec.	end-Mar.	end-Jun.	end-Sep.	end-Dec.	end-Dec.	end-Dec.
Performance criteria							
Overall balance of the nonfinancial public sector (cumulative floor) 1/	-1,171	-300	-475	-700	-1,047	-830	-637
Gross debt of the public sector (flows) 2/ 3/	1,235	339	468	729	1,117	895	637

Continuous performance criteria

Standard continuous performance criterion of zero-ceiling on non-accumulation of external debt service arrears by the nonfinancial public sector. 4/

Continuous zero-ceiling on non-accumulation of domestic payment arrears by the nonfinancial public sector. 5/

Consultation clauses

If at any point during the arrangement, the sum of private-sector bank deposits and external short-term bank liabilities, should be less than US$7,432.4 million (i.e., ten percent below the end-November 2009 level), a consultation clause will be triggered and the authorities will contact Fund staff to discuss possible remedial actions. 6/

If at any point during the arrangement the authorities consider it necessary to modify the reserve requirements or liquid asset requirements, a consultation clause will be triggered and the authorities will contact Fund staff to discuss such actions. 7/

1/ Adjusted upward if observed tax revenues are higher than projected, as defined in the accompanying TMU.

2/ Excludes Central Bank obligations to the Fund incurred under the SBA.

3/ Adjusted upward for any debt placed for prefinancing that would result in an increase in BCR deposits.

4/ For the purpose of the program ceiling, external nonfinancial public sector debt-service arrears are defined as unpaid debt service payments by the non-financial public sector to nonresidents beyond 30 days after the due date.

5/ For the purpose of the program ceiling, domestic payment arrears of the nonfinancial public sector are defined as unpaid obligations overdue by more than 60 days.

6/ For definition of private sector deposits and external liabilities, see TMU ¶8.

7/ For reference rates of reserve and liquid asset requirements, see TMU ¶9.

Table 3. El Salvador: Structural Measures

Prior actions	Test date
Congressional approval of legislation projected to raise tax revenue by about US$140 million in 2010.	n/a
Congressional approval of budget for 2010 consistent with a nonfinancial public sector deficit of no more than US$1,047 million.	n/a
Structural benchmarks	
Tax Administration	
Publication of strategic plan for the modernization of both DGII and DGA.	Apr. 30, 2010
Enhance coordination in the tax collection process across agencies. 1/	Apr. 30, 2010
Strengthen the large taxpayers office at the DGII. 1/	June 30, 2010
Consolidate the authority of the audit department at the DGII and improve its auditing capacity. 1/	Dec. 31, 2010
Subsidy Reform	
Finalize plans to improve the targeting of subsidies for electricity, water, and liquid propane gas.	May 30, 2010
Implement plans to improve the targeting of subsidies for electricity, water, and liquid propane gas.	Oct. 31, 2010
Budget and Tax Policy	
Implement revenue measures yielding 1.5 percent of GDP.	June 30, 2012
Financial System	
Pass financial supervision bill containing following elements: i) Merge the supervisory entities for banks, pensions, and the stock exchange. ii) Enhance the autonomy of the merged supervisory institution. iii) Strengthen legal protection for supervisors. iv) Strengthen cross-border consolidated supervision. v) Empower the central bank to be the sole regulator of the financial system.	July 31, 2010
Congressional approval of investment funds law containing following elements: i) Create clear legal framework for investment funds. ii) Specify accounting and asset valuation rules. iii) Set terms for investor entry and exit.	Oct. 31, 2010

1/ A description of the steps needed to meet this benchmark is in ¶10 of the TMU.

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. **This Technical Memorandum of Understanding (TMU) describes the understandings** reached between the authorities of El Salvador and IMF staff for monitoring performance under the Stand-By Arrangement (SBA). In particular, it defines concepts employed in measuring the quarterly fiscal and debt quantitative performance criteria; the continuous performance criteria on external debt and domestic payments arrears; the adjuster for the overperformance of tax revenues; triggers for consultation clauses; structural benchmarks; and reporting requirements under the SBA.

A. Quantitative Performance Criterion on the Fiscal Balance of the NonFinancial Public Sector

2. **The nonfinancial public sector (NFPS) comprises** the central government, the rest of the general government (Instituto Salvadoreño del Seguro Social (ISSS), municipal governments, public hospitals, the national university, and other decentralized agencies), and the non-financial public-sector enterprises (Comisión Ejecutiva Hidroeléctrica del Río Lempa (CEL), Comisión Ejecutiva Portuaria Autónoma (CEPA), Administración Nacional de Acueductos y Alcantarillados (ANDA), and Lotería Nacional de Beneficiencia (LNB)).

3. **The overall balance of the NFPS is measured on a cash basis from below the line**, defined as: (a) net domestic financing of the NFPS; *plus* (b) net external financing of the NFPS; *plus* (c) proceeds from exceptional sources such as, but not limited to, proceeds from privatization or licenses and concessions, (see Table A1). The components of NFPS financing are defined and measured as follows:

(a) **The net domestic financing of the NFPS is defined** as the sum of: (i) the increase in net claims of the domestic financial system on the NFPS, excluding government bonds initially sold abroad; (ii) the net increase in the amount of public sector short-term paper (LETES) and bonds held outside the domestic financial system and the NFPS, excluding bonds initially sold to nonresidents; and (iii) floating debt of the NFPS due to expenditure operations and tax refund payments.

(b) **The net external financing of the NFPS** comprises: (i) disbursements of external loans; plus (ii) receipts from the issuance of government bonds abroad and LETES held by nonresidents; minus (iii) cash payments of principal (current maturities of loans, bonds, and LETES); minus (iv) cash payments of external arrears (principal and interest); minus (v) debt buy-backs or other prepayments of debt (at market value); minus (vi) debt-equity swaps accounted at the market value of these papers; and minus/plus (vii) the increase/decrease in other net foreign assets of the non-financial public sector.

(c) **Proceeds from exceptional sources** such as, but not limited to, privatization, the sale of licenses, and the granting of concessions are defined as: (i) the cash payments received by the Treasury from the sale of state-owned assets; plus (ii) debt-equity swaps, accounted at market values. Also included are up-front payments received by the Treasury for the granting of concessions for public services and capital leasing agreements.

B. Performance Criterion on Debt Flows Contracted by the Public Sector

4. **The performance criterion measures the sum of debt contracted by the non-financial public sector in the year**, as defined in paragraph 2, which shall apply to all external debt as specified in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-00/85), and all domestic debt flows in the year; plus external debt contracted by the central bank (excluding any obligations to the IMF under the SBA) in the year; plus any new debt with a sovereign guarantee.

C. Non-Accumulation of External Debt or Domestic Payments Arrears

5. **The NFPS will not accumulate any external debt arrears during the program period**. For the purpose of this performance criterion, an external debt payment arrear will be defined as a payment by the NFPS that has not been made within thirty days after falling due under the contractual agreement, unless specified otherwise. The performance criterion will apply on a continuous basis.

6. **The NFPS will not accumulate any domestic payments arrears during the program period**. For the purpose of this performance criterion, a domestic payments arrear will be defined as an obligation by the NFPS that has not been paid within sixty days after falling due under the contractual agreement, unless specified otherwise. The performance criterion will apply on a continuous basis.

D. Adjuster for Overperformance of Tax Revenue in 2010

7. **In the event that net tax collections exceed the program baseline of** US$662 million as of end-March 2010, US$1,531 million as of end-June 2010, US$2,220 million as of end-September 2010, and of US$2,940 million as of end-2010,[1] the performance criterion on the overall balance of the NFPS will be raised by 50 percent of any such excess.

E. Consultation Clauses

8. **Floor on the sum of total bank deposits of the private sector and external short-term liabilities of banks**. These are defined, respectively, as deposits of the private sector in commercial banks, and external liabilities of commercial banks with an original maturity of

[1] The latter two estimates of tax collections are indicative.

up to one year.[2] If at any point during the arrangement, the sum of private-sector bank deposits and external short-term bank liabilities should be less than US$7,432.4 million (i.e., ten percent below the end-November 2009 level), a consultation clause will be triggered and the authorities will contact Fund staff to discuss possible remedial actions.

9. **The reserve requirements and liquid asset requirements of the banking system are defined as in current regulations**[3] (currently at about 22 percent and about 3 percent, in effective terms, respectively). If at any point during the arrangement the authorities consider it necessary to modify the reserve requirements or liquid asset requirements, a consultation clause will be triggered and the authorities will contact Fund staff to discuss such actions.

F. Structural Benchmarks

10. **The authorities will publish their strategic plan for the modernization of the Domestic Tax Administration Directorate (DGII) and the General Custom Administration Directorate (DGA) by end-April 2010 (structural benchmark)**. The plan will include the following steps:

- *Enhance coordination in the tax collection process across agencies*. The DGII and DGA should move to the same IT platform so that there can be communication between the databases of the two units.

- *Strengthen the large taxpayers unit (LTU) at the DGII*. The authorities should create a new centralized LTU office located in San Salvador. The LTU would perform audits of the largest 50 taxpayers, and also perform collection and taxpayer assistance functions for those taxpayers.

- *Consolidate the authority of the audit department at the DGII and improve its auditing capacity, including by refining the risk-management approach to taxpayer selection for audits*. Improving the audit capacities would include the following: (i) implementing a new structure for the audit department that encompasses all activities related to auditing, including planning and taxpayer selection; (ii) adopting international practices by establishing a clear model of taxpayer selection, using cross-checked information; (iii) changing the focus of the "gestion de carteras" from a flexible and negotiable on-going audit into a group performing monitoring, analysis, and internal audits; and (iv) increasing the number of traditional external audits.

---

[2] The definition consists of the sum of line items 211 (*DEPOSITOS)* and 212108 (*PRESTAMOS PACTADOS HASTA UN AÑO PLAZO—ADEUDADO A ENTIDADES EXTRANJERAS*) of the balance sheets of banks as compiled by the Superintendency of the Financial System on a weekly basis; minus the lines noted in Table A2, which represent public sector deposits and accrued interest. As of November 27, 2009 (the agreed baseline data) the sum of private sector bank deposits and external short term liabilities of banks was US$8,258.3 million.

[3] Regulations on liquid reserve requirements NPB3-06 and NPB3-11.

11. **The reform on the liquid propane gas (LPG) and electricity subsidies will contain the following elements**: (i) for LPG we will introduce a new tariff structure and a new targeted subsidy to assist the most vulnerable; and (ii) for electricity, we will adjust tariffs, so these reflect market prices better, and will improve the targeting of the subsidy for low usage customers.

12. **The Financial System Supervision and Regulation Law should contain the following elements**: (i) merger of the supervisory entities for banks, pensions, and the stock exchange; (ii) enhanced functional autonomy of the new supervisory institution; (iii) stronger legal protection for supervisors; (iv) provisions to strengthen cross-border supervision through improved information sharing; and (v) invest the Central Bank to be the consolidated financial system regulatory authority.

13. **The Investment Funds Law should contain the following elements**: (i) a clear legal framework for investment funds; (ii) accounting and asset valuation rules for investment funds; and (iii) terms for investor entry and exit.

G. Reporting Requirements

14. **To facilitate monitoring of program implementation, the government of El Salvador will prepare and send to the IMF**, by e-mail or by fax, monthly data and reports within six weeks following the end of the preceding month, and quarterly data and reports within six weeks after each test date, unless specified otherwise. Such data will include (but are not limited to) the following:

(a) The Central Bank of El Salvador will provide on a monthly basis the comprehensive monetary survey and the central bank balance sheet (electronic file);

(b) The Central Bank of El Salvador will provide on a daily basis the total bank deposits in commercial banks with a lag of at most three working days;

(c) The Central Bank of El Salvador will provide on a weekly basis the balance sheets of individual banks and the total banking system, as well as detailed information on their liquidity positions, with a lag of at most five working days;

(d) The Central Bank of El Salvador will provide quarterly balance of payments data in electronic format with a lag of a quarter;

(e) The Ministry of Finance will provide monthly data on tax revenue with a lag of at most five working days;

(f) The Ministry of Finance will provide monthly data on revenue and the execution of expenditure for the central government and the rest of the general government (ISSS, the municipal governments, public hospitals, the national university, and other decentralized agencies) with a lag of at most four weeks, and quarterly data on revenue and the execution of expenditure for the four non-financial public sector enterprises (CEL, CEPA, ANDA, and LNB);

(g) The Ministry of Finance will provide monthly information on the financing of the nonfinancial public sector and stock of debt of the NFPS (as defined above) as specified in the table attached to this TMU;

(h) Indicators and other statistical data on recent economic developments, such as the household consumer price index, will be provided as they become available. In addition, the central bank will provide its quarterly reports on economic activity with a lag of at most a quarter;

(i) The authorities will provide a status report on the implementation of the structural reforms specified in Table 3 of the Memorandum of Economic and Financial Policies attached to the Letter of Intent of March 1, 2010; and

(j) The authorities will provide to IMF staff any other information that the latter may deem necessary for the effective monitoring of the Stand-By Arrangement.

Table A1. El Salvador Financing of the Non-Financial Public Sector

	2010			
	March	**June**	**September**	**December**
A. Net domestic financing of the non-financial public sector (NFPS)				
i. Net claims of the financial system (1+2+3)				
1. Net credit of commercial banks to the NFPS:				
a. Credits				
b. Liabilities				
2. Net credit of the BCR to the NFPS:				
a. Credits				
b. Deposits				
3. Net credit of the non-bank financial institutions to the NFPS 1/				
a. Credits				
b. Liabilities				
ii. Stock of NFPS liabilities (including Letes) held outside the domestic financial system and the NFPS 2/				
iii. Floating debt				
B. Net external financing				
i. Multilateral development banks (IADB, WB, CABEI)				
a. Disbursements				
b. Amortizations				
ii. Bilateral creditors				
a. Disbursements				
b. Amortizations				
iii. Financial institutions				
of which : bonds				
of which : LETES				
iv. Other				
C. Privatization and concessions				
D. Non-financial public sector overall balance (A+B+C)				
Memorandum:				
Stock of LETES in circulation				
Disbursements				
Amortization				

Sources: Ministry of Finance; Fund staff estimates.

1/ Includes trust funds: (FOSEDU, FOP).
2/ Includes amortization of ISTA bonds.

Table A2. Public-Sector Deposit Account Numbers

Public Sector Accounts

2110010101, 2110010102, 2110010201, 2110010202, 2110020101, 2110020102, 2110020201, 2110020202, 2111010101, 2111010102, 2111010201, 2111010202, 2111020101, 2111020102, 2111020201, 2111020202, 2111030101, 2111030102, 2111030201, 2111030202, 2111040101, 2111040102, 2111040201, 2111040202, 2111050101, 2111050102, 2111050201, 2111050202, 2111060101, 2111060102, 2111060201, 2111060202, 2111070101, 2111070102, 2111070201, 2111070202, 2111080101, 2111080102, 2111080201, 2111080202, 2111130101, 2111130102, 2111130201, 2111130202, 2111140101, 2111140102, 2111140201, 2111140202, 2111990101, 2111990102, 2111990201, 2111990202, 2112010101, 2112010102, 2112010201, 2112010202, 2112020101, 2112020102, 2112020201, 2112020202, 2112030101, 2112030102, 2112030201, 2112030202, 2112040101, 2112040102, 2112040201, 2112040202, 2114010101, 2114010102, 2114010201, 2114010202, 2114020101, 2114020102, 2114020201, 2114020202, 2114030101, 2114030102, 2114030201, 2114030202, 2114040101, 2114040102, 2114040201, 2114040202, 2114050101, 2114050102, 2114050201, 2114050202, 2114060101, 2114060102, 2114060201, 2114060202, 2114070101, 2114070102, 2114070201, 2114070202.

Accrued Interest

2110019901, 2110019902, 2110029901, 2110029902, 2111019901, 2111019902, 2111029901, 2111029902, 2111039901, 2111039902, 2111049901, 2111049902, 2111059901, 2111059902, 2111069901, 2111069902, 2111079901, 2111079902, 2111089901, 2111089902, 2111139901, 2111139902, 2111149901, 2111149902, 2111999901, 2111999902, 2112019901, 2112019902, 2112029901, 2112029902, 2112039901, 2112039902, 2112049901, 2112049902, 2114019901, 2114019902, 2114029901, 2114029902, 2114039901, 2114039902, 2114049901, 2114049902, 2114059901, 2114059902, 2114069901, 2114069902, 2114079901, 2114079902.