



USAID
FROM THE AMERICAN PEOPLE

EL SALVADOR



Country Development Cooperation Strategy

2013-2017

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DEVELOPMENT CONTEXT, CHALLENGES AND OPPORTUNITIES

Overview

El Salvador is the third largest economy in Central America, and the most densely populated, with 6.2 million mainly urban inhabitants.

In the years following the end of the civil war in 1992, El Salvador made significant democratic advances, including successive free and fair elections.

While the democratic transition has been accompanied by significant, social and economic progress and social indicators such as infant mortality rates and literacy have improved, poverty and inequality of opportunity have increased as problems.

Meanwhile, criminal activity, particularly gang related violence, has increased dramatically. In recent years, El Salvador has had one of the highest homicide rates in the world.

The United States has an interest in a stable, prosperous El Salvador, one that shares U.S. democratic values, is a reliable partner in the fight against transnational crime, and plays an active and responsible role in international affairs.

During a March 2011 visit to El Salvador, President Barack Obama pledged to strengthen cooperation through the new Partnership for Growth (PFG) initiative. PFG is the President's flagship foreign assistance initiative. Its focus on citizen security constraints to growth is aligned with and complementary to the U.S. Government (USG) Central America Citizen Security Partnership and the Central America Regional Security Initiative (CARSI). The PFG commits both governments to work closely together to boost competitiveness and reduce insecurity in order to rapidly expand broad-based economic growth in El Salvador. Successful implementation of the PFG initiative will be the cornerstone of this Country Development Cooperation Strategy (CDCS).

Development Context

Political and Economic Overview

Following the signing of Peace Accords in 1992, ending over a decade of bitter civil war, El Salvador has had a series of free and fair elections, and peaceful transfers of power. El Salvador has laws and institutions in place that mandate accountability and transparency in the use of public funds. In recent years, El Salvador, with USAID assistance, has undertaken a series of transparency and accountability reforms, including the passage of the Ethics Law (2005), the

EXPECTED RESULTS

Between fiscal years 2013 and 2017, USAID will expand broad-based economic growth and security in El Salvador through measurable development results. These expected results are:

DEMOCRACY /GOVERNANCE:
Citizen Security and Rule of Law in Targeted Areas Improved

ECONOMIC GROWTH: Economic Growth Opportunities in Tradables Expanded

Tradables are those goods and services which are or can be traded internationally and whose prices are set on world markets.

creation of the Government Ethics Tribunal (2006), the creation of the Sub-Secretariat of Transparency (2009), and the passing of the Access to Public Information Law. However, the country's culture of transparency and accountability needs further strengthening and official corruption remains a serious problem. Although democratic reforms have been implemented, tangible improvements in government efficiency and effectiveness have proceeded slowly.

In the economic realm, El Salvador is seeking to boost investment and growth, which has been inhibited by low productivity, natural disasters, and insecurity. However, El Salvador's poor economic performance is driven in part by a rift between the Funes government and the private sector, which contributes to an unstable investment climate.

Partially as a result of USAID-funded structural adjustment and policy reform programs in the 1980-90s, El Salvador is an open economy. Over the last decade it has reached out to global markets as a signatory to the Central America-Dominican Republic Free Trade Agreement (CAFTA-DR), a regional free trade agreement (FTA) with the United States, and six FTAs with Chile, Mexico, Panama, Dominican Republic, Colombia and Taiwan.

From 1992-2006, the country's poverty rate declined significantly. With the global financial crisis of 2008-9, coinciding with the leftist government taking office and a protracted wave of gang-led crime and violence, El Salvador's economy suffered reversals that are still being felt today.

According to the National Household Survey, total poverty levels, defined by the number of households in poverty, increased from 30.7 percent in 2006 to 40.6 percent in 2011. Urban poverty increased from 27.7 percent in 2006 to 35.4 percent in 2011, while rural poverty had a significant jump from 35.8 percent in 2006 to 50.2 percent in 2011.¹ A major factor in this reversal was the global financial crisis, which reduced remittances from the U.S. by 10 percent, and led to a decline in demand for Salvadoran products. The country is dependent on remittances, which total 17 percent of Gross Domestic Product (GDP), and surpass the combined value of the nation's coffee and sugar exports. By 2011, combined unemployment/underemployment was 42 percent. While men have traditionally had higher levels of unemployment, women are more likely to be underemployed,² and 47.6 percent of women live below the poverty line.³

El Salvador has also lost ground to its regional neighbors in terms of GDP growth and in the attraction of private, especially foreign investment. Economic growth rates (1.4 percent in 2010 and 1.5 percent in 2011) are well below the Latin American average. In 2012, for the fifth consecutive year, El Salvador had the lowest level of gross GDP growth in Central America of 1.5 percent, with the regional average around 3.9 percent. The International Monetary Fund

¹ Dirección General de Estadísticas y Censos, "Encuesta de Hogares de Propósitos Múltiples 2011", DIGESTYC, San Salvador 2012, <http://www.digestyc.gob.sv/index.php/temas/des/ehpm/publicaciones-ehpm.html>

² Cuadro Y7. "La igualdad y la equidad de género en El Salvador." June 2011, No. 10, UNDP

³ 2011 National Household Survey

(IMF) projected that real GDP will grow at 1.5 percent in 2013-2014, reflecting low domestic investment and lower export prices. The IMF further suggested that the Salvadoran Government should strive to raise investment and increase competitiveness in order to reverse the downward trend in economic growth.

El Salvador, however, faces severe challenges in its levels of Foreign Direct Investment (FDI) due to insecurity, weak macroeconomic stability, a poor business environment, and low competitiveness. Since 2009, El Salvador has had the lowest level of FDI in the Central American region. In 2010, FDI dropped from a previous average yearly increase of \$645 million to only \$80 million, though it since has recovered slowly to \$420 million in 2011, and to \$515 million in 2012.⁴

El Salvador's economy is dominated by the service sector, which accounts for 60 percent of GDP. The manufacturing sector accounts for 25 percent, and agriculture and related sectors for 12 percent. The economy has been officially dollarized since 2001. El Salvador's most important export category remains *maquila* products (manufactured products assembled for re-export), which account for 22.6 percent of all exports, and which have traditionally been composed of products with low value-added that are not technologically intensive.

The share of tradables (exports whose prices are set on the international market), in GDP has declined since 1990, likely as a consequence of low productivity of Salvadoran firms operating in this sector. El Salvador's share of tradables as a percent of GDP has declined from 45 to 40 percent over this period and has consistently been 5 to 10 percentage points below the average for Middle Income Countries, and 10 to 15 percentage points below the Lower-Income Country average.⁵ Economic performance of the tradables sector in El Salvador is heavily affected by changes in international commodity prices. As well, the country's fragile domestic manufacturing base, combined with an increase in the cost of oil imports, contribute to a persistent structural trade deficit.

Natural disasters also impact the country's economy. In El Salvador, 88.7 percent of the country's territory is susceptible to severe impacts of natural disasters and approximately 95.4 percent of El Salvador's population is at some risk.⁶ Since the current administration took office in June 2009, three major tropical storms have occurred (Ida, Agatha, and 12E) resulting in loss of human life and infrastructure. Disasters affect stocks of physical and human capital and ultimately reduce per capita GDP growth rates and the domestic savings rate. Studies have shown women are particularly vulnerable to natural disasters and are impacted even more than men.⁷ Because women often have more limited access to assets, they often have less capacity to adapt to changes provoked by natural disasters.

⁴ Partnership for Growth Constraints Analysis

⁵ Partnership for Growth Joint Country Action Plan

⁶ UNDP/OCHA Report 2010

⁷ IUCN, June 17, 2009, "How Natural Disasters Affect Women"

Increasingly convinced that prosperity and economic safety were to be found outside the country, many Salvadorans emigrated during the war years, and this outflow continues with more than 10 percent of native-born Salvadorans residing abroad. Historically, more men than women have migrated to the U.S., but this dynamic is shifting, and currently approximately 48 percent of migrants are women.

Crime and Insecurity

Criminal activity, particularly gang related violence, has increased dramatically. According to the Civilian National Police (PNC), El Salvador recorded a murder rate of 69 per 100,000 inhabitants in 2011, one of the highest in the world. As part of this, homicide rates for women have increased alarmingly in recent years and are currently the highest in the region. Between 2008 and 2010, female homicides increased by 88.5 percent, most being ages 10 to 29 years old. Drug trafficking organizations (DTOs), including Salvadoran groups have also increased their illicit activities in the country, including money laundering. Between 20,000 and 35,000 Salvadoran youth belong to *maras* (street gangs), which former PNC officials had maintained were responsible for half of all homicides and a majority of extortion in the country.⁸

Extortions and disappearances are also extremely high. Particularly appalling are the levels of brutality, sexual assault and patterns in the attacks, in which victims often disappear and are later found brutally murdered. The public transportation sector is particularly vulnerable to assaults and extortion. In 2010, a bus with seventeen people on board was burned, and a bus strike resulted from the Legislative Assembly passing an anti-gang law. The bus companies protested due to the fear of reprisal by the gangs, and the strike closed 80 percent of public transportation.

However, bus companies are not the only businesses living in fear of gangs and criminal activity. Crime and violence have a large negative impact on small businesses due to lower revenues and sales. According to a World Bank Enterprise Survey, security costs add approximately 10 to 30 percent to the price of doing business, and that the “shadow price” of crime is somewhere between 4.8 percent and 10.8 percent of GDP (depending on the inclusion of health costs). Both figures are higher than the Central American average, and more than double the figure for Costa Rica, the only country in Central America not classified as having an “epidemic” level of crime. Moreover, about half of the businesses surveyed by the World Bank report that crime is an obstacle to their operations—at least 15 percentage points higher than the Latin American and lower-middle-income country average. Statistics show that on a local level, higher numbers of robberies per 100,000 in a municipality correlates with lower scores on the USAID-funded Municipal Competitiveness Index for that municipality. In the 2010-2011 Global Competitiveness Report, El Salvador ranked last of 139 countries under the Organized Crime indicator and second to last on the Business Costs of Crime and Violence indicator.

⁸ Congressional Research Service “El Salvador: Political and Economic Conditions and U.S. Relations,” Clare Ribando Seelke, April 5, 2013

Challenges and Opportunities

The Government of El Salvador (GOES) is determined to reverse these trends by laying the groundwork for a development model built on a new cycle of investment and economic growth. The United States has an interest in a stable and prosperous El Salvador, one that shares its democratic values, is a reliable partner in the fight against transnational crime, and plays an active and responsible role in international affairs. Both the GOES and the USG acknowledge the importance of a well-functioning market economy, and the critical role of the private sector in leading economic development, while the government serves an essential purpose by establishing an institutional environment conducive to economic growth, addressing social gaps, and investing in the nation.

In order to achieve these goals, the GOES and the USG entered into the Partnership for Growth (PFG). PFG is a Presidential Initiative that strengthens the GOES-driven process of steering El Salvador toward an era of investment and broad-based economic growth. In this way, PFG is a critical part of creating real opportunity for Salvadoran development.

El Salvador is one of four countries that participate in PFG, putting the principles of President Obama's Policy Directive on Global Development into practice. This plan includes a government-wide approach focusing on the full range of available development resources to help meet the development objectives of the GOES and spur higher, sustained and more inclusive economic growth in El Salvador. PFG focus on security constraints to growth is aligned with and complementary to the USG Central America Citizen Security Partnership and the CARSI.

Under PFG, a joint U.S.-El Salvador team conducted a Constraints Analysis and identified two primary binding constraints to economic growth in El Salvador: crime and insecurity, and low productivity in the tradables sector (exports whose prices are set on the international market). Based on this Constraints Analysis, both countries developed a Joint Country Action Plan (JCAP), signed in November 2011. The JCAP identifies twenty broad goals to be pursued over the five-year life of the PFG agreement. The principal themes of the JCAP are: institutional strengthening; crime and violence prevention; human capital development; investment in infrastructure; attracting foreign investment; and, improving the business environment. CARSI, which provides citizen security assistance in the Central America Region, including El Salvador, has aligned many of its prevention and law enforcement efforts to support achievement of PFG goals. In addition, the JCAP aligns with the top priorities of the GOES, developed in its National Five-Year Strategic Development Plan (2010-2015) to reduce crime and violence and to expand the economy.

DEVELOPMENT HYPOTHESIS

CDCS Goal

Broad-based economic growth and security are threatened by crime and violence, weak rule of law, and low competitiveness in the tradables sector. To better understand current obstacles to development, a constraints to growth analysis (Executive Summary presented as Annex 1) was prepared by a joint technical team composed of economists from the Government of El Salvador (GOES) and the Government of the United States (USG). The analysis provides an analytical and empirical foundation for joint efforts as part of the PFG Presidential Initiative. This analysis utilized information drawn from a wide variety of sources, including data provided by various entities of the GOES, analysis from international organizations (including the International Monetary Fund, the World Bank, and the Inter-American Development Bank), and the work of independent experts. It also benefited from various consultations, including focus groups with a variety of stakeholders in El Salvador, including government officials, entrepreneurs, and academics. Using the data from internationally comparable indicators, surveys, graphical, statistical and other analysis, the Constraints Analysis identified two binding constraints to growth in El Salvador: crime and insecurity, and low productivity in the tradables sector. The research also identified El Salvador's vulnerability to natural disasters and climate change as an area that while not technically a binding constraint, heavily impacts the economy and that "investments made under this effort need to be made with full acknowledgement of El Salvador's vulnerability to natural disasters and the effects of global climate change."⁹

USAID/El Salvador proposes to target its resources to expand broad-based economic growth in a more secure El Salvador. This goal will be accomplished through strategic investments under two Development Objectives (DOs): DO1) citizen security and rule of law in targeted areas improved; and DO2) economic growth opportunities in tradables expanded. The overall efforts will address cross-cutting themes, agency priorities, and Presidential Initiatives, such as gender, youth, and climate change. Through these efforts, USAID will contribute to achieving the goals of Partnership for Growth and the Central America Regional Security Initiative to reinforce and expand democratic principles, security, and economic growth in El Salvador. A graphical representation of the relationship among them is presented in the Results Framework in Figure 1.

Linkage to Partnership for Growth Joint Country Action Plan (JCAP)

All USAID activities under this CDCS and included in the resource request from FY 2013 to FY 2017 are aligned with and support the PFG goals. Activities under DO1 will contribute to eight of the 14 JCAP security goals and DO2 contributes to all six JCAP tradables goals. Several activities began under the former strategy with prior-year funding and will be continued under the CDCS, as they directly support achievement of PFG JCAP goals. USAID recognizes that achievement of the JCAP goals will require government-wide involvement, and contributions from all of the 17 USG agencies that are currently contributing to the effort. Consistent with the LAC Mission Statement to, "Advance prosperity and security in the

Americas by strengthening the capacity of governments, civil society and the private sector to promote broad-based economic growth, improve democratic governance, and enhance citizen security,” the JCAP defines a set of specific goals and actions that each government will undertake to achieve the overall PFG goal to expand economic growth. USAID/El Salvador’s goal statement directly aligns with the overall goal of PFG and CARSI to steer El Salvador towards a new era of higher investment and broad-based economic growth. USAID’s activities will complement those of the GOES and other USG agencies, as well as the efforts of other donors, to achieve an expansion of broad-based economic growth in a secure El Salvador. (See Annex 2: Other Donors-Security and Tradables Activities.)

Linkage with USAID Policy Framework, Strategies, and USAID Forward

This CDCS is consistent with USAID Policy Framework 2011-2015 and will support two of the Core Development Objectives: 1) Expand and Sustain the Ranks of Stable, Prosperous, and Democratic States, captured in CDCS DO1; and 2) Promote Sustainable, Broad-Based Economic Growth, captured in CDCS DO2.

Activities also support President Obama’s Central America Citizen Security Partnership and CARSI. Under this CDCS, DO1 citizen security and rule of law activities, including CARSI funding, support goals of the Central America Citizen Security Partnership: 1) Create safe streets for the citizens of the region; 3) Support the development of strong, capable, and accountable Central American governments; and 4) Re-establish effective state presence, services and security in communities at risk.

USAID also supports two of the three goals under the Agency’s Education Strategy. Under both DO1 and DO2, activities will contribute to Goal Two: Improved ability of tertiary and workforce development programs to produce a workforce with relevant skills to support country development goals by 2015; and Goal Three: Increased equitable access to education in crisis and conflict environments for 15 million learners by 2015.

Under DO2, the CDCS will support the USAID Climate Change and Development Strategy—“SO 3. Strengthen development outcomes by integrating climate change in Agency programming, learning, policy dialogues and operations,” through specific GOES technical and institutional capacity building, and in maximizing the involvement of local organizations to meet GCC sustainable adaptation targets.

USAID Forward

Implementation and Procurement Reform: In order to implement effectively the actions required under the Implementation and Procurement Reform priorities, USAID conducted a Stage 1 - Rapid Appraisal (RA) of El Salvador’s public financial management system in August 2011. Based on the RA conclusions and recommendations and in close collaboration with the Regional Inspector General, USAID conducted a Stage 2 risk assessment of the Ministry of Environment as a potential USAID partner. Activity designs will include analyses for using host country systems and/or local organizations when possible, and/or include local capacity development components to transition to host-country and/or local organizations implementation. Under DO1, a justice sector reform feasibility study will be conducted of possible methods to engage directly

with the GOES in future projects, rather than using a contractor. Similar studies may be conducted under other USAID activities. Private sector engagement and local capacity development will be critical elements to achieving the Development Objectives and the CDCS Goal across all sectors.

USAID/El Salvador currently has five Global Development Alliances (GDAs), including the Agency's largest GDA with a local partner, and will look for new alliances in support of the CDCS objectives.

Monitoring and Evaluation: Over the next five years (2013-2017), USAID/El Salvador has 18 mid-term and final evaluations planned to cover bilateral and regional projects. Higher level impact evaluations of CDCS objectives will be undertaken as part of the planning and implementation of upcoming projects.

Talent Management: The Talent Management working group will continue to assess personnel abilities and skills, recommend training opportunities and enhance training tools to make them available and accessible to Mission personnel. A formal mentoring program has also been established.

Science, Technology and Innovation (ST&I): USAID has established a ST&I working group and is moving to integrate key ST&I activities such as GIS mapping into programs and key results. Under DO2, the promotion of ST&I is integrated into higher education activities and initiatives to increase productivity of Small and Medium Enterprises (SMEs).

Focus/Synergy/Selectivity

USAID activities will focus on crime prevention, strengthening the justice sector, increasing productivity and competitiveness, and the development of human capital. Efforts will be concentrated in high crime locations with the potential to ensure synergies between crime prevention and economic growth objectives. Project designs will routinely examine possibilities for co-locating activities to maximize both resources and effectiveness. Resources will continue to benefit municipal approaches to improved administration, competitiveness and crime prevention, with citizen participation in design and implementation.

Geographic Focus

The GOES has identified 54 of 262 total municipalities as "high crime." USAID's crime prevention and education activities will focus on those high-crime municipalities. In addition, work will occur at the national level, and in specific economic sectors. A major USAID municipal competitiveness activity to promote greater investment and employment opportunities will target 50 municipalities, 26 of which are identified as "high crime" municipalities, and thus overlap with crime and violence prevention activities. USAID will ensure alignment with the GOES priority to achieve expanded economic growth in high-crime areas, but at the same time areas of high economic potential that are not rated as high crime will not be neglected.

Sector Focus

USAID has narrowed the scope of its program, both in terms of the overall number of sectors, and within sectors in an effort to better align the CDCS with PFG goals. For example, USAID will no longer work in the health sector, and will not provide election support. Basic Education programs have moved away from primary education and will focus on secondary education, in high crime communities in support of the PFG security goals.

Division of Labor

The PFG initiative will maximize the impact of the State Department and all USG agencies by consolidating and focusing efforts and enabling each USG agency to work in areas where they have comparative advantage and legal authority. In addition, USAID is currently leading the development and implementation of a vibrant strategy to involve the private sector through public-private alliances. For example, USAID will increase private sector active participation in the security and GOES-led crime and violence prevention initiatives by leveraging support from the private sector through alliances. USAID will also collaborate with multilateral organizations and other donors to support the efforts of the GOES in the areas of tax policy and administration, public expenditure management systems, and public-private dialogue with the private sector and civil society.

FIGURE 1-RESULTS FRAMEWORK GRAPHIC

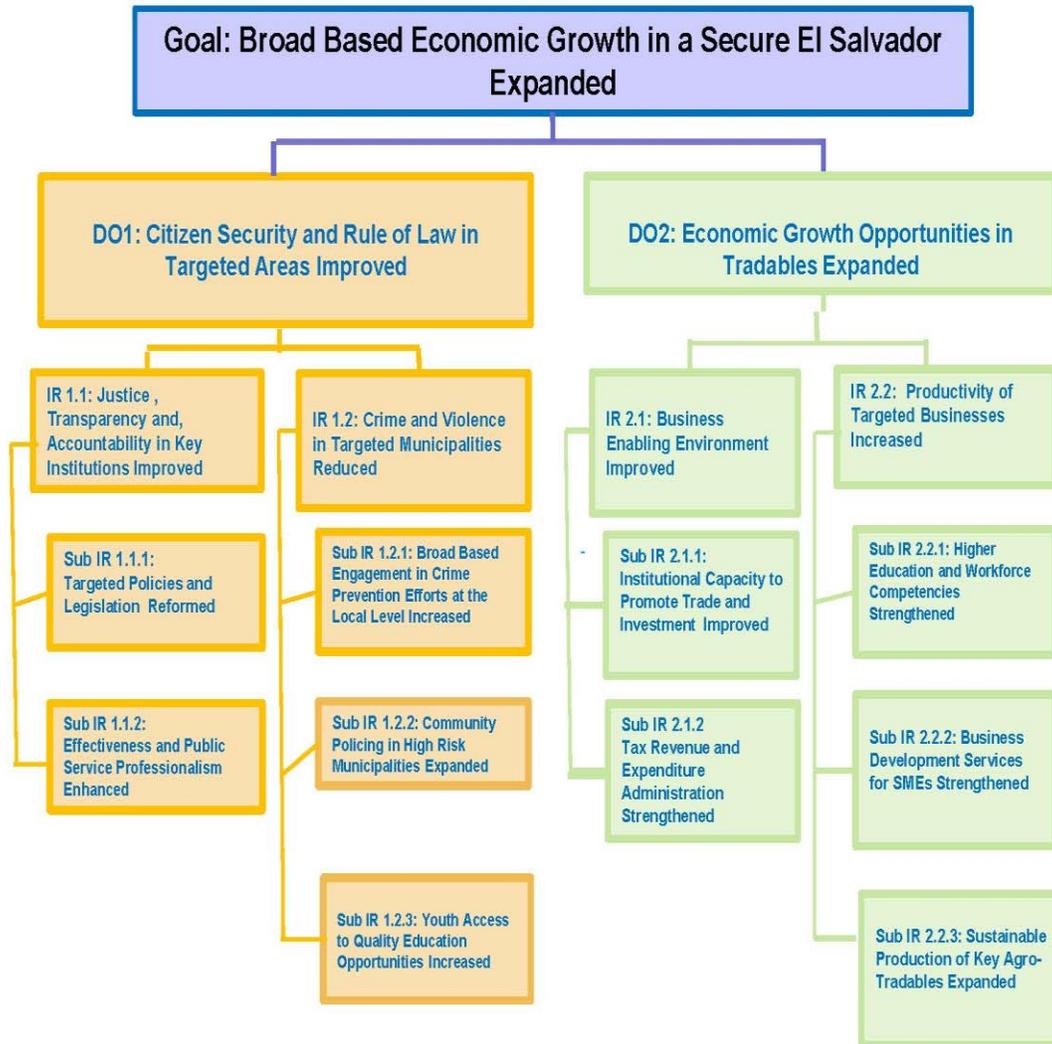
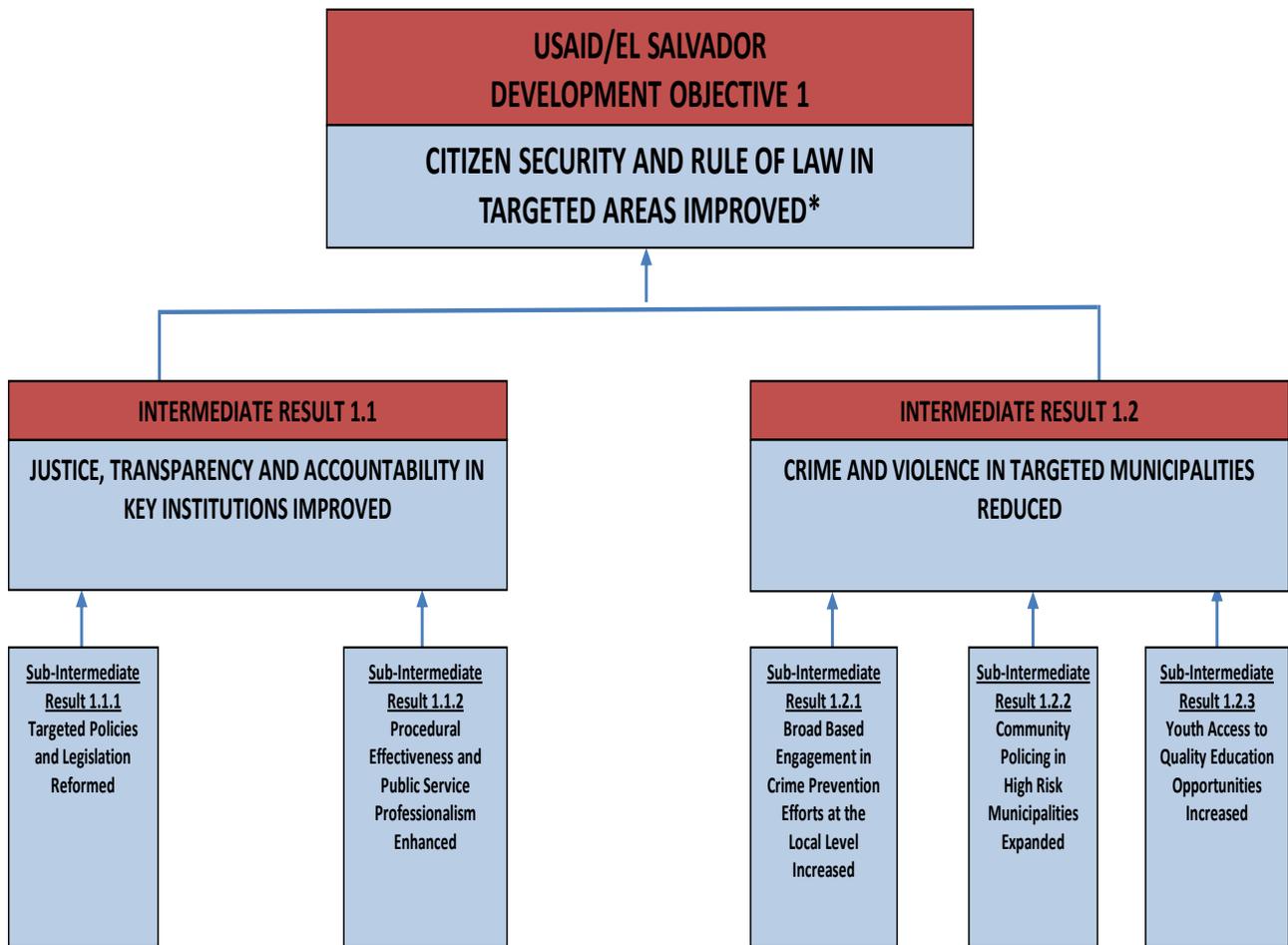


FIGURE 2 – DEVELOPMENT OBJECTIVE 1: RESULTS FRAMEWORK GRAPHIC



*Co-funded by CARSI

DEVELOPMENT OBJECTIVE 1: CITIZEN SECURITY AND RULE OF LAW IN TARGETED AREAS IMPROVED

El Salvador has one of the highest levels of non-political violence in the world and one of the highest homicide rates in the Americas, with 69 homicides per 100,000 inhabitants in 2011. While a GOES-negotiated truce between rival gangs, in effect since March 2012, has lowered the murder rate, extortion, robbery and other crimes that impact average citizens on a daily basis continues to be high.¹⁰ A 2007 Global Study on Homicide, published by the United Nations Office of Drugs and Crime (UNODC), notes that the legacy of armed conflict and violence, availability of firearms, chaotic urbanization, high income inequality, a demographically large youth population, local gang structures, organized crime, and drug trafficking all contribute to high levels of violent crime in the sub-region.

RESULTS: DEMOCRACY/GOVERNANCE

By 2017, USAID will have improved justice, transparency and accountability in key institutions and reduced crime and violence in targeted municipalities.

The 2011 UNODC Global Study on Homicide suggests there is a clear link between homicide rates and development. According to the study, countries with high levels of income disparity experience homicide rates almost four times higher than countries with more equitable income distribution. However, the same report identifies drug trafficking as the major cause of the increase in homicide rates in recent years. The geographic position of the sub-region, between the lucrative drug market of the United States and the main cocaine production areas in South America, has made El Salvador an increasingly important drug trafficking route.

Crime and insecurity also negatively affect the legitimacy of the authority and institutions of the government. The limitations of the state to combat and prevent crime can erode the confidence of the people and can undermine good governance. In particular, an ineffective, slow, and unpredictable judicial system has had limited success in prosecuting, convicting, and incarcerating violent criminals; of all the homicides committed in the country, only four percent of the cases brought to trial receive a conviction. Fundamental institutional weaknesses with regard to investigative and organizational capacity of key justice sector actors inhibit an effective, sustainable response to criminality and perpetuate an unfair justice system. Studies also show that weak institutions inhibit economic growth. A 2009 survey by the Salvadoran Investment Promotion Agency (PROESA) concluded that the government, in terms of inefficiency of bureaucracy and inconsistency of judicial decisions, constituted one of three major obstacles to doing business in El Salvador (PROESA 2009).

There are definite interaction effects where the level of crime contributes significantly to the problems of rule of law, both in reality and in the metrics used to measure the rule of law.

¹⁰ In March 2012, a truce was negotiated between rival gangs, and over the next 12 months the homicide rate dropped by 49 percent. However, there are questions about the relationship between the truce and the apparent reduction in homicides, and whether the lower rate can be sustained. As well, there are clear indications that other criminality, including extortions, continue to be unchanged or are even higher during the same time period.

Conversely, there seem to be some problems with the justice system that contribute to the crime issue. While the rule of law is not determined to be a binding constraint on its own, the aspects of this area are so intertwined with the crime and security situation in El Salvador that it should be considered as a critical component for improving citizen security. (Annex 1 Constraints Analysis).

As noted in the PFG constraints analysis, violent crime in El Salvador constitutes a substantial disincentive to economic activity. Violence likewise adversely impacts other U.S. interests in El Salvador, such as public confidence in democratic governance. Enhancing citizen security will therefore be a major Mission focus, with complementary CARSI programming and assistance providing the basic components to support the PFG framework for action.

Thus, USAID/El Salvador's work will focus on delivering assistance in two key areas: improving justice, transparency and accountability in key institutions (IR 1.1) and reducing crime and violence in targeted municipalities (IR 1.2) with the end development objective to *improve citizen security and rule of law in targeted areas*. USAID efforts will improve citizen security and rule of law by reforming targeted policies and legislation and enhancing procedural effectiveness and public service professionalism. USAID will simultaneously increase broad-based engagement in crime prevention at the local level, expand community policing in high-risk municipalities, and increase youth access to quality education. The end results expected are improved justice, transparency and accountability in key institutions, and reduced crime and violence in targeted municipalities. Both Intermediate Results depend on a sound legal framework, strong local governments, greater transparency and accountability, and civil society participation and oversight of institutions.

Non-USAID Resources

USAID's assistance in achieving DO1 is complemented by other USG agency and GOES commitments in the PFG JCAP, and by the work of other donors, civil society organizations, and the private sector. In improving justice, transparency and accountability in key institutions (IR.1.1), the GOES will implement the necessary changes in practices, policies, regulations and applicable laws, and ensure merit-based hiring of personnel within the framework of the modernization of the State, a plan under the responsibility of the Secretary for Strategic Affairs, through the Sub-secretary for Governability and Modernization. The GOES will also provide the necessary resources to implement a new civil service law, provide adequate budgetary resources for the functioning of the Institute of Access to Information, and the Access to Information Units, and fully participate in programs to support the justice sector. Department of State (DOS) will use diplomatic leverage to facilitate PFG objectives. INL will provide technical assistance to establish a vetted unit/task force to combat crimes against business, including those in the public transportation sector. The Treasury Department will provide technical support to the GOES financial regulations authorities, the Attorney General's office, and the GOES Financial Intelligence Unit in investigation of financial crimes. The Department of Justice will provide technical assistance to draft legislation and recommend strategies to establish a viable extradition process. Several other bilateral and multilateral donors also provide assistance for justice sector strengthening, including Canada, Spain, and the UNDP (See Annex 3 Other Donors Security and Tradables Projects).

For IR 1.2, USAID assistance will be complemented by the GOES' commitments to promote the establishment of a strategic partnership with the private sector to generate employment opportunities for at-risk youth, the adoption of community policing practices by senior and mid-level police and the implementation of the Police Career Law, and to implement the full-time inclusive school strategy. The GOES will identify dedicated funding to implement crime prevention plans at the municipal level and promote the decentralization of authority and responsibility for preventing crime to the municipalities. Canada, the European Union, the German Cooperation Agency for Development, the Japanese International Cooperation Agency, the Korean International Cooperation Agency, Spain, and the UNDP provide crime prevention assistance. The World Bank and the Inter-American Development Bank provide over \$100 million in loans for education and crime prevention. (See Annex 3 Other Donors Security and Tradables Projects). There are a number of local civil society organizations and private sector foundations that support crime prevention activities, including a USAID Crime Prevention Global Development Alliance with five local organizations that will leverage \$22 million from private and public sources for crime prevention activities, and a local foundation, which funds an education program, targeting at-risk youth.

Intermediate Result (IR) 1.1: Justice, Transparency and Accountability in Key Institutions Improved

Epidemic crime rates, impunity and corruption in El Salvador's justice sector diminish the legitimacy of state institutions, erode citizen security, and hamper broad-based economic growth. Fundamental institutional weaknesses with regard to investigative and organizational capacity of key justice sector agents inhibit an effective, sustainable response to criminality, and perpetuate an unfair justice system. Public perception of these institutions remains low, as the prosecution of crimes lacks transparency, efficiency or efficacy.

Impunity for domestic violence and gender-based crimes is a particular issue in the country. The Ombudsman's Office reported that the majority of the 2,660 cases of murder of women recorded from 2001 to May 2009 remained under investigation and unpunished. Data also show that, of the 2,057 cases of sexual violence, more than 58 percent were provisionally or definitively dismissed. These are challenges to the country's consolidation of democratic governance and human development.¹¹

Under this IR, USAID will support the PFG JCAP goals to improve the effectiveness of the criminal justice procedures and practices and strengthen justice/security sector institutions. USAID will provide technical assistance to promote increased coordination between justice sector agents and institutions, and to improve the management and investigative capacity of the Attorney General (AGO), Public Defender (PGR), National Civilian Police (PNC), forensic services, judges and court personnel. Interventions will also help professionalize El Salvador's civil service, and enhance public confidence in the government.

¹¹ Report of the Special Rapporteur on violence against women, its causes and consequences, Rashida Manjoo, United Nations Human Rights Council, 14 February 2011

An independent, well-functioning, transparent and unified justice sector will reduce impunity, act as a deterrent to crime and improve citizens' trust in its institutions. By improving key justice sector institutions and enhancing the capacity of justice sector personnel, USAID expects to see marked improvements in the transparency, accountability and effectiveness of the justice sector. USAID programming will seek to promote reform in targeted policies and legislation (Sub-IR 1.1.1) in order to help create the structure in which transparency and accountability can thrive, while supporting GOES efforts to promote public policy reform with a gender focus and incorporating women-based civil society organizations in consultations. However, to ensure the effectiveness of structural reform, USAID will also work to enhance procedural effectiveness and public service professionalism (Sub-IR 1.1.2) in the justice and other relevant sectors. Through this approach of combining structural and implementation reform, improvements in performance will be both meaningful and sustainable.

Sub-Intermediate Result (Sub-IR) 1.1.1: Targeted Policies and Legislation Reformed

While the basic institutions for democratic governance exist in El Salvador, key initiatives that help promote ethical behavior and transparent decision-making remain in progress. USAID's work in this area seeks to improve public confidence in key government institutions by helping create essential reforms in collaboration with key GOES institutions and actors.

Targeted reforms/actions under this Sub-IR will include the promotion of merit-based hiring in the civil service, improvement of the Access to Information Law, and implementation of a recently reformed code of ethics, all of which are specific actions in the PFG JCAP. USAID will also promote the involvement of the private sector in the fight against corruption by promoting the adoption of integrity pacts and a code of ethics, as well as the development of partnerships with civil society organizations to advocate for access to information, transparency and anti-corruption.

Security in the public transport sector is another major PFG line of action. Through CARSI-funded programming, USAID will promote the adoption and implementation of transparency mechanisms in the public transport sector, while the GOES and other USG organizations address physical security of those using public transportation. Resolving the security problem associated with public transportation will also enhance the public's confidence in the government and contribute to increased economic productivity, as the majority of El Salvador's work force uses public transportation.

Sub-Intermediate Result (Sub-IR) 1.1.2: Procedural Effectiveness and Public Service Professionalism Enhanced

To ensure that the structural policy improvements under Sub-IR 1.1.1 have their intended effects, effective implementation guidelines and procedures need to be combined with personnel training to promote sustained compliance. USAID activities will contribute in particular to the professionalization of justice sector public service, and the improvement of judicial and investigative procedures.

Interventions will establish mechanisms and a legal framework for increased transparency within the judiciary, and improved capacity to monitor accountability of public officials. These include improved management and administration of justice sector institutions and increased effectiveness of criminal investigations (including proper forensic testing) in order to reduce rates of impunity in violent crimes. Greater transparency in the selection of judges and better controls to reduce the incidence of corrupt judges will result in more effective criminal justice and in greater credibility in the judiciary, prompting more citizens to report crime.

One important focus of justice sector reform activities will be to reduce levels of impunity and promote fairness in the treatment of cases involving gender-based violence.¹² USAID activities include the creation of victims' assistance centers to provide support and legal advice to victims of domestic and sexual violence nationwide, the establishment of a specialized justice of the peace court that will handle sexual and domestic violence cases, and the creation of a rape crisis center to support victims. USAID's justice sector projects will also provide specialized assistance for victims for personal recuperation, and for collecting scientific evidence to prove their cases. Technical assistance and training will strengthen the capacity of the justice sector system to better handle gender-based violence and reduce impunity.

Intermediate Result (IR) 1.2: Crime and Violence in Targeted Municipalities Reduced

Criminality in El Salvador is a complex social phenomenon that reflects a history of both social exclusion and the use of violence to resolve social and political conflicts. These conditions have been exacerbated in recent years by the absence of economic opportunity - especially for young people - and the social disorganization that has resulted from decades of massive out-migration, notably to the United States, and increasing deportations. In many high crime municipalities, youth have little access to quality education or vocational training, and few alternatives to gang membership. A poorly-trained police force, operating under an antiquated model of reactive policing, and with little meaningful connection to the communities it serves, has had little impact on crime. The lack of meaningful cooperation between the police and local communities is a fundamental obstacle to reducing crime and violence.

In support of the PFG JCAP, USAID activities will support a comprehensive approach to crime and violence prevention, focusing on municipalities which have been identified by the GOES as having high crime rates. Activities include the establishment/support of crime prevention councils, particularly promoting citizen participation on these councils, in high crime municipalities, and mobilizing local organizations and leveraging the private sector through public/private partnerships for crime prevention (Sub-IR 1.2.1); replicating a successful community policing model tested under a previous USAID project (Sub-IR 1.2.2); and providing education and skills training, and business creation and job placement for at-risk youth, (both boys and girls), (Sub-IR 1.2.3).

¹² Gender Assessment USAID/El Salvador (2010) found that gender-based violence is the principle issue of the government's Institute for Women, donor organizations active in gender and development, and women's advocacy non-governmental organizations (NGOs).

Through these measures, it is expected that fewer youth will join gangs, crimes will be reported, and evidence brought to the attention of authorities in a more timely and effective manner, and violence and crime will be reduced.

Sub-Intermediate Result (Sub-IR) 1.2.1: Broad-based Engagement in Crime Prevention Efforts at the Local Level Increased

Under this Sub-IR, USAID will support municipal-led crime and violence prevention efforts that foster effective partnership between the communities and local authorities, government institutions, observatories, civil society and the private sector. USAID will work with targeted high crime municipalities to develop crime prevention councils and observatories. USAID assistance will provide support to the GOES to implement the National Strategy for Social Violence Prevention in Support of Municipalities, and to improve the national policy framework for crime and violence prevention by supporting emerging laws and policies, and assisting with the establishment and/or strengthening of municipal crime prevention observatories that collect and provide data on crime, including crimes against women. In addition, USAID will place an equally large focus on private sector engagement, involvement, and encourage increased private sector investment in crime and violence prevention. USAID will also produce pertinent and highly needed state of the art research in key areas that have yet to be sufficiently explored and are key to crime prevention policy decision-making.

Sub-Intermediate Result (Sub-IR) 1.2.2: Community Policing in High-Risk Municipalities Expanded

Activities under this Sub-IR will build upon the evidence and successes gained in former USAID community policing projects. In the areas where community policing has been recently implemented, murder rates decreased 27 percent and robbery rates decreased by 33 percent, while confidence in the police increased. With CARSI assistance, USAID will provide assistance for the roll out of the community policing model in additional high crime municipalities, and support the National Civilian Police (PNC) in its effort to become a more community-oriented model of operation. USAID will identify and support leaders in the institution that are working towards a cooperative and productive relationship with citizens. Activities will focus on management policies and practices, professional development, and awareness training. USAID will also promote collaboration between the PNC, municipal officials, and community organizations to draft security action plans to tackle crime problems.

Sub-Intermediate Result (Sub-IR) 1.2.3: Youth Access to Quality Education Opportunities Increased

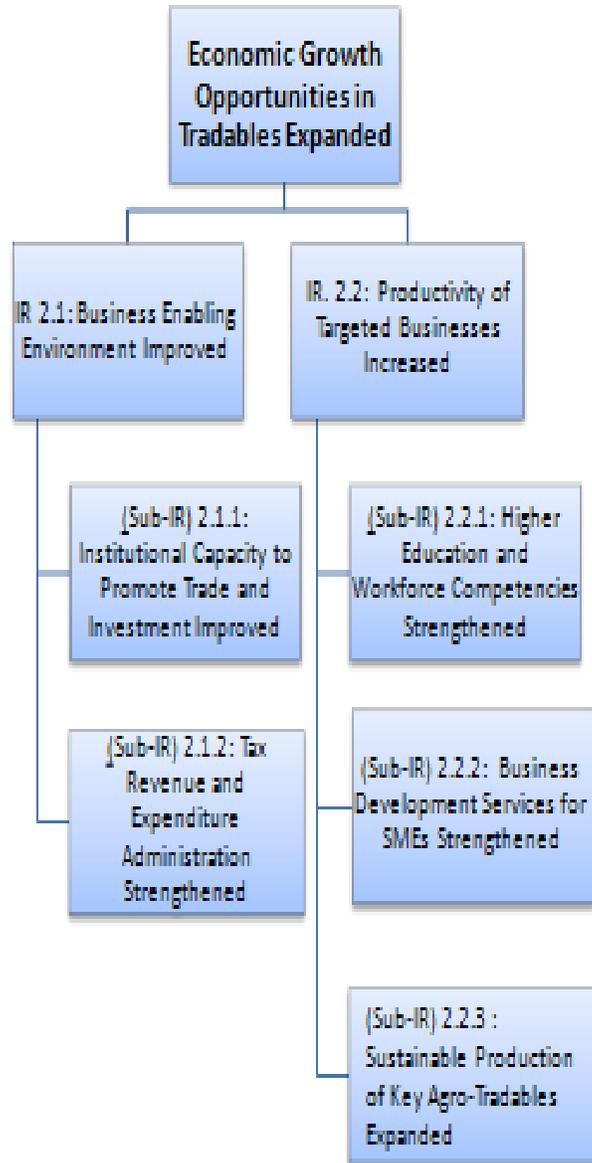
In support of the PFG JCAP, USAID activities under this Sub-IR will improve educational opportunities for vulnerable, disadvantaged boys and girls in lower secondary school (grades 7-9), and out-of-school youth, ages 12-24, living in selected municipalities with high crime rates. Interventions will support the Salvadoran Ministry of Education (MOE) to expand the Full Time Inclusive School approach, improve student transition to lower secondary education, support teacher development, and promote violence prevention in schools. This is particularly important given recent trends in 2012 of more girls dropping out of public schools due to security

reasons.¹³ USAID aims to reintegrate youth back into a formal school setting, or to provide an equivalent primary or secondary school diploma. Activities will also provide youth vocational training linked with local labor market demand. Other activities include engaging and encouraging youth to continue their education through community-based programs, providing academic reinforcement focused on literacy, math, and basic skills to out-of-school youth through after-school programs, and life skills training (e.g., team building, effective communications, conflict resolution and leadership).

By increasing access to education for children and youth living in areas of high violence and crime, and by assisting community-based organizations and local authorities to provide out-of-school youth with vocational skills, USAID will prepare youth for productive alternatives to criminal gang activity. As a result of these interventions, it is expected that rates of crime and violence will be decreased in the targeted communities.

¹³ From a survey conducted by MINED in 2012 on school enrollment rates at public and private schools.

FIGURE 3 – DEVELOPMENT OBJECTIVE 2: RESULTS FRAMEWORK GRAPHIC



DEVELOPMENT OBJECTIVE 2: ECONOMIC GROWTH OPPORTUNITIES IN TRADABLES EXPANDED

The Partnership for Growth (PFG) Constraints Analysis considered a vast array of economic sectors and subsectors before concluding that the most critical economic constraint to El Salvador's growth is low productivity in the country's tradables sector. Tradables are defined as those goods and services which are or can be traded internationally and whose prices are set on world markets. El Salvador's share of tradables as a percent of GDP declined from 45 percent to 40 percent since 1990, and has consistently been below the average for both middle-income and lower-income countries. El Salvador is missing eight percentage points of potential GDP compared to CAFTA colleagues due to the productivity constraint in tradables. "Low productivity and accompanying relative lack of competitiveness in international markets dampens the possibility for a structural transformation and accompanying growth acceleration in El Salvador, where the growth potential of the non-tradables sector is limited by the small size of the country." (Partnership for Growth: El Salvador Constraints Analysis 2011, 4)

RESULTS: ECONOMIC GROWTH

By 2017, USAID will have improved the business enabling environment, and productivity of targeted SMEs in the tradables sector.

Recent global economic indices reports show that El Salvador continues to fall compared with other countries. The World Bank's "Doing Business" index shows a decline in ranking from 84 in 2010 to 113 in 2013, and the World Economic Forum's Global Competitiveness index shows El Salvador dropped in ranking from 77 in 2009 to 104 in 2013.

The PFG Constraints Analysis indicated that the issues limiting El Salvador's productivity in tradables are factors of productivity-- physical capital (infrastructure), human capital, and financial capital—and the institutional environment in which tradables firms operate. Based on this analysis, the goals of the PFG JCAP with the GOES that address low productivity in the tradables sector include: improving the business enabling environment to spur private investment, competitiveness, and export potential; investment in infrastructure to reduce production costs; improving the quality of the education system in order to create a more highly qualified and technologically skilled labor force; strengthening tax collection and the efficiency and transparency in the use of public resources; and improving production innovation and quality of tradables, with a focus on the international market.

Under the Development Objective, Economic Growth Opportunities in Tradables Expanded, USAID will contribute to achieving the PFG goals that address the tradables constraint by improving the business enabling environment, strengthening tax collection and transparency, (IR 2.1: Business Enabling Environment Improved), and increasing the productivity of Salvadoran businesses, through a more highly skilled workforce, business development services for Small and Medium Enterprises (SMEs), and expanding productivity of natural resource-based industries (IR 2.2: Productivity of Targeted Businesses Increased). The JCAP also cautions that investments under the PFG effort need to be made with full acknowledgement of El Salvador's vulnerability to natural disasters and the effects of global climate change. Within the DO and

across both IRs, USAID will work to increase resiliency to economic and climatic impacts by strengthening GOES capacity and local efforts to promote climate change adaptation, in the sustainable production of agro-tradables.

The environment in which businesses function is a key determinant of overall productivity. A supportive and secure environment boosts confidence and thus attracts investment (both foreign and domestic). Positive business environments also reduce the costs of doing business and directly enhance the relative competitiveness of firms. El Salvador's poor economic performance is driven in part by a rift between the government and the private sector that has created an unstable investment climate.

In support of PFG, USAID/El Salvador enabling environment reforms will include specific efforts to build public capacity to promote trade and investment (sub-IR 2.1.1), and improve the collection and expenditure of public funds (sub-IR 2.1.2).

The focus on SMEs is also a key strategic choice. SMEs in El Salvador represent over 70 percent of total employment,¹⁴ and are the drivers of innovation and job creation.¹⁵ Fifty percent of SMEs are female-owned (as self-employment).¹⁶ At the same time, SMEs face the most severe credit and productivity constraints and are often those most impacted by economic and climatic events.¹⁷

USAID/El Salvador will also improve SME productivity through higher education and workforce development (sub-IR 2.2.1), and by strengthening business development services, including greater access to credit, for SMEs (sub-IR 2.2.2). Exportable agricultural commodities are a sector of the economy that offer El Salvador an opportunity to expand its tradables sector (sub-IR.2.2.3).

The PFG Constraints Analysis identified the restrictions inhibiting all sectors, without recommending specific products or services. As outlined in the PFG, the issues limiting El Salvador's productivity in tradables are factors of productivity – physical capital (infrastructure), human capital, and financial capital – and the institutional environment in which tradables operate. USAID's contribution will lead to an improved business enabling environment that

¹⁴ Dirección General de Estadísticas y Censos, "*Encuesta Económica de El Salvador 2011-2012*"; DIGESTYC, San Salvador 2012. <http://www.digestyc.gob.sv/index.php/servicios/descarga-de-documentos/category/46-presentaciones-encuestas-economicas.html>

¹⁵ Economic National Directory (2011) Ministry of Economy

¹⁶ Calculations based on the Multiple Purpose Household Survey 2010, DIGESTYC, San Salvador, 2010.

¹⁷ International Finance Corporation, "*Guía informativa de banca PYME*", IFC, Washington D.C., 2009, http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/282884-1279136526582/FINAL_SPANISH.pdf; World Economic Forum, <http://reports.weforum.org/global-agenda-council-2012/councils/disaster-management/>

spurs private investment, competitiveness, and export potential. Specifically, USAID's interventions will help to address the following PFG Tradable Goals:

- #2: Reduce firm's costs due to infrastructure to improve their competitiveness;
- #3: Improve the quality of the education system in order to create a more highly qualified and technologically skilled labor force;
- #4: Raise (net) tax revenues to 16 percent of GDP by 2015 and use public resources efficiently and transparently;
- #5: Support a strategy for attracting and promoting FDI and making El Salvador a more attractive place for foreign investment;
- #6: Surmount low productivity of tradables by transforming factors of production of the tradables sector through implementation of strategies to improve innovation and quality, and a focus on the international market.

Illustrative tradables identified by private sector organizations and public institutions, which could grow in export markets and thus contribute to expansion of the economic activity of El Salvador include: coffee and cacao in the agro-industry sector; food and beverage processing, chemical and pharmaceutical, paper and graphic printing, plastics, textile, and handcrafts in the manufacturing sector; and tourism, information technology and communications, financial and professional services in the service sector. Additional tradables may be highlighted as the new GOES administration takes office in 2014, the private sector identifies new economic trends and opportunities in global markets, and as progress on specific tradables is achieved.

Non-USAID Resources

USAID's assistance in achieving DO2 is complemented by other USG agency and GOES commitments in the PFG JCAP, and by the work of other donors, civil society organizations, and the private sector.

To improve the business enabling environment (IR: 2.1) the GOES established a Growth Council with the objective of identifying and removing bottlenecks to growth and facilitating a climate of trust, communication, and collaboration between the government and the private sector. The GOES will also develop and implement a strategy to address the causes and barriers that have kept investors from setting up operations in El Salvador and strengthen PROESA's institutional capacity to develop and implement an investment promotion strategy. To increase tax revenues, the GOES will improve information systems and taxpayer databases, and transparency and efficiency in the use of public resources. Department of State (DOS) will use diplomatic leverage to facilitate PFG objectives, including the support of the Growth Council. The Department of Commerce (DOC) will complement work under this IR by strengthening the Growth Council's analytical and advisory function and broadening private sector involvement. The DOC will also provide technical assistance to improve customs administration. Other bilateral and multilateral donors working in improving the business enabling environment include the European Union and Japan (See Annex 3 Other Donors Security and Tradables Projects). A number of civil society and private sector organizations are actively involved in advocating for, and promoting an improved business climate at the national and municipal level.

The GOES contribution to increasing business productivity (IR 2.2) includes a number of infrastructure projects to improve competitiveness such as the modernization and expansion of El Salvador's International Airport and a specialized multi-terminal container port at the port of La Union. The GOES will also promote a regulatory framework for renewable energy. To create a more highly qualified and technologically skilled labor force, the GOES intends to improve the quality of El Salvador's education system and develop an education and employment plan for youth and women, including a scholarship program. The GOES will focus on innovation and technological development in priority tradables sectors for the Salvadoran economy, and create an integrated system to serve SMEs seeking to export. The U.S. Treasury Department will provide technical assistance to the GOES to complete a concession agreement for the La Union Port, for the modernization of the international airport, and for knowledge transfer in developing cleaner energy sources. Other donors contributions to achieving this IR include the European Union, Italy and Japan, and a \$60 million Inter-American Development Bank (IDB) loan to increase competitiveness and exports. (See Annex 2 Other Donors Security and Tradables Projects). USAID will build on the success of GDAs in El Salvador to expand partnerships with local organizations and private businesses to leverage additional resources for workforce and SME development.

Intermediate Result (IR) 2.1: Business Enabling Environment Improved

El Salvador ranks last among Central American countries over the past five years in attraction of foreign direct investment, and is the only country in the region currently experiencing a decline in absolute foreign direct investment (FDI) levels. El Salvador's failure to attract higher levels of FDI stems from a combination of institutional, regulatory and political factors. The GOES' investment and export promotion agency, PROESA, provides inadequate levels of support to potential investors. The GOES has also been slow, relative to its neighbors, to offer and communicate attractive fiscal and regulatory incentives to investors. The private sector complains that the Salvadoran regulatory environment for business development is overly complex and the tax collection system inefficient and non-transparent. El Salvador's decline in various international rankings of the ease of conducting business (such as the International Finance Corporation's Doing Business Index), reflect this sentiment. As the business environment sets the stage for robust economic growth driven by the private sector, USAID will work with the GOES at the central and municipal level, and with the private sector to spur private investment, competitiveness, and export potential (Sub IR 2.1.1). Similarly, the efficient collection of tax revenues at the central and municipal levels and well-planned infrastructure investment help create an environment that attracts investors and facilitates business opportunities. USAID will provide technical assistance to improve tax administration, optimize processes, and promote greater transparency to reduce evasion and avoidance. The Domestic Finance for Development (DF4D) will enhance municipal governments' capacity to collect tax revenues while promoting transparency (Sub-IR 2.1.2).

Sub-Intermediate Result (Sub-IR) 2.1.1: Institutional Capacity to Promote Trade and Investment Improved

Municipalities in El Salvador represent the first level of citizen participation and business interaction with the public sector and are crucial to the process of improving the business

environment. USAID will help attract trade and investment in targeted municipalities by providing technical assistance and training to improve municipal administration and service delivery capacity. This Sub-IR is designed to build the sustainable institutional capacity of local governments and local organizations to identify and solve problems that hinder local economic development.

Specifically, activities will support the creation of Municipal Competitiveness Councils, the development of economic action plans, and the elaboration of a Municipal Competitiveness Index. The index ranks municipalities based on transparency, quality of services, timeliness and cost of regulatory compliance, public safety initiatives, tax and fee structures, and business start-up procedures. Investing in municipal one-stop windows for business start-ups and other services will facilitate economic activities and streamline start-up processes, thus reducing time and costs. Municipal government transparency pacts with civil society and the private sector will generate an environment of trust and confidence for doing business. USAID will promote public-private dialogue to encourage local investment and business opportunities in the targeted municipalities. USAID will train women in topics such as entrepreneurship, competitiveness and leadership, to increase participation and leadership in local government and business. USAID will also identify and reach out to businesswomen's associations and professional networks, and other women's groups to strengthen business capabilities and to ensure women's involvement in Municipal Competitiveness Councils and in the elaboration of economic development plans.

At the national level, USAID will offer programs of institutional strengthening to the Ministry of Economy and PROESA in trade and investment facilitation, and to develop an export strategy that promotes innovation and quality. USAID plans to support the Ministry of Environment in the reform and streamlining of the Environmental Impact Assessments (EIA) process, one of the biggest constraints cited by investors.¹⁸ Activities will provide technical assistance for the passage and implementation of the GOES' package of investment promotion legislation, including public-private partnership legislation.

Sub-Intermediate Result (Sub-IR) 2.1.2: Tax Revenue and Expenditure Administration Strengthened

Transparent and efficient tax revenue collection at the central and municipal level provides the potential for effective and well planned public investment to facilitate business. USAID will help the GOES strengthen tax revenue and expenditure administration, and to engage in pro-growth fiscal policies through key investments and transparent fiscal management practices. USAID projects will support the GOES to improve tax compliance and fortify fiscal solvency by building capacity and improving systems for public expenditure management, tax revenue mobilization, and private sector engagement. Technical assistance to the GOES will help modernize budgeting and expenditure management systems, improve audit techniques, strengthen enforcement, and build capacity for multi-year results-oriented budgeting, including

¹⁸ Fundación Salvadoreña para el Desarrollo Económico y Social (FUSADES) *"Encuesta de Dinámica Empresarial, IV trimestre 2011"*. San Salvador, 2012

the incorporation of a single treasury account system. USAID will also help promote tax policy analysis and reform.

Activities will also support municipal tax and budgeting transparency through interventions that improve the administrative capabilities of local governments and support the development of efficient procedures for business registration and permits. Through the Domestic Finance for Development (DF4D) Challenge Fund, USAID will promote increased tax collection and the transparent use of public resources through accounting system improvements and the creation of Municipal Information Units.

The expected end results are increased tax revenue that will lead to increased public investment in infrastructure and social sectors. Increased investment in these areas will improve factors for increased productivity (physical capital, human capital and financial capital) and also contribute to economic growth (e.g., by reducing transportation costs and by promoting a healthier, better educated workforce), particularly benefitting women who have traditionally had more limited access to these types of assets and services.

Intermediate Result (IR) 2.2: Productivity of Targeted Businesses Increased

Salvadoran firms face a variety of obstacles to achieving higher levels of productivity and enhancing their competitiveness in international markets. The challenges are particularly difficult for the SMEs that account for 70 percent of all formal sector employment. A weak basic education system hinders human capital development, and secondary and higher education institutions fail to graduate students with marketable skills to meet labor market demands. Many Salvadoran SMEs are unfamiliar with international markets and have difficulty meeting standards of quality required to export. Innovation is lacking throughout the Salvadoran economy.

As outlined in PFG, USAID will seek to enhance the competitiveness of Salvadoran firms, especially SMEs and those led by women entrepreneurs, through an integrated strategy of work force enhancement, targeted assistance to firms seeking to access international markets and fully leverage markets created by CAFTA-DR, and improved access to financing through DCA loan guarantees. Tertiary education curricula and training programs will be designed to improve workforce competencies (Sub-IR 2.2.1) to match private sector labor demands and to facilitate new, innovative business development. Helping the GOES and the private sector improve the effectiveness of business and export development services to SMEs (Sub-IR 2.2.2) will increase productivity and competitiveness in international markets. USAID assistance to expand natural resource-based tradables will provide new economic opportunities for SMEs through activities that will also mitigate the impacts of climate change. (Sub-IR 2.2.3).

USAID will encourage linkages between Higher Education Institutions (HEIs) and the private sector to promote productivity for tradables. For example, HEIs may implement research activities such as an academic review of expired patents to develop new and updated plastic packaging products for the plastic industry. In addition, a data base of private sector challenges could detail opportunities for HEI's applied research programs to improve industry efficiency and productivity.

Similarly, USAID will encourage alliances in workforce development with the private sector to provide job training and improve basic competencies to allow beneficiaries to compete for private sector employment. USAID may provide specific technical training for tradables in the service sector such as airplane maintenance services for the aeronautical services cluster of El Salvador.

Criteria for Selection of Specific Tradables

Industries with annual growth exceeding the national annual GDP growth of 3.4 percent could have positive future potential for USAID support. Of those 19 industries, six are basic agricultural products which are tradables, but they do not require a high level of productivity because El Salvador's advantage is largely determined by natural resource endowments. Many of the other sectors are either non-tradables (transportation and storage, for example) or tradables of basic goods (basic metal and processed products). One significant exception to this is the growth in the maquila industrial services. (PfG Constraints Analysis, page 141). See Annex 3 which shows the average annual growth rate by sector, 1990-2009 (PfG Constraints Analysis, page 142).

Under this IR, USAID/El Salvador will support SME's capacity to produce innovative and more competitive tradable products and services for international markets. Illustrative tradables in the agro-industry sector may include: coffee, cacao, processed food and beverages, including dairy products. Illustrative tradables in the manufacturing sector may include: pharmaceuticals, organic/inorganic chemicals, handcrafts, paper and cardboard packaging, and plastic containers. Illustrative tradables in the service sector may include: tourism, information technology and communication, and financial and professional services. The efforts above will be focused on developing or improving competitiveness in the tradables sector.

Sub-Intermediate Result (Sub-IR) 2.2.1: Higher Education and Workforce Competencies Improved

USAID will bolster the Salvadoran labor market through quality higher education, and job training programs that align workforce skills (both men and women) with productive sector needs and promote innovative business expansion.

In 2012, USAID conducted an assessment that analyzed the needs, constraints, and opportunities of higher education in El Salvador. Based on the assessment, USAID will build the institutional capacity of Higher Education Institutions (HEIs), and strengthen university human resources to provide educational programs and research that contribute to the country's economic growth. Activities will strengthen the institutional capacity and effectiveness of HEIs and official entities, such as the Higher Education Council, Accreditation Commission, and the Ministry of Education's Higher Education Directorate to address broader policy reforms that are needed to bring relevance to the higher education system.

USAID will also continue working with employers and institutions dedicated to workforce training and professional education to develop industry standards in the skills and competencies

needed by private industry or to start a business. Activities will expand career counseling and internship programs with private business to create a system that provides both male and female students, and workers opportunities for job placement. USAID will also improve the quality of education offered by technical and vocational training centers, by providing relevant labor market information in order to plan adequate policies and programs. USAID will build on successful GDAs that leveraged private sector resources for vocational training, job placement, and small business development.

Gender equality is a particularly essential element of workforce development activities in El Salvador. USAID will provide beneficiaries, particularly women entrepreneurs, with special business skills through the implementation of workshops and technical assistance. Special emphasis will be placed on incorporating women heads of household into the labor force. USAID will also continue to provide training and opportunities to people with disabilities to meet private sector requirements.

Activities will also focus on youth from vulnerable neighborhoods in need of employment to support their families, through a national internship bridge program for college students with no prior work experience, and an at-risk youth initiative to provide training for entry-level positions. The Mission will explore opportunities to expand student loan programs through DCAs and U.S. university tuition waivers.

Sub-Intermediate Result (Sub-IR) 2.2.2: Business Development Services for SMEs Strengthened

Business development services ideally bring together public institutions and private entities to provide businesses with tools and information to facilitate business creation and operation. USAID will help the GOES and the private sector improve the effectiveness of their business and export development services to help SMEs become more productive and competitive. USAID will work directly with the Ministry of Economy and its ascribing institutions, including the National Commission for Micro and Small Enterprise (CONAMYPE), PROESA, the Ministry of Environment, the Ministry of Agriculture, as well as private sector organizations.

USAID assistance will support the establishment of small business development centers in targeted municipalities, which are a particularly useful way to extend access to business services locally to female entrepreneurs. USAID recognizes the importance of incorporating women head of households (35 percent of total) into the labor force because these households generally have a larger proportion of persons that do not work (children and elders), and incomes are generally inferior to those with male heads of households, as female heads of household more frequently accept underpaid jobs.¹⁹ In El Salvador, women-led businesses play an important role in the country's economic and social development as the income they generate provides food, education and healthcare for their families. However, few programs exist to provide these women the entrepreneurial training or mentoring required to ensure their success. USAID will provide women technical assistance and training to start, improve, or expand their businesses,

¹⁹ Salvadorian Institute for Women Development (ISDEMU, by its acronym in Spanish), Newsletter No. 27, San Salvador, 2008

and to take advantage of the opportunities provided by global trade. Activities will leverage other resources, and work with foundations and/or NGOs to further support women-owned SMEs.

Moreover, USAID will provide technical assistance, training, institutional strengthening, and information technology to key GOES counterparts to help SMEs seeking to export or expand their trade capacities. Activities will also help small and medium enterprises improve productivity and to develop innovative product strategies to create value-added products for export. USAID will help establish linkages and alliances with private sector organizations to identify business opportunities for SMEs and develop their abilities to consistently secure sales of their tradable products and services. Productive partnerships with private sector organizations will be established to facilitate transactions, ensure technology transfer and innovation, and ultimately increase sales and employment for SMEs.

USAID also implements a financial sector activity to improve the financial systems, methodologies, tools and products appropriate for micro, small and medium firms. DCA loan guarantees will provide greater access to loans for SMEs. In addition, to facilitate banking and loan repayments, USAID, in coordination with the Central Reserve Bank and the Superintendence of the Financial System of El Salvador, will design norms and regulations that support mobile banking in the country. This work to improve SME access to credit will help alleviate one of the key impediments to business development for SMEs, and will be a key component of building financial resiliency within small firms.

Sub-Intermediate Result (Sub-IR) 2.2.3: Sustainable Production of Key Agro-Tradables Expanded

El Salvador's economy in recent years has failed to grow as a partial result of lagging production of key tradables, including exportable agricultural commodities, even though 74 percent of Salvadoran territory is used for agricultural purposes.²⁰ Expansion of production requires not only the diversification of high-value exports, but adoption of sustainable production methods given the fact that El Salvador is consistently identified as one of the most vulnerable countries in the world to natural disasters. With global climate change, each recent decade has brought increasingly devastating storm events that have eroded hillsides and led to the loss of crops and topsoil, as well as downstream economic infrastructure. As unemployment and poverty rates have risen sharply in the past seven years, rural Salvadorans are increasingly depending on agricultural production for subsistence and livelihoods, and are increasingly deforesting the small amounts of remaining indigenous wooded lands to cultivate steeper slopes with marginal soils.

USAID's support for shade-grown coffee, which helped turn around that sector from the collapse of the late 1990s, through a focus on high-altitude canopy grown coffee, is an important model for sustainable farming systems. Today, half of all forestry canopy in El Salvador is coffee plantations – not only does the canopy protect steep mountain slopes, but has been an important factor in protecting numerous bird species and other biodiversity. And coffee remains the

²⁰ National Biodiversity Strategy, Ministry of the Environment, June 2013.

country's largest agricultural export earner, although the outbreak of coffee rust in El Salvador will negatively impact the livelihoods of thousands of Salvadorans for several years as the GOES and international donor work in partnership to eradicate this disease.

In support of this sub-result, USAID will consider public-private partnerships, including possible revitalization of the sustainable production of cocoa – another canopy crop--in lower altitude areas of El Salvador including already identified target areas for climate change adaptation. Through partnerships with such groups as the Buffett Foundation, the Ministry for the Environment (MARN), the Millennium Challenge Corporation, and local cooperatives, USAID would take on specific technical and institutional capacity building roles to ensure that this sub-sector program meets GCC sustainable adaptation targets and reaches the planned 10,000 small farmers who would undertake cocoa production. Large-scale canopy-grown cocoa, beyond raising rural incomes and providing an exportable tradable, would also create a new environmental habitat for birds and other biodiversity at lower altitudes.

USAID will also promote the sustainable production of other agro-tradables, including through agro-forestry and associated intercropping and by addressing the challenges of coffee rust. The focus of efforts under IR 2.2.3 will also concentrate on adaptation issues vis-à-vis specific agricultural tradables. While the focus is on the creation of a more conducive operating environment for tradables, such as coffee and cacao, (not the country as a whole), the specific ways in which climate change affects these commodities will be articulated and programming will be targeted to address those vulnerabilities. Increased cultivation of tree crops will reduce the trend toward deforestation and soil erosion. USAID's role will be to work with MARN and other government counterparts, providing capacity building, and maximizing the involvement of local organizations for implementation – a current GOES plan.

The identification of target sites would also include the criteria of rural poverty, youth marginalization and crime, and the activities would be expected to generate employment that would provide alternatives to youth joining gangs.

III. MONITORING AND EVALUATION

Overview and Rationale

Monitoring and Evaluation (M&E) are the processes by which the Mission can understand how its interventions are affecting the country and make any necessary course corrections during the period of the strategy. Monitoring includes the definition of indicators at each level of the Results Framework (RF) in order to check progress made through projects and activities. This monitoring becomes a tracking mechanism to influence future program and project design and implementation to optimize resource use for the best expected results.

Monitoring efforts will persistently seek to verify the progress of specified indicators as well as the causal linkages to higher levels within the RF. This involves the rigorous, consistent and timely collection of indicator data, as well as regular consultation with stakeholders and implementing partners. Timeliness and the establishment of solid channels of communication are essential in order to ensure the ability to make adjustments and course corrections before projects reach an end.

In addition to monitoring, the Mission also has plans to use evaluations to make periodical checks on the performance of its interventions and results to date to determine if and how they are contributing to gains noted through monitoring of RF indicators. Evaluations will be used to identify what is working and why in order to make optimal use of resources for the greatest changes in the country. These evaluation results will be rolled up into planned PFG mid-term and final evaluations.

The overall Mission plan for Monitoring and Evaluation thus engages a feedback CLA (Collaboration, Learning and Adapting), mechanism consisting of three key elements:

- *Collaboration*: Establishing systems and networks of reporting and communication between mission staff and appropriate stakeholders
- *Learning*: monitoring indicators, generating systems for data analysis, assessing progress through the lens of the development hypothesis.
- *Adapting*: utilizing evidence to enhance program and project management and performance to strengthen results.

High-level Indicators and Evaluation Questions by Development Objective

USAID/El Salvador will track progress towards the CDCS objectives through the following high-level indicators and will evaluate program impact based on the following evaluation questions:

A. Portfolio wide evaluation question:

How have USAID activities contributed to addressing the binding constraints to economic growth identified in the Partnership for Growth?

B. GOAL LEVEL INDICATORS: Broad-Based Economic Growth in a Secure El Salvador Expanded

Custom Indicator: Index of crime affecting economic activity in El Salvador

PFG Indicator: Percentage of overall Gross Domestic Product (GDP) Growth

C. DO1: Citizen Security and Rule of Law in Targeted Areas Improved

Custom Indicator: Perception of community safety [disaggregated by sex]

Custom Indicator: Public satisfaction with the performance of justice and security institutions [disaggregated by sex]

Custom Indicator: Corruption Perception Index Score

IR 1.1: Justice, Transparency and Accountability in Key Institutions Improved

Custom Indicator: Percentage of citizens expressing confidence in the Justice system in USG supported areas [disaggregated by sex]

Custom Indicator: Number of criminal cases resolved through conviction or alternative dispute processes

Sub 1.1.1: Targeted Policies and Legislation Reformed

Custom Indicator: Number of policies and laws promoted

Custom Indicator: Number of non-judiciary public officials trained in ethics and government ethics laws [disaggregated by sex]

Sub 1.1.2: Procedural Effectiveness and Public Service Professionalism Enhanced

Indicator GNDR-6: Number of people reached by USAID funded interventions providing gender based violence services [disaggregated by sex and age]

CARSI Indicator: Number of justice sector personnel that received USG training [disaggregated by sex]

Custom Indicator: Number of transparency and accountability initiatives promoted with USG assistance

Custom Indicator: Number of Access to Information Law requests fulfilled

IR 1.2: Crime and Violence in Targeted Municipalities Reduced

Custom Indicator: Incidence of selected violent crimes in targeted municipalities, including domestic violence, rape and murder [disaggregated by sex]

Sub 1.2.1: Broad-based Engagement in Crime Prevention Efforts at the Local Level Increased

Custom Indicator: Number of municipalities with crime prevention councils

Custom Indicator: Number of action plans developed

Sub 1.2.2: Community Policing in High-Risk Municipalities Expanded

Custom Indicator: Number of municipalities implementing community policing programs

CARSI Indicator: Number of communities with police/citizen groups

Sub 1.2.3: Youth Access to Quality Education Opportunities Increased

Custom Indicator: Enrollment rate in secondary schools in high risk municipalities [disaggregated by sex and age]

Custom Indicator: Number of municipalities offering education programs for at-risk youth

Performance and Impact Evaluation Questions for DO1

1. How have anti-corruption and transparency initiatives been institutionalized or operationalized in GOES processes?
2. To what extent did program activities increase equitable access to educational opportunities for participating in-school and out of school youth in targeted municipalities?
3. To what extent have municipal leaders and community members' capacity for prevention, planning, implementation, and analysis changed?
4. To what extent have women and men participated differently in crime prevention efforts?
5. How has access to justice sector services for women changed because of program implementation?
6. To what extent have different crime prevention implementation models produced similar or different results in targeted municipalities?
7. Has the provision of educational opportunities to youth resulted in less participation in criminal activities?

D. DO2: Economic Growth Opportunities in Tradables Expanded

Custom Indicator: Percent change in the value of non-traditional and service exports

IR 2.1: Business Enabling Environment Improved

Custom Indicator: Private sector perception of business climate

Custom Indicator: Percent change in the number of exporting firms as a result of USG assistance

Sub 2.1.1: Institutional Capacity to Promote Trade and Investment Improved

Custom Indicator: Number of municipalities that have simplified administrative procedures in business registration as a result of USG assistance

Custom Indicator: Number of firms receiving trade capacity assistance

Sub 2.1.2: Tax Revenue and Expenditure Administration Strengthened

Custom Indicator: Change in total tax collection as a percentage of GDP as a result of USG assistance

Custom Indicator: Number of people receiving training in fiscal policy and fiscal administration supported by USG assistance [disaggregated by sex]

IR 2.2: Productivity of Targeted Businesses Increased

Custom Indicator: Increase in annual export sales of assisted small and medium enterprises

Indicator 4.6.2-11 Person hours of training completed in private sector productive capacity supported by USG assistance.

Sub 2.2.1: Higher Education and Workforce Competencies Improved

Indicator 3.2.2-36: Number of USG-supported tertiary programs with curricula revised with private and/or public sector employers' input or on the basis of market research.

Indicator 3.3.3-42: Number of tertiary institution faculty or teaching staff whose qualifications are strengthened through USG-supported tertiary education programs.

Indicator 4.6.3-2: Number of people gaining employment or better employment as a result of participation in USG funded workforce development programs [disaggregated by sex]

Sub IR 2.2.2: Business Development Services for SMEs Strengthened

Custom Indicator: Number of small business development centers established and operating as a result of USG assistance

Custom Indicator: Number of new or improved financial products or instruments used by SMEs with USG assistance

Sub IR 2.2.3: Sustainable Production of Key Agro-Tradables Expanded

Custom Indicator: Value of exports of agro-tradables as a result of USG assistance

Indicator 4.8.1-6: Number of people with economic benefits derived from sustainable natural resource management and conservation as a result of USG assistance [disaggregated by sex]

Indicator 4.5.2-42: Number of private enterprises, producers organizations, water users associations, women's groups, trade and business associations and community-based organizations (CBOs) that applied new technologies or management practices as a result of USG assistance [disaggregated by organization type and new or continuing technology]

Performance and Impact Evaluation Questions for DO2

1. How has the GOES strengthened its institutional capacity to promote trade and investment?
2. What difference has the workforce development program made to beneficiaries in terms of facilitating access to employment? Sub-question: What differences have been noted about the results between men and women?
3. To what extent have gender considerations been integrated into programming at the municipal and SME levels?
4. What influence have municipal competitiveness initiatives had on crime prevention efforts in targeted municipalities?
5. To what extent has the GOES taken steps to manage natural resources?
6. To what extent do improved workforce competencies alleviate El Salvador's human capital constraints?
7. To what extent has targeted SME productivity increased as a result of USG assistance?

ANNEX 1: PARTNERSHIP FOR GROWTH: EL SALVADOR: CONSTRAINTS ANALYSIS

Executive Summary (Taken Directly from PFG Constraints ANALYSIS)

This constraint to growth analysis (CA) was prepared by a joint technical team composed of economists from the Government of El Salvador and the Government of the United States. Its purpose is to provide an analytical and empirical foundation for joint efforts to promote broad-based economic growth in El Salvador. These efforts will be undertaken as part of Partnerships for Growth (PFG), an effort by the Obama Administration to foster growth in a select number of countries and seed the next generation of emerging markets. The exercise of analyzing growth restrictions under the Partnerships for Growth has been enriching for both governments, as it has helped to deepen the shared understanding of the problems of economic growth in El Salvador.

All four of the countries selected for the Partnerships for Growth undertake a Constraints Analysis following the growth diagnostics methodology developed by Hausmann, Rodrik, and Velasco (HRV). The results of these studies are intended to facilitate planning of a consensus set of near-term public policies agreed to by the partner country and United States governments aimed to improve investment and economic growth.

This analysis drew on information from a wide variety of sources, including data provided by various entities of the Government of El Salvador, analysis from international organizations (including the International Monetary Fund, the World Bank, and the Inter-American Development Bank), and the work of independent experts. It also benefited from various consultations and seven total focus groups over a period of three months with a variety of stakeholders in El Salvador, including government officials, entrepreneurs, and academics.

Using this data and internationally comparable indicators, surveys, cross-sectional and panel data, graphical, statistical, and regression analysis and other tools, it systematically analyzes potential factors that may be hindering private investment in the economy. It identifies two binding constraints to growth—factors that, based on the available evidence, can be said to be the most critical obstacles to private investment and to economic growth. These constraints impose a very significant cost—or “shadow price”—on the economy.

The study focused on the economy of El Salvador; these are some of its most salient characteristics:

- With a mostly-urban population of 6.2 million people, El Salvador had a Gross Domestic Product (GDP) of US\$21.2 billion in 2010.
- Since the Peace Agreements in 1992, El Salvador has demonstrated mixed economic growth. According to World Bank statistics, the country experienced a post-war boom between 1992 to 1995, when it averaged annual economic growth of 6.8 percent. From 1996 to 2000, annual economic growth averaged a much lower 3.0 percent. For the past decade from 2000-2009, El Salvador averaged just 2.1 percent annual economic growth, with GDP receding by 3.1 percent in 2009 due to the financial crisis. The rates of growth over the last decade are below the Latin American average.

- A historically open economy, El Salvador is part of CAFTA-DR, a regional free trade agreement with the United States, and has six Free Trade Agreements with Chile, Mexico, Panama, Dominican Republic, Colombia and Taiwan. El Salvador is also part of the Tratado General de Integración Centroamericana (Central America General Treaty).
- Today, this is a service-dominated economy: the services sector accounts for 60 percent of GDP, manufacturing for about a quarter, and agriculture and related sectors for 12 percent.
- The economy has been officially dollarized since January 2001; annual remittances, mostly from workers in the United States, amount to 17 percent of GDP.
- El Salvador's most important export category remains maquila products (manufactured products assembled for re-export), which have traditionally encompassed low value-added and are not technologically intensive; maquila products account for almost half of all exports.
- The stock of foreign direct investment (FDI) increased from US\$1.97 billion in 2000 to US\$7.76 billion in 2010, mainly directed to the financial and manufacturing industries. The United States remains the largest source of FDI to El Salvador.

A. Key Conclusions of the CA

The study identified two binding constraints to growth in El Salvador:

a. Security/Crime

- The “shadow price” (the effect on GDP if the constraint were removed) of crime is between 4.8 percent and 10.8 percent of GDP spent or foregone due to crime (depending on whether health costs are included). Either of these figures is higher than the Central American average and more than double the figure for Costa Rica, the only country in Central America not classified as having an “epidemic” level of crime. Moreover, just under half of businesses surveyed by the World Bank Enterprise Survey report that crime is an obstacle to their operations—at least 15 percentage points more than the Latin American and lower-middle-income average. In the Global Competitiveness Report, El Salvador ranks last out of 139 countries under the Organized Crime indicator, and next-to-last in Business Costs of Crime and Violence.
- Economic growth does show some movement with crime rates for the period from 1994 to 2000. Also, higher numbers of robberies per 100,000 in a municipality correlates with lower scores on a Municipal Competitiveness Index for that municipality.
- According to surveys in El Salvador, businesses spend 7.7 percent of their budget on security. A related study estimates that businesses and families spent a combined 4.7 percent of GDP on private security in 2007. Private security guards outnumber police by a ratio of 3 to 2 in El Salvador.
- Larger businesses have been shown to be more capable of absorbing the security costs and are less affected by crime (measured as percent of sales lost) as a result. In addition, there is strong anecdotal evidence that certain industries which are more affected—such as delivery and bus companies—also suffer more. Public transportation has been particularly hard-hit,

with the burning of a bus last summer with 17 people on board and a bus strike as a result of the Congress passing an anti-gang law. The strike closed 80 percent of public transportation. The bus companies seemingly were protesting due to fear of reprisal by the gangs.

- Understanding causes and effects of particular types of crime in El Salvador is an important next step. We also note that possible remedies for this constraint extend well beyond the traditional responses of increasing security, and should also include a comprehensive and integral strategy. Initiatives including (but not limited to) improving school attendance and quality to facilitate viable economic opportunities for vulnerable youth should be combined with prevention strategies.

b. Low Productivity in the Tradables Sector

- The share of output of tradables has been declining in El Salvador since 1990, perhaps as a consequence of low productivity of Salvadoran firms operating in the tradables sector. El Salvador's share of tradables as a percent of GDP has declined from 45 to 40 percent over this period and has consistently been 5-10 percentage points below the average for Middle-Income Countries, and 10-15 percentage points below the Lower-Income Country average. El Salvador may be missing 8 percentage points of GDP compared to CAFTA colleagues due to the productivity constraint in tradables.
- In this context, "tradables" refers to products that are or can be traded internationally. Their prices are set on international markets, whereas the prices for non-tradables are set domestically.
- Because their prices are set in international markets, the price of tradables facing Salvadoran firms is conditioned by factors largely exogenous to production. Therefore, the Salvadoran tradables sector is the world tradables sector, and El Salvador's competition in tradables is global competition. With prices set at or very near world prices, Salvadoran firms must have a high level of productivity in order to enter the tradables sector. The observation that share of output in tradables is falling, even while it is rising in neighboring countries such as Panama and Nicaragua, implies that firms are not able to realize such high levels of productivity.
- Low productivity and accompanying relative lack of competitiveness in international markets dampens the possibility for a structural transformation and accompanying growth acceleration in El Salvador, where the growth potential of the non-tradables sector is limited by the small size of the country.
- Agents may attempt to bypass this constraint in the form of maquilas, which receive tax and tariff exemptions to reduce their costs.
- Because we did not find that transportation, finance to large firms, or innovation issues are binding constraints in this analysis, low productivity in the tradables sector seems less likely to be due to these issues.
- Economic theory implies that because El Salvador's tradables sector needs to be competitive with world markets, the factors of production of tradables must also be competitive with

world markets. The canonical total factors of productivity include human capital, physical capital, financial capital, and often logistics/transportation. Institutional environment also affects productivity.

- While cannot conclude that human capital is a binding constraint in itself, it is clear that the quality of El Salvador's education is far below what would be competitive in the world market. The data point to particular short comings in the poor attainment scores in math and science education in upper primary and secondary education, and a relatively higher demand for labor with tertiary education. Anecdotal evidence from the private sector suggests a lack of vocational education aimed at developing skills needed in the labor market, particularly English language skills.
- We also point out that crime and security issues effectively act as an additional tax on the Salvadoran economy. These additional costs make it more difficult for the tradables sector to compete globally.
- Other issues that merit investigation for the low productivity in the tradables sector include physical capital use and logistic efficiency.

In addition to the binding constraints identified above, the study also included a detailed inquiry into a broad range of potential constraints including the following topics:

- Cost of Finance, including interest rates, international finance, domestic savings, financial intermediation (costs, competition, and risks), and costs of finance by firm size of enterprise;
- Appropriability, including political uncertainty, institutions, informality, macroeconomic stability, and innovation;
- Social Returns, including human capital in education and health; transportation, water, and electricity infrastructure; and geography.

B. Methodological Caveats

To identify the binding constraints, the methodology suggests the application of four tests that each candidate constraint must pass. This step imposes analytical rigor in the identification of binding constraints in order to establish the crucial discipline in decision-making needed to direct public resources toward the resolution of a constraint to growth.

While the HRV approach is the methodology chosen for the Partnerships for Growth Constraints Analyses in the four selected PFG countries, other approaches may yield different results. The identification of binding constraints is something of a “disciplined art,” but ultimately the analyses for PFG need to be driven by hard data to arrive at credible conclusions.

Because the CA process requires strong evidence to reject the hypothesis that a restriction is not binding, in working through this constraints analysis we encountered topics that we could not accept as a binding constraint because of a lack of solid data (as opposed to concluding that the topic was not a constraint because of contrary data).

The areas where we ultimately lacked data to make a conclusion include credit to small and medium enterprises, climate change and vulnerability, and institutions of government effectiveness in commerce and some particular areas of the justice system. We suggest that more data collection on these issues, as well as on labor market issues such as education and the drivers of emigration, would significantly aid an understanding of current constraints to growth in El Salvador.

We stress that not identifying other issues as binding constraints should not imply that El Salvador does not need continued improvement in those other areas in order to enjoy continued economic growth. Indeed, if those other areas were to be completely neglected, they can quickly become binding constraints themselves. The country must give constant attention to the many factors that affect economic growth.

Finally, we recognize that public policy and national development have many important goals and functions beyond economic growth through private sector investment. Even if a particular issue is not identified as a current binding constraint to economic growth in this analysis, it does not rule out the possibility that the same issue could be a constraint to other public policy objectives. Other objectives of public policy beyond economic growth are indisputably important, but are beyond the scope of this particular analysis.

ANNEX 2 – El Salvador -- Average Annual Growth Rate by Sector, 1990-2009

