

Systematic Country Diagnostic Update

# El Salvador: Addressing Vulnerabilities to Sustain Poverty Reduction and Inclusive Growth





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## Abbreviations and Acronym

AAL	Average Annual Losses	FDI	Foreign Direct Investment
AG	Attorney General	FES	Fundación para la Educación Superior
ALMP	Active Labor Market Policies	FI	Financial Intermediaries
BCR	Banco Central de Reserva de El Salvador	FMLN	Frente Farabundo Martí para la Liberación Nacional
BER	Business Environment Reforms	FODES	Social and economic municipal development fund
BTI	Bertelsmann Transformation Index	FUSADES	Fundación Salvadoreña para el Desarrollo Económico y Social
CA	Central America	GANAN	Grand National Alliance
CAD	Current Account Deficit	GBV	Gender-Based Violence
CAT DDO	Catastrophe Deferred Draw Down Option	GCI	Global Competitiveness Index
CCT	Conditional Cash Transfers	GDP	Gross Domestic Product
CEM	Country Economic Memorandum	GMI	guaranteed minimum income
CEMLA	Centro de Estudios Monetarios Latinoamericanos	GNI	Gross National Income
CEQ	Commitment to Equity	GVC	Global Value Chains
CERC	Crisis and Emergency Risk Communication	GWP	Global Warming Potential
CICIES	Comisión Internacional contra la Impunidad en El Salvador	HCI	Human Capital Index
CIT	corporate income tax	HFS	High-Frequency Surveys
CSOs	civil society organizations	ICT	Information and Communication Technology
DB	Doing Business	ID	Identification
DGII	General Directorate of Internal Taxes	ID4D	Identification for development
DGT	General Directorate of the Treasury	IDA	International Development Association
DIGESTYC	General Directorate of Statistics and Census	ICG	International Crisis Group
DRM	Disaster Risk Management	ILO	International Labor Organization
DSL	Digital Subscriber Line	IMF	International Monetary Fund
ECCE	Early Childhood Care Centers	IOM	International Organization of Migration
ECD	Early Childhood Development	IT	Information Technology
ECE	Early Childhood Education	KG	Kindergarten
ECE	Encuesta Competitividad Empresarial	LAC	Latin America and the Caribbean
EDD	Exporter Dynamics Database	LAPOP	Latin American Public Opinion Project
EHPM	Encuesta de Hogares de Propósitos Múltiples (Household Survey)	LGBTI	Lesbian, Gay, Bisexual, Transgender, and Intersex
EMDE	Emerging Market and Developing Economies	LMI	Lower Middle-Income Countries
EME	Emerging Market Economy	LMIS	Labor Market Information Systems
ENCPE	Survey of Education Continuity	LPI	Logistic Performance Index
EOR	Enhanced Oil Recovery		
FAO	Food and Agriculture Organization		

MCA	Fomilenio II (Millennium Challenge Account El Salvador).	SITC	Standard International Trade Classification
MFN	Most Favored Nation	SIMLAB	Simulation of Labor Economics
MICS	Multiple Indicator Cluster Survey	SME	Small and Medium Enterprise
MINEDUCYT	Ministerio de Educación, Ciencia y Tecnología	SOE	State-Owned Enterprise
MINSAL	Ministerio de Salud	SSN	Social Safety Nets
NCD	Non-Communicable Disease	SOGI	Sexual Orientation and Gender Identity
ND-GAIN	Notre Dame Global Adaptation Index	NSO	National Statistical Office
NEET	Not in employment, education, or training	TADAT	Tax administration Diagnostic Assessment Tool
NI	Nuevas Ideas	TFP	Total Factor Productivity
NPL	Non-Performing Loans	TVET	Technical and Vocational Education and Training
OAS	Organization of the American States	UN	United Nations
OECD	Organization for Economic Cooperation and Development	UNICEF	United Nations Children's Fund
OOP	Out-of-Pocket	UNDP	United Nations Development Programme
PAYG	Pay As You Go	UNFPA	United Nations sexual and reproductive health agency
PEFA	Public Expenditure and Financial Accountability	UNESCO	United Nations Educational, Scientific and Cultural Organization
PFM	Public Finance Management	UNFCCC	United Nations Framework Convention on Climate Change
PHC	Primary Health Care	US	United States
PISA	Programme for International Student Assessment	USAID	United States Agency for International Development
PIT	Personal Income Tax	USD	United States Dollar
PMR	Product Market Regulation	VAT	Value Added Tax
PPIAF	Public-Private Infrastructure Advisory Facility	VET	Vocational Education and Training
PPP	Public-Private Partnership	WB	World Bank
PPP	Purchasing Power Parity	WBG	World Bank Group
R&D	Research and Development	WDR	World Development Report
REER	Real Effective Exchange Rate	WDI	World Development Indicators
RISE	Regulatory Indicators for Sustainable Energy	WEC	Women's Equality Center
RREE	Ministerio de Relaciones Exteriores	WEF	World Economic Forum
SAFI	Government Financial Management Information System	WEO	World Economic Outlook
SAFIM	Municipal Financial Management Information System	WFP	World Food Program
SAI	Supreme Audit Institutions	WGI	Worldwide Governance Indicators
SCD	Systematic Country Diagnostic	WJP	World Justice Project
SDG	Sustainable Development Goals	WHO	World Health Organization
		WTO	World Trade Organization

# Overview

## Context of the 2015 Systematic Country Diagnostic and Objectives of this Update

The 2015 Systematic Country Diagnostic (SCD) concluded that El Salvador was “trapped” in vicious cycles of low poverty reduction and growth and argued for a “big push” in six priority areas. Three mutually reinforcing cycles hampered growth and shared prosperity: (i) low growth and violence, (ii) low growth and migration, and (iii) low growth, savings, and investments. The SCD concluded that a big reform push in six priority areas was needed to break these cycles. Despite progress in some of these areas, previous governments have not built consensus for the “big push” of simultaneous reforms to break the cycles.

This SCD Update (the Update) builds on the SCD as follows: (i) updating the country context and assessing progress in poverty and growth, (ii) broadening the analysis to include a vulnerability lens, and (iii) rerunning the prioritization framework to confirm or update priorities.

## Country Context and Progress in Poverty and Growth

The overall context for this Update is different from that of the 2015 SCD in two ways:

- › **The COVID-19 pandemic.** The pandemic dealt a major blow to growth as GDP declined by 7.9 percent in 2020. Poverty (using the US\$5.5 poverty line) is estimated to have increased by up to 4.6 percentage points between 2019 and 2020. Inequality (measured by the Gini Index) is expected to have increased from 38.8 to 39.4.
- › **The political landscape.** The two main political parties (*Alianza Republicana Nacionalista*—ARENA and *Frente Farabundo Martí para la Liberación Nacional*—FMLN) have alternated in power but neither one has ever had a qualified legislative majority. Support for the traditional parties waned and, in the 2019 elections, Nayib Bukele from the New Ideas (NI) party was elected. The 2021 legislative elections solidified this change by granting the NI party a qualified majority, the first majority since the end of the civil war in 1992.

Two structural factors of El Salvador still constitute critical developmental challenges:

- › **Crime rates have shown improvements over time, but there is still scope for improvement.** The homicide rate fell from 103 per 100,000 people to 20 per 100,000 people between 2015 and 2020, the lowest in two decades but still high relative to other countries. The SCD concluded that crime poses a major risk to poverty reduction by affecting the ability of households and firms to prosper in a stable setting and as a result of the challenges presented by crime in communities for the state to be able provide basic services. Gender-based violence and other crimes continue to be high.

- › **Net migration flows appear to have stabilized, but the underlying push and pull factors are likely still in play.** In the 2015 SCD period,<sup>1</sup> the Salvadoran foreign-born population living in the United States increased significantly (136 percent); however, its growth slowed to 8.6 percent in the pre-COVID-19 period, stabilizing the migrant population abroad at around 1.5 million over 2013–2017. Push factors such as the lack of economic opportunities and exposure to natural disasters have not changed, and pull factors including networks and economic opportunities overseas remain. Partly due to migration trends, the demographic dividend<sup>2</sup> identified in the SCD is closing, with economic and social implications.

**In the pre-COVID-19 period, El Salvador’s economic performance was mixed** (Table ES1). Per capita growth accelerated slightly, inflation fell, the current account improved, but the level of international reserves decreased. Fiscal sustainability worsened, a trend that was magnified by the COVID-19 crisis. Poverty during the pre-COVID-19 period fell at a faster pace, on average by 7.8 percent per year, registering a very high poverty-to-growth elasticity of -4.3. Inequality improved albeit at a slower pace, and the poor did not move too far up the “income ladder.” In 2019, the country had the highest level of people vulnerable to poverty in Latin American and the Caribbean (LAC).<sup>3</sup> The middle class has been expanding but in 2019 represented less than a third of the population, only larger than Honduras in LAC.

**The poverty reduction experienced by El Salvador is commendable, but tackling key development constraints is critical for sustainable poverty reduction going forward.** First, given the high vulnerability to poverty, a large share of households experiencing economic and disaster and climate shocks may revert to poverty and be trapped unless strong income opportunities or instruments to cope and recover from disasters (such as access to assets and basic services and prospects for income diversification) are made available. Second, as the poor did not move too far up the income ladder, trickle-down effects may not continue to reduce poverty because the mean income level is low. Third, a large share of poverty reduction was due to rising labor earnings rather than structural transformation or reforms tackling development constraints. As shown in Chapter 2, most of the priority areas in the 2015 SCD have seen either negligible improvements or deterioration. Fourth, there were very few economic opportunities for the poor, which resulted in an increase in people neither-in-education-nor-jobs (rising NEETS), an increase in unemployment rates and a reduction in labor force participation rates—especially among the bottom income quintiles. Finally, fiscal policy become less pro-poor over time and unsustainable.

**The COVID-19 crisis reversed hard-won poverty-reduction gains despite mitigation efforts, pointing out to the vulnerabilities of the current growth poverty reduction pattern.** Poverty (using the US\$5.5 poverty line) increased by 4.6 percentage points in 2020 despite government mitigation measures, however, this would have increased by up to 7.6 percentage points without mitigation. Inequality is expected to have increased (from a 38.8 Gini index in 2019, to 39.4 in 2020), and the middle class shrank, even with government mitigation measures.

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1 This Update divide the analysis in three periods, when possible: (i) the 2015 SCD period (circa 2000–2012); (ii) the pre-COVID-19 period (circa 2012–2019), and (iii) the post-COVID-19 period (circa 2019–2020). Data was not available for all indicators for all years of each period, but an effort was made to interpret trends nonetheless.

2 The demographic dividend is defined as the accelerated economic growth that can result from changes in the age structure of the population.

3 Vulnerability is measured as the percent of the population living with daily income between US\$5.5 and US\$13 per day at 2011 purchasing power parity (PPP). The middle class is measured as those who have a daily income between US\$13 and US\$70 per day (2011 PPP).

**Table ES1. Evolution of key macroeconomic, poverty, and equity indicators - 2015 SCD vs. SCD Update**

	2015 SCD, Circa 2000–2012			SCD Update, Circa 2012–2020			
	2000	2012	2000–2012 (a)	2019	2020 (e)	pre-COVID-19 2012–2019 (a)	post-COVID-19 2019–2020 (b)
<b>Macroeconomics and Fiscal, % of GDP unless indicated otherwise</b>							
GDP per capita, 2017 PPP \$	6,549	7,755	1.4	8,796	8,057	1.8	-8.4
Current account balance, % of GDP	-3.7	-5.8	3.8	-2.1	0.5	-13.5	2.6
International reserves, import months	4.7	3.3	-2.9	3.7	3.0	1.6	-0.7
Consumer prices, annual %	2.3	1.7	3.4	0.1	-0.4	0.6	-0.4
Fiscal deficit, % of GDP	-3.4	-3.9	1.1	-3.0	-9.2	-3.7	-6.2
Government debt, % of GDP	40.9	67.8	4.3	73.6	91.8	1.2	18.2
<b>Poverty and Equity, Line in 2011 constant PPP prices and % of the population, unless indicated otherwise</b>							
Poverty rate, \$5.50/day	45.1	39.5	-1.1	22.3	26.9	-7.8	4.6
Vulnerable rate, \$5.5–\$13/day	34.6	43.6	1.9	48.2	48.0	1.4	-0.2
Middle class ratio, \$13–\$70/day	20.3	17.2	-1.4	29.0	25.0	7.7	-3.9
Gini index	51.4	41.8	-1.7	38.8	39.4	-1.1	0.6
Survey mean income per capita, bottom 40% of population (2011 PPP \$ per day)	2.7	3.6	2.4	5.1	4.7	5.1	-0.4
<i>Sources:</i> LAC Equity Lab for Poverty and Equity Data; World Development Indicators (WDI) and Central Bank (BCR) for Macroeconomics and Fiscal.							
<i>Notes:</i> (a) For inflation, changes represent the annualized inflation for the period. (b) Poverty and equity estimates are based on simulations, considering fiscal mitigation measures taken by the government. Both (a) and (b) are Average Percentage Point Change per Year. (e) = WB staff projections for poverty and equity data.							

While the fiscal policy response to the COVID-19 crisis helped mitigate its social and economic impacts, it also deteriorated the fiscal accounts, leading to growing financing needs. The fiscal response cost around 15 percent of GDP and together with low revenues and rigid expenditures pushed public debt to beyond 90 percent of GDP; interest payments reached 4.8 percent of GDP, and the fiscal reached 5 percent of GDP in 2021 (after topping at 9.2 percent of GDP in 2020). To avoid debt distress and meet forthcoming debt service commitments, El Salvador requires a fiscal consolidation that improve revenue mobilization and increase spending efficiency, while also protecting the economic recovery and the poor. A credible fiscal package might help el Salvador reduce refinancing risks—and thus allow for a more gradual adjustment. The aggression to Ukraine, and its impact on commodity prices might further affect el Salvador’s fiscal and external balances, as the country is both food- and oil-dependent, like most countries in Central America

## Prioritization Approach

This Update uses the prioritization approach of the SCD in two steps (Figure ES1). The two-step process is a useful improvement as it allows the inclusion of key vulnerability factors, which are then narrowed down systematically and transparently. The first step uses only the “impact on the twin goals”<sup>4</sup> as a screening

<sup>4</sup> The World Bank Group’s strategic focus are the twin goals of ending extreme poverty and promoting shared prosperity. See: <https://ieq.worldbankgroup.org/blog/world-bank-group-course-meet-twin-goals>

filter. If this criterion is not met, the focus area is not prioritized. The second step uses additional filters to identify a second tier of priorities. The Update has made two noteworthy improvements to the first step:

- › **The first improvement is the application of an enhanced asset-based framework** (“vulnerability framework”<sup>5</sup>) that considers the vulnerabilities of households, firms, and the state separately, and explicitly incorporates risks and resilience. The framework captures the post-COVID-19 context better since: (i) it shifts the focus from only poverty reduction to poverty and vulnerability reduction; (ii) it enhances understanding of the low-growth/high-poverty reduction observed in the pre-COVID-19 Period and offers elements to assess why poverty reduction may not be sustainable going forward; and (iii) it combines the usual aggregated, or macro, approaches with a microeconomic approach based on households, firms, and the state, it also includes their resilience to shocks, which opens new analytical avenues.
- › **The second improvement is to run an extensive benchmarking exercise** (Annex 2.2), some rigorous modeling (Annex 3), and thorough consultations to help validate priorities (Annex 4.2).

**The second step is to select the first tier of PAs from the eight identified in the first step.** It uses the two remaining criteria from the SCD: (i) time horizon and complementarity between priority areas and (ii) feasibility of taking action; it also adds “impact on crime and migration” as an additional filter, given that these continue to be key structural factors affecting households, firms, and the state. Priority is given to those reforms that: (i) have shorter-term impacts, can enable other reforms, or have significant spillovers; (ii) are considered technically and politically feasible based on political economy analysis and consultations; and (iii) are likely to improve the living condition of potential migrants and make migration more productive<sup>6</sup> or reduce crime or mitigate its effects (Annex 4.1). To achieve the twin goals all PA reforms will be beneficial and PA action does not need to be carried out in one “big push.”<sup>7</sup> Tier 1 priorities will have direct and indirect impacts on growth: a stable macroeconomic framework is critical for investments by companies and households, including in human capital-will be better able to make; improved social safety nets will help protect households from falling into poverty, freeing up resources for consumption and human capital formation; and reducing barriers to employability and working on creating better job/skills matches should lead to higher employment.

**The Update slightly deviates from the SCD in the treatment of crime.** The Update confirms that crime is still a key issue (as confirmed by the benchmarking exercise) but applies a broader perspective. Instead of treating crime as a separate priority as in the SCD, the Update: (i) prioritize the areas with the potential to reduce crime (a filter in the second step of the prioritization), as violence prevention in El Salvador can be closely linked to better development outcomes and, (ii) treats crime as a cross-cutting issue (to understand how crime affects each PA).

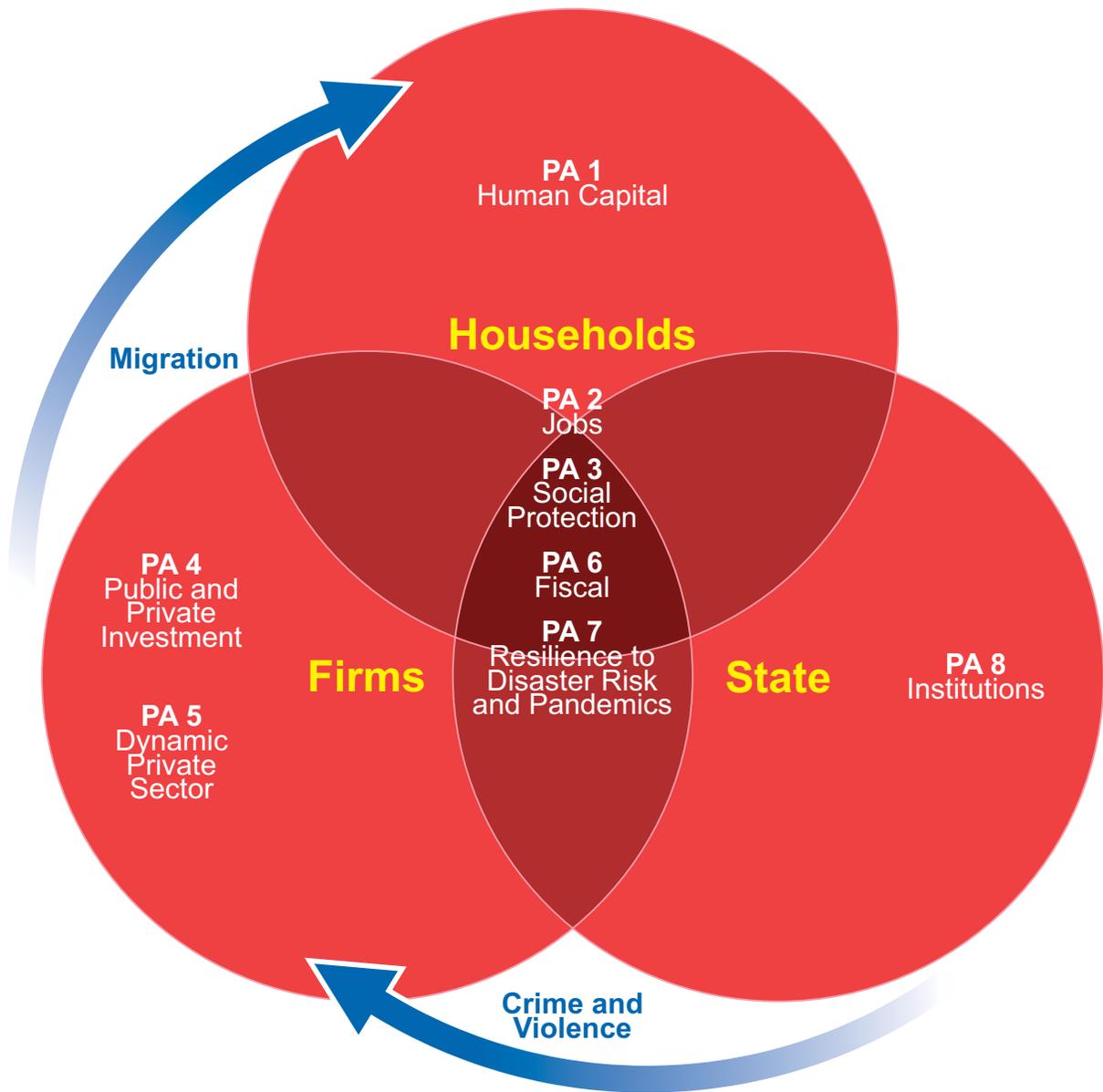
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5 The vulnerability framework is an “enhanced” asset-based framework, expanded to i) emphasize the role of risks and resilience; ii) include not only households but also firms and the state. More details are in Annex 4.1.

6 The underlying view on migration, based on the literature, is that it can have considerable benefits for individuals (migrants) and sending countries, but can also be costly. Therefore, this filter serves to select policy areas that can improve the conditions of migrants and enhance the net benefits of migration.

7 There is no data or empirical evidence to suggest that a big push is needed to achieve the twin goals. In fact, the evidence shows that El Salvador achieved substantial poverty reduction and shared prosperity during the pre-COVID-19 period, despite not having had a big push on reforms. Additionally, the country witnessed a steady decline in trust towards state institutions and an erosion in satisfaction with democracy. In this context, the Update looks for pragmatic entry points where progress is actually possible.

Figure ES1. The SCD Update two-step prioritization approach



Source: Own elaboration based on Dercon (2001), Calvo et al. (2007), and Hallegatte (2014).

## Comparison with the 2015 SCD

The Update captures most SCD priorities but increases the list from six to eight in light of the challenges revealed by the COVID-19 crisis (Table ES2). Annex 4.3 provides a detailed comparison.

2015 SCD	SCD Update	Tier 1 Priority
	<i>Priority Areas</i>	<i>Tier 1 Priority</i>
(PA1) Improving education and skills to compete	(PA1) Fostering human capital accumulation	<input checked="" type="checkbox"/>
Not in 2015 SCD	(PA2) Promote access to jobs	<input checked="" type="checkbox"/>
Not in 2015 SCD	(PA3) Strengthening the effectiveness of the social protection system	<input checked="" type="checkbox"/>
Not in 2015 SCD	(PA4) Enhancing private and public investment	<input checked="" type="checkbox"/>
(PA2) Improving productive services...	(PA5) Fostering a more dynamic, competitive, and innovative private sector	<input checked="" type="checkbox"/>
...and increasing financial inclusion	Not in SCD Update	<input checked="" type="checkbox"/>
(PA3) Strengthening the fiscal position to safeguard fiscal sustainability	(PA6) Ensuring sustainable and equitable fiscal policy	<input checked="" type="checkbox"/>
(PA4) Improving the resilience of the country to natural disasters	(PA7) Improving the resilience of the country to disaster risk and pandemics	<input checked="" type="checkbox"/>
(PA5) Forging political consensus to build a more transparent and effective state	(PA8) Strengthening governance and institutions	<input checked="" type="checkbox"/>
(PA6) Strengthening violence prevention and law enforcement	Crime is treated as a cross-cutting issue and a filter in the second stage of the prioritization. Actions to prevent violence are included in PA 1, 2, 3, and 8.	<input checked="" type="checkbox"/>
*Note: The red color denotes Tier 1 priorities.		

## Eight Priority Areas to Reduce Vulnerability and Begin Breaking the Vicious Circles

### *Priority Area 1: Fostering human capital accumulation*

Low quality and quantity of human capital undermine the potential for households' income growth over the lifecycle. Enrollment rates for early childhood care centers (ECCC) (3 years old and below) are extremely low. Gross preprimary and tertiary school enrollment rates are some of the lowest in the world at 66.7 and 29.4 percent in 2019 respectively, and progress during the pre-COVID-19 period was negligible. Out-of-school rates have been rising since 2012, particularly among the poor, and on quality, El Salvador is at the bottom of the performance scale worldwide.

Investment in human capital needs to be ramped up with a life cycle perspective, focusing on early childhood development (ECD) and policies to reduce dropout rates. ECD interventions can become the

basis for cognitive development, ensuring school readiness. Promoting equity and access in primary and secondary education is also crucial, with deliberate efforts to curtail out-of-school rates. A continuous and systematic learning assessment system is needed to improve the quality of education.

### *Priority Area 2: Promoting access to jobs*

**Access to high-quality jobs among the bottom 40 percent of the population (B40) has decreased, worsening vulnerability to poverty and several barriers to employment affect these labor market outcomes.** Labor force participation rates fell, and unemployment rose for the B40 during the pre-COVID-19 period. Female labor force participation continues to be among the lowest in LAC and the incidence of informality is extremely high. Remittances create disincentives to work, and a large tax wedge on labor and a significant public-sector wage premium reduce incentives to work in the formal sector. There are several barriers to productive employability, affecting disproportionately women, young and low-wage workers, including skill mismatches, inflexible work arrangements and rigid labor regulations, lack of access to child and elder care, limited geographic mobility (associated with gang presence), a digital urban-rural divide, and patriarchal attitudes and social norms.

**Reducing these barriers to employability and promoting entry into the labor force is critical to increasing labor productivity and accelerating recovery.** This calls for a comprehensive age-sensitive approach that addresses the various barriers Salvadorans face during their lifecycle. Also, reducing disincentives to formal work is essential.

### *Priority Area 3: Strengthening the effectiveness of the social protection (SP) system*

**An ineffective social safety net limits households' ability to cope with shocks and curtails the ability of fiscal policy to reduce poverty and inequality.** The social safety net has low progressivity, and the coverage for the bottom income quintile of the conditional cash transfer program (Comunidades Solidarias), and pensions is low. The share of beneficiaries of all social programs, already among the lowest in the world, dropped further during the 2015 SCD period and barely improved in the pre-COVID-19 period. The social protection system is not adaptive enough to address existing or emerging shocks and lacks administrative efficiency, and the COVID-19 crisis brought its existing shortcomings.

**An effective and adaptive SP system is critical for resilient and inclusive recovery and for improving the equity impacts of fiscal policy.** The three main reforms to strengthen the SP system are: (i) developing an integrated social protection system and enhancing its responsiveness to shocks, (ii) improving targeting; phasing out costly non-contributory transfers and untargeted indirect subsidies; and (iii) increasing the coverage and benefit level of well-targeted social programs.

### *Priority Area 4: Enhancing public and private investment*

**Public and private savings and investments rates have been consistently low.** El Salvador has no overall domestic savings as consumption equals GDP, however net overseas transfers raised the national savings rate to 13.5 percent of GDP during the pre-COVID-19 period. This enabled an investment rate of 16.4 percent

of GDP over this period (2.5 percentage points of GDP were contributed by the public sector), this rate is below peers' rates.<sup>8</sup>

**Increasing investment rates is key to fostering a dynamic and competitive private sector.** Three reforms are crucial: (i) increasing the level and efficiency of public investment; (ii) improving the regulatory framework to attract private investment in infrastructure; and (iii) better targeting investment promotion efforts, including tax incentives.

#### *Priority Area 5: Fostering a more dynamic, competitive, and innovative private sector*

**A inadequate business environment, low trade integration, and inadequate firms' capabilities prevent new firms from entering the market and innovating.** The SCD highlighted the challenging business environment. Strengthening the rule of law and reducing corruption are vital to attracting efficiency-seeking foreign direct investment (FDI) that could boost participation in global value chains (GVCs). Crime and poor trade facilitation discourage entry of firms that need imports for production or that wish to export. Innovation is constrained by the lack of an educated workforce, low entrepreneurial capabilities, and low access to the internet.

**Greater trade integration, enhancing competition, and investment in skills and entrepreneurial capabilities are critical for productivity.** Laws can be improved to avoid abuse of dominant position by large firms and to increase competition. Reducing the cost of doing business will address informality, this can be done by simplifying the issuance of operational licenses and permits and by reducing fees. Trade facilitation requires consolidating norms, implementing digital services, and promoting participation in GVCs. Improvements in education will benefit the workforce in the long term, just as programs on workforce development can yield benefits in the short term, as long as private sector input, monitoring and evaluation are part of the package.

#### *Priority Area 6: Promoting a sustainable and equitable fiscal policy*

**Fiscal imbalances and the inability of fiscal policy to reduce poverty constrain household income growth, firm growth, and poverty reduction efforts.** Despite running a primary surplus in the pre-COVID-19 period, public debt increased largely as a result of the need to finance pensions. Fiscal policy contributes to reducing inequality but not poverty. Most fiscal policy components are progressive, with poorest households in the bottom 10 percent of the income distribution being net receivers of social benefits. But, households from the second decile and up pay more in taxes than they receive in transfers.

**Reforms to increase revenue mobilization and spending efficiency must support recovery and increase distributional impacts.** On the revenue side, broadening the base for income tax is essential; tax compliance needs to be simplified and property taxes should be introduced. On the spending side, better targeting of subsidies, and increased coverage of well-targeted programs are key to sustaining the recovery and to minimizing the social impacts of the COVID-19 crisis.

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<sup>8</sup> Defined using a dynamic benchmarking methodology (Annex 2.1). Structural peers are Albania, Bosnia and Herzegovina, Honduras, Jamaica and Jordan. Aspirational peers are Dominican Republic, Georgia, Bulgaria.

### Priority Area 7: Strengthening resilience to disaster risk and pandemics

El Salvador is highly vulnerable to natural disasters; it can detect impending epidemics, but lacks adequate prevention and rapid response and mitigation strategy. The ND-GAIN (Notre Dame Global Adaptation Index), which summarizes a country's vulnerability to climate change and other global challenges in combination with its readiness to improve resilience, places El Salvador below the 100 best-ranked countries. Despite the country is well prepared in detecting and reporting epidemics early on, there is still scope for improvement on outbreak prevention, rapid response and mitigation strategy.

Improving resilience and disaster risk management requires a comprehensive system focused on risk prevention and reduction, effective recovery, and disaster risk financing. Households, firms, and the government need to invest more in risk mitigation, to enhance preparedness, and mount a timely response. Accurate modeling and evaluation of risks, basic insurance coverage for key assets, incorporation of disaster risks in public investment management and using all cost-effective layers of disaster risk financing will help achieve this. Investment in pandemic preparedness and resilient health systems are essential for response and mitigation, especially in the context of pandemics.

### Priority Area 8: Strengthening governance and institutions

High-quality institutions are the foundation of an efficient government, indicators suggest institutional quality is low and declining. The Bertelsmann Transformation Index<sup>9</sup> and the Worldwide Governance Indicators<sup>10</sup> suggest that El Salvador's quality of governance and institutions declined in the pre-COVID-19 period. Institutional weaknesses are undermining government capacity to address vulnerabilities related to service delivery, the availability of inclusive economic opportunities and private sector growth, and transparent and accountable management of public resources.

Improving government accountability and service delivery is critical. Reforms should focus on enhancing interagency coordination, improving access to public services, transparency of public services, and better human resource management. These efforts should be complemented by reforms aimed at ensuring a fairer and more effective justice sector and oversight institutions; accountability mechanisms for civil servants and elected officials should also be introduced.

### Setting Priorities: Tier 1 Challenges

The Update applies filters to the eight priorities to identify four Tier 1 priorities to best help address the vicious circles. These are: (#2) promoting access to jobs, (#3) strengthening the effectiveness of the SP system, (#6) ensuring a sustainable and equitable fiscal policy, and (#7) improving the resilience of the country to disaster risk and pandemics (Table A.5). Tier 1 priorities are not a *sine qua non* condition for addressing other priorities, nor do they need to be carried out in a "big push". In fact, any progress in the PAs will contribute to achieving the twin goals.

9 Bertelsmann Transformation Index data and methodology is available here: <https://bti-project.org/en/reports/country-report/SLV>

10 Worldwide Governance Indicators data and methodology can be found here: <http://info.worldbank.org/governance/wgi/>



These Tier 1 priorities should take precedence as they will enable further reforms, they have political support, and relatively short-term impacts. Creating fiscal space has a short-term impact on the ability of the government to meet its financing needs and fund reforms in other priority areas. Strengthening resilience to climate-related disasters and pandemics, and refining preparedness systems are critical to reducing risks and losses, and providing for rapid, sustained recovery. Removing barriers to employability and enacting social protection measures are critical for creating employment among the poor and vulnerable in the post-COVID-19 recovery. Spillover effects from these priorities can be considerable; for example, increasing the efficiency of spending through improved targeting of transfers can increase the effectiveness of the safety net. Public opinion surveys and the SCD survey among Salvadorans show support for these priorities.

These four priorities can contribute to reducing crime and can help maximize the benefits of migration. Most gang members are young males from vulnerable backgrounds with limited economic opportunities. Tackling crime demands a multisectoral approach, but focusing on economic opportunities, particularly among vulnerable and at-risk groups, and protecting them from falling into poverty could reduce violence (Acosta and Monsalve 2021). The emerging push factors for emigration are violence, insecurity, extreme weather, and poor economic prospects. Even for those with relatively low skills and educational attainment, better job prospects abroad are a pull factor. More equitable fiscal policies and effective safety nets could provide a buffer for households' financial constraints and allow them to redirect remittances towards productive investments. Improved resilience to disasters could dampen this push factor for emigration in the short term (Ibanez et al., 2021).

### **Knowledge and Data Gaps**

This Update identifies the knowledge gaps to be addressed. The Update identified knowledge and data gaps that have been addressed, confirmed the ones that still exist, and identified new ones (Annex 5).

# 1. Country Context: Where is El Salvador Today?

This chapter assesses the country context; it presents the evolution and outlook for the economy, as well as key poverty and equity variables. The analysis covers three periods: (i) the 2015 SCD period, (ii) the pre-COVID-19 period, and (iii) the post-COVID-19 period.

## *A Shifting and Challenging Context*

Two key features make the context in El Salvador today different from that reported in the SCD: the COVID-19 crisis and a political landscape with an unprecedented alignment of the three branches of government.

El Salvador has succeeded in avoiding the worst health impacts of the COVID-19 pandemic. The country took early and stringent measures against the pandemic. The result in saving lives is commendable (15.7 cases/million habitants compared to 107.8 and 100.1 in Panama and Brazil, respectively, as of early October 2021), despite evidence of under-reporting (Pearson, Prado, & Colburn, 2021). The vaccination campaign is well-positioned, with 66 percent of its population being fully vaccinated by March 2022.

In 2019, a candidate belonging to none of the two traditional parties won the presidency and subsequently a qualified legislative majority. A series of corruption cases started in 2014, and the brand dilution of the traditional parties (FMLN and ARENA) opened room for a third-party candidate. In 2019, Nayib Bukele won the presidency with 53.1 percent of the votes for his party NI. Bukele's party solidified political control in the 2021 legislative elections in which NI obtained an absolute majority—two-thirds of the seats in parliament (56 out of 84). An ambitious reform agenda can now be enacted, but strengthening investors' confidence would require improved checks and balances.

## *Key Structural Factors*

High levels of crime and migration continue to pose significant development challenges.

Despite recent positive trends, crime rates continue to be high. The current government is working to reduce violence through the implementation of the Territorial Control Plan. The homicide rate increased from about 40 to 71 homicides per 100,000 people during the 2000–12 period to a peak of 103 per 100,000 in 2015, but fell to 20 per 100,000 in 2020. Interim data from 2021 shows further reductions in the homicide rate, but progress on disappearances is unclear, with data from the Attorney General registering a decline since 2018 but data from the national police showing an increase. Other crimes, like extortion, are also prevalent. The country needs to do more to reduce crime and violence, as it still ranks very low compared to other countries in the region and globally. The rate of violent deaths among women is one of the highest globally (more than 13 out of 100,000 women between 2010 and 2017).

**Gang violence is volatile and can spike again.** There are nearly 60,000 gang members across all municipalities (International Crisis Group, 2020). They commit nearly 70 percent of homicides and most extortions (Katz et al., 2016). Gang activities and affiliations extend to prisons; today, some 38,000 Salvadorans are in prison, and approximately half are active or former gang members (US Department of State, 2021). Most of these gang members are men aged 18–25, who are both victims and perpetrators of criminal acts (Infosegura, 2021; Cruz et al., 2017).

**Net migration flows have stabilized, but the intention to migrate is still high.** The stock of migrants stabilized at around 24 percent of the population during the 2013–17 period (Figure A.1), reaching more than 1.5 million in 2017. Most (89 percent) emigrated to the United States (World Bank bilateral migration matrix 2017). As of 2018, one in every four people would like to emigrate in the next three years (LAPOP, 2018). Remittance inflows are among the highest in LAC (Figure A.2).

**Migrants are disproportionately young adults who, though not highly skilled by international standards, represent important human capital in El Salvador.** In 2015, the Salvadoran diaspora population was among the two least educated in a comparison of a group of 15 different countries (MPI, 2015). The number of Salvadoran migrants in the US is made up largely of low- and medium-skilled workers with complete or incomplete secondary education, reflecting the low levels of educational attainment in the Salvadoran population. Salvadoran migrants in the US are more likely to come from the middle and upper half of the wage distribution of their country of origin (Arayavechkit, Scott & Sousa, forthcoming) and recent migrants to the US tend to have higher levels of schooling.

**The demographic dividend highlighted in the SCD is fading.** Partly due to migration and fertility, the relative size of older age groups is rising while the young dependency ratio is decreasing (Figure A.3). The labor force is also expected to shrink without changes in labor force participation. These trends can increase job mismatches. As the dependency ratio increases, the need for a financially robust pension scheme increases; an aging population will exert pressure on the health system and could worsen fiscal policy outcomes.

## *Macroeconomic Developments Before the COVID-19 Crisis*

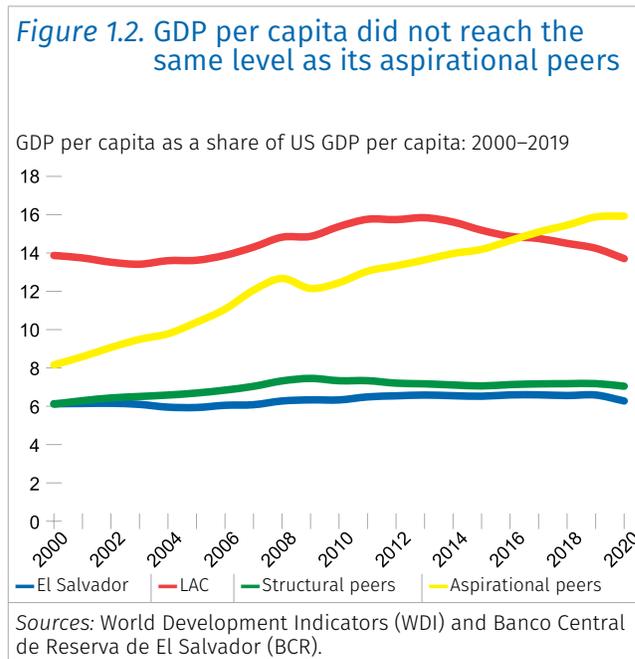
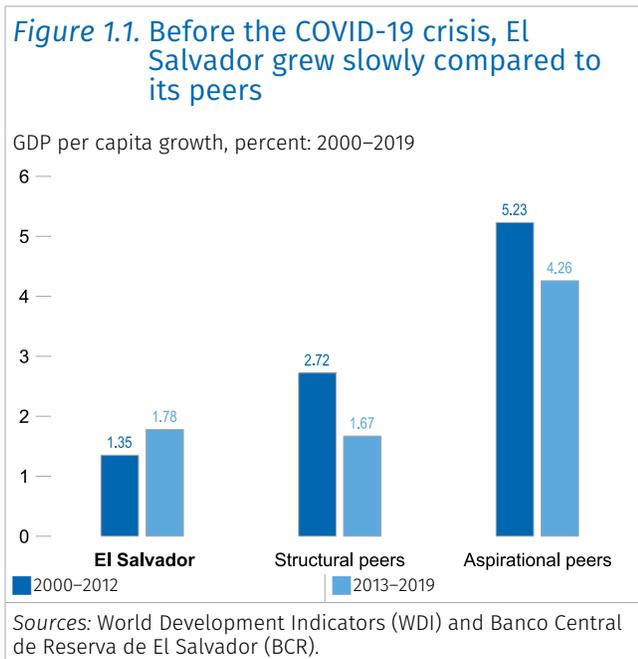
### *Macroeconomic and Fiscal Trends*

**Growth performance improved during the pre-COVID-19 period, but only slightly.** Per-capita growth improved from 1.4 to 1.8 percent between the 2015 SCD period and the pre-COVID-19 period (Figure 1.1).<sup>11</sup> Per capita growth reached the rate of structural peers during the pre-COVID-19 period (1.8 versus 1.7 percent) but was below that of aspirational peers (4.3 percent) (Figure 1.2). Faster growth made only a small dent in convergence as income in El Salvador increased from 6 to 6.4 percent of the US GDP per capita. Structural peers saw a similar catch-up, from 7.3 to 7.8 percent, while aspirational peers saw their income raised from 12.5 to 16.8 percent of the US income.

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<sup>11</sup> Unless otherwise noted, the 2015 SCD period refers to the average from years 2000 to 2012, while the pre-COVID-19 period refers to the average from 2013 to 2019. In the case of stock variables, the comparison is done between 2012 and 2019.

Factor accumulation offset the decline in productivity between 2001 and 2017.<sup>12</sup> The average annual contribution of productivity to growth was negative by 0.6 percentage points in 2001–10 and 2011–17; labor, and human and physical capital contributed positively. Capital stock contributed 1.1 and 0.9 percentage points in 2001–10 and 2011–17. Labor accumulation contributed 0.9 percentage points in both periods. Human capital contribution doubled from 0.5 to 1 percentage points between the first and second periods.



Labor reallocation was the primary source of labor productivity gains from the structural shifts.<sup>13</sup> Figure A.4 shows that recent labor productivity growth came mainly from static reallocation and within-sector productivity. Salvadoran workers reallocated from sectors with below-average productivity (for example, agriculture, and construction) toward sectors with above-average productivity (such as financial intermediation), increasing aggregate productivity. Figure A.5 shows some reallocation between agriculture toward services. Labor productivity is higher in the service sector than in agriculture, but it is low relative to service sectors in peer countries, limiting any positive contribution that this structural shift could make to economy-wide productivity growth.

El Salvador’s macroeconomic framework is conducive to price stability but under current policies sustainability is at risk given the low level of international reserves; public debt is increasing due to persistent fiscal imbalances. Monetary policy autonomy is reduced as a result of dollarization, but it has delivered on price stability. Dollarization impedes adjustment of the nominal exchange rate to achieve

12 This analysis is based on a Solow-growth decomposition in which TFP is computed as the ratio of output to aggregate inputs: labor (adjusted by the quality of human capital) and capital. For a critique on the shortfalls of growth accounting, please see (Cusolito & Maloney, 2018).

13 Changes in GDP per capita can be explained by: (i) demographic changes; (ii) labor force participation and employment changes; (iii) sectoral productivity changes (within-sector component), and (iv) labor reallocation across sectors (between-sectors component). The latter is known as structural change and can be broken down into two components. The “static” component measures whether workers move to sectors with above-average productivity; the “dynamic” component measures whether productivity growth is higher in sectors with an increase in employment.

external equilibrium, but the high level of remittances helps balance the external accounts. The banking system, despite being well-capitalized, channels insufficient investments to the private sector and suffers from low financial inclusion. The growth of the Salvadoran economy is intertwined with the US economy through trade, remittances, and investments. Medium-term growth prospects are affected by elevated gross financing needs as a result of high public debt and high borrowing costs. The twin deficits, low revenue mobilization, and expenditure rigidities require a concerted and sustained effort to ensure a sustainable and equitable fiscal policy that will support growth, and local financial market development, and not jeopardize dollarization.

**Dollarization has anchored price stability.** The country adopted the US dollar as its legal currency in 2000 and has seen inflation decline since, for example, it fell from 3.4 percent in the 2015 SCD period to 0.6 percent in the pre-COVID-19 period. Food prices grew by 1.2 percent (annual average) above overall prices in the same period. More recently, the country adopted a bi-monetary system giving bitcoin legal tender, but the macro and distributional impacts are still unknown (Table A.11).

**International trade increased slightly during the pre-COVID-19 period, but its composition has not improved.** Trade flow (sum of exports and imports) increased from 68.2 percent of GDP in 2012 to 76.6 percent of GDP in 2019, which is still below its peers (83.1 percent and 108.4 percent of GDP for structural and aspirational peers, respectively). Exports (from 23.8 to 29.2 percent of GDP) and imports (from 44.4 to 47.4 percent of GDP) grew during the pre-COVID-19 period, but with higher growth in exports, the trade deficit declined slightly from 20.6 (2012) to 18.2 percent of GDP (2019). The predominant exports are textiles and apparel (40 and 42 percent of all exports of goods in 2012 and 2019, respectively), followed by agricultural and food products whose share has declined from 2012 to 2019. Travel and tourism are the main service export, followed by information and communication technology (ICT) services. The three main import groups are oil, machinery, and apparel.

**The flow of remittances has steadily risen, while the cost of sending them has fallen.** Remittances grew steadily from 15 percent of GDP in 2000 to 21 percent of GDP in 2019. The cost of sending remittances has fallen from 5.3 percent in 2012 to 2.9 percent in 2019. Remittances tend to be sent monthly (55 percent in 2018) through formal channels (98 percent in 2018). In 2020, 96 percent of remittances originated in the United States. Remittances are an important tool for households to deal with poverty and vulnerability that can have both positive and negative macroeconomic effects. They help finance the current account, boost consumption and can increase tax revenues as a result of remittances-fueled consumption; remittances have also contributed to “Dutch disease” effects in LAC.<sup>14</sup> They can alter labor market outcomes by increasing the time dedicated to household production and leisure, thus increasing reservation wage. Numerous studies (Sousa and García-Suaza (2018), Arayavechkit, Scott & Sousa, (forthcoming) and Rude, Robayo-Abril (forthcoming) have found that remittances act as a disincentive to participate in the labor market, but the magnitude of the impact differs. Behavioural responses to remittances has also been found to differ, by gender. Sousa and García-Suaza (2018) found that remittances decrease the labor participation rates of

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<sup>14</sup> Increased household income due to the inflow of remittances increases consumer demand. This raises the relative prices for domestic nontradable goods, leading to higher relative wages in these sectors (such as local services) and prompting a reallocation of labor away from export sectors and a real exchange rate appreciation. Lopez, Molina, and Bussolo (2008) find that, among LAC economies, a one percentage point increase in remittances as a proportion of GDP is estimated to lead to a real exchange rate appreciation of 18–24 percent. Rising domestic demand and lowered competitiveness of domestic tradable sectors widen the current-account deficit, weakening the country’s macroeconomic position.

women in El Salvador by about 25 percent relative to similar women who did not receive remittances, and by 6 percent for men. It also increases the likelihood of men working in the informal sector.

**Dollarization, “Dutch Disease” effects, and the increase in reservation wages caused by high remittances reduce El Salvador’s relative competitiveness among regional peers; however, the country remains competitive for manufacturing.** El Salvador has not experienced a significant Real Effective Exchange Rate (REER) appreciation. From 2007 to 2020, the REER appreciated by 2 percent, although for the 2015–2017 period, appreciation was closer to 5 percent. At the same, the US REER appreciated 19 percent. The data does not show higher manufacturing wages in El Salvador (i.e., less competitive) than its regional peers, although the wage differential has narrowed since 2015. The mean monthly wage in El Salvador (US\$695.2 US\$ PPP) is higher than in Honduras (US\$648.5), and Guatemala (US\$597), but the mean wage in the manufacturing sector in El Salvador (US\$638.5) is lower (Honduras: US\$748, Guatemala: US\$659.1). El Salvador has the second-lowest minimum wage for the maquila sector (US\$359.2 current US\$), Nicaragua has the lowest, but El Salvador’s output per worker (US\$21,106) is higher than in Honduras (US\$13,581) and Nicaragua (US\$12,631) and almost the same as Guatemala (US\$21,613). Finally, although the tax wedge in El Salvador is higher than in other CA peers, the difference between it and the regional peers (around ten percentage points) is not high enough to clearly put El Salvador in a disadvantageous position.<sup>15</sup>

**El Salvador’s current account deficit (CAD) improved, driven by trade and remittances flows, but FDI deteriorated.** During the pre-COVID-19 period, the CAD improved from 4.5 percent of GDP (2012) to 3.8 percent of GDP (2019). However, FDI declined from 2.6 percent of GDP in the 2015 SCD period to 2 percent of GDP in the pre-COVID-19 period. FDI also declined for structural and aspirational peers, from 6.2 to 5.2 percent, and from 6.9 percent to 4.5 percent of GDP respectively, FDI levels in El Salvador are the lowest among all peers.

**External buffers have eroded.** International reserves declined from 3.6 months in the 2015 SCD period to 3 months in the pre-COVID-19 period, while structural and aspirational peers experienced an increase from 4.6 to 5.6 months and 3.3 to 3.8 months, respectively. As a share of external debt, reserves also decreased from 25 to 20 percent, while structural and aspirational peers had 40 and 33 percent ratios, respectively.

**The fiscal stance improved slightly during the pre-COVID-19 period.** The average budget deficit, including the pension system, fell from 4 to 3.3 percent of GDP between the 2015 SCD period and the pre-COVID-19 period. The primary balance improved by 1.3 percent of GDP between these periods, driven by tax revenues, which grew from 14.3 to 17.3 percent of GDP. Spending increased by 1.8 percentage points of GDP; current expenditures increased by 2.4 percentage points and capital declined by 0.6 percentage points of GDP. However, El Salvador’s tax revenues are still below those of its peers.

**Adverse debt dynamics and fiscal deficits have increased risks.** The lower government deficit translated into moderate increases in public debt in its broadest concept, which grew from 67.8 percent of GDP in 2012 to 73.6 percent of GDP in 2019, split almost equally between domestic and external debt, 61 percent came from private investors. The main growth driver of the debt in this period was the debt issued to cover the transition cost of the pension regime, which increased by 9.2 percentage points of GDP. The risk indicators of the debt also deteriorated during the pre-COVID-19 period. The average interest rate grew from 5.1 percent in 2012 to 5.5 percent in 2019, and the average time to maturity declined from 16 to 12.9 years. As a result,

15 Data for minimum wage are from ILO and government websites. The ILO database has a series on labor unit costs but does not include CA countries. The data for the tax wedge comes from the El Salvador Jobs Diagnostic.

interest rate payments increased from 2.5 percent of GDP in 2012 to 3.7 percent of GDP in 2019, reducing fiscal space and hampering progress towards poverty reduction.

**El Salvador entered the COVID-19 crisis with a fragile fiscal situation that deteriorated during the pandemic and could, in the absence of a policy change, become unsustainable.** The country enacted the most generous fiscal response in the region as it spent nearly 15 percent of GDP, financed mainly by debt. The government response prevented a further decline in economic activity but severely impacted fiscal sustainability, with fiscal deficit and public debt reaching 9.2 and 91.8 percent of GDP by the end of 2020.<sup>16</sup> More worrisome, debt with a maturity of less than one year increased from 3.5 percent of GDP in 2019 to 9.2 percent in November 2021. GDP was reduced by 7.9 percent in 2020. Under a no-policy change scenario, fiscal forecasts put the country in a challenging fiscal situation due to a large wage bill (11.9 percent of GDP in 2020) and increasing interest payments (4.6 percent of GDP in 2021), putting public debt and financing needs on an upward trajectory in the absence of policy changes. Additionally, the country is facing high spreads on its sovereign external bonds, making it harder to cover its financing needs, especially in 2023 and 2025, when two large sovereign bonds will mature. Given the high cost of the private external market, the low availability of funding in the domestic market, and the lack of an IMF program, the government could run into problems to meet its financing needs.

## Poverty and Equity Developments Before the COVID-19 Crisis

### Poverty and Shared Prosperity

**Poverty rates fell sharply just prior to the onset of COVID-19, with faster declines in rural areas.** The pre-COVID-19 period saw a substantial decline in official poverty<sup>17</sup> of 5.8 and 9.8 percentage points per year for moderate and extreme poverty respectively, registering a high poverty-to-growth elasticity.<sup>18</sup> This is a sharp improvement from the 2015 SCD period when poverty fluctuated between 40 and 45 percent, partly explained by food price volatility (Figure 1.3). Similar trends are observed in international poverty (US\$5.5 poverty line), which fell by 7.8 percentage points per year during the pre-COVID-19 period, compared to only 1.1 percentage points per year in the 2015 SCD period (Figure 1.4). Spatial disparities in monetary poverty continue to be large,<sup>19</sup> and the rural poverty rate was still higher than the urban poverty rate in 2019.

**Economic growth was pro-poor in the pre-COVID-19 period, but B40 income grew slowly in the 2015 SCD period.** In the pre-COVID-19 period, the primary force behind poverty reduction was growth rather than redistribution (Figure A.7).<sup>20</sup> Income growth for the B40 was high (5.1 percent) by LAC standards and significantly higher than the average income growth for the whole population (3.9 percent) (Figure A.8), and

16 Preliminary numbers from the BCR point to a slight improvement in the debt (90.4 percent of GDP) and the deficit (6 percent of GDP) in 2021.

17 This is expressed as a percentage of population. Official estimates by DIGESTYC are expressed as percentage of households.

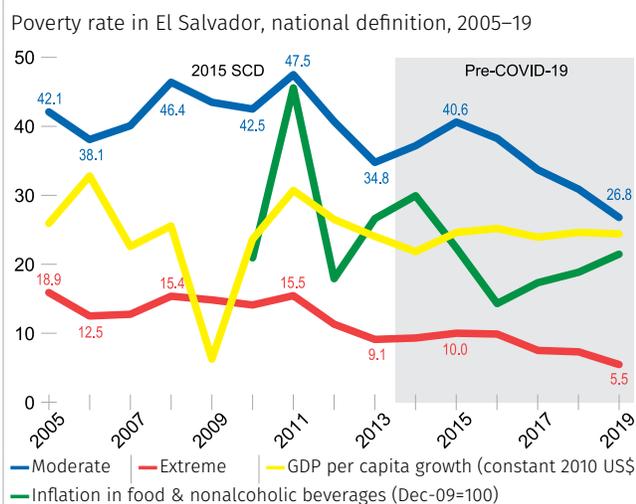
18 In the 2015 SCD period, El Salvador had a slightly higher, but still low, poverty-to-growth elasticity compared to its structural peers: 0.77 and between -0.4 and -0.5 for peers with available data. In the Pre-COVID-19 period, this elasticity grew significantly (-4.3), compared to its peers.

19 Across departments, the poverty rate (5.50 PPP\$/day) ranges from 12.4 percent in San Salvador to 40.7 percent in Morazán. Given its size, San Salvador is home to the largest number of poor. The latest poverty maps show large variation across municipalities (Figure A.6).

20 Datt-Ravallion decompositions show that out of 17.2 percentage points reduction in the poverty rate (US\$5.5 line), about 13.8 percentage points can be attributed to growth and only 3.4 percentage points to redistribution.

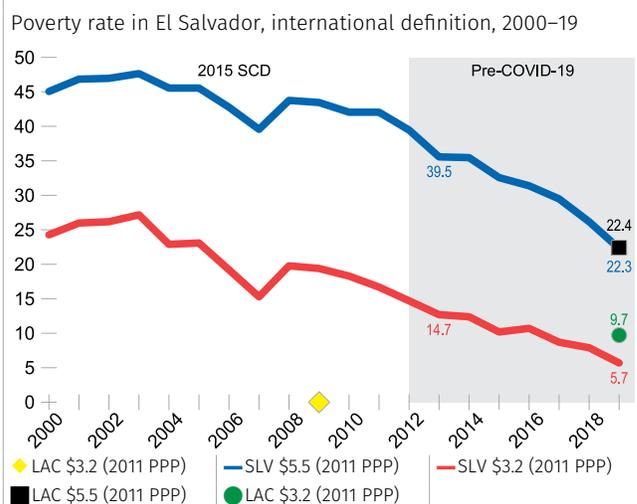
this “shared prosperity premium” was higher in rural areas. Notably, the top of the distribution experienced welfare losses during this period (Figure A.9). In contrast, in the 2015 SCD period, incomes at the bottom grew much slower, but the premium was higher, reflecting a larger redistribution of income (Figure A.10).

**Figure 1.3. National poverty was stagnant during the 2015 SCD period, but fell significantly during the pre-COVID-19 period**



Source: World Bank estimates based on Salvadoran household surveys (*Encuesta de Hogares de Propósitos Múltiples*).  
 Note: National Poverty rates are expressed as a percentage of the population, while official poverty rates published by DIGESTYC are expressed as a percentage of households. 2020 poverty estimates are excluded, given that 2020 survey data is not fully comparable with previous rounds.

**Figure 1.4. International poverty declined at a fast clip in the pre-COVID-19 period, but it is still larger than the LAC average**



Source: World Bank estimates based on Salvadoran household surveys (*Encuesta de Hogares de Propósitos Múltiples*).  
 Note: National Poverty rates are expressed as a percentage of the population, while official poverty rates published by DIGESTYC are expressed as a percentage of households. 2020 poverty estimates are excluded, given that 2020 survey data is not fully comparable with previous rounds.

In contrast with the 2015 SCD period, poverty reduction pre-COVID-19 was mainly driven by rising labor earnings; remittances and demographics also played a role; although the magnitude of these effects was comparatively small. In the pre-COVID-19 period, moderate poverty (US\$5.5/day line) declined by 17.2 percentage points. Being the main asset of the poor, labor earnings explained more than half of the change. Moreover, it was the growth in labor income per worker that contributed the most to poverty reduction, rather than an increase in employment (measured by the share of working adults). Remittances accounted for about 13 percent of the overall change in poverty; declining dependency ratios had a similar contribution. Public transfers and retirement pensions played a minor role, given the low progressivity of social safety nets and low coverage of pensions (contributory and social) among the bottom income quintile. In rural areas, remittances and public transfers have played a more critical role but are still lower in size when compared to labor earnings (Figure A.11, Panel A).<sup>21</sup> Remittances and labor income drove poverty reduction in the 2015 SCD period, and government transfers also played a limited role.

The predominant role of labor earnings in poverty reduction in the pre-COVID-19 period is consistent with rapid real earnings growth among the bottom three quintiles, and among low and medium-skilled workers. Average hourly real wages grew fast during this period, in contrast to the 2015 SCD period when real wages were flat. Earning growth was faster among the bottom three quintiles than among the top two quintiles

21 Based on Shapley counterfactual decomposition methods.

(Figure A.12, Panel A). These trends are consistent with those observed across the skill distribution, as the earnings for low and medium-skilled workers grew faster than the earnings among high-skilled workers,<sup>22</sup> and the employed in the bottom three quintiles are much more likely to be low or medium-skilled workers (Figure A.12 Panel B). Earnings grew the most among the low-skilled (cumulative 15.5 percent), followed by those with medium-skills (cumulative 13.7 percent). High-skilled workers experienced a lower, though still high, real wage growth (11.7 percent). The Gini coefficient of labor income has fallen significantly since 2012 (Figure A.12 Panel C).

**Higher earnings at the bottom reflect rising real wages in the agriculture and retail sectors, and B40 shifts from agriculture to better paid, unskilled labor-intensive jobs in services.** Real wages grew more for low-wage sectors. Real wages in the wholesale and retail sectors grew most during the pre-COVID-19 period (annual 4 percent). In contrast, real wages in the agriculture sector grew only 1.9 percent per year. Poverty reduction was highly associated with increased agricultural and retail earnings as these two sectors employed a large share of the poor. Labor shifts toward higher growth (mainly services) sectors were also observed, with the share of the B40 employed in agriculture declining from 42 percent in 2012 to 32 percent in 2019 and increasing in hotels and restaurants, construction, and wholesale and retail trade (Figure A.13). These shifts played a secondary role, and account for only 11.9 percent of the labor income poverty reduction, with lower effects in urban areas (Figure A.14).<sup>23</sup>

**Employment contributed little to poverty reduction.** In the pre-COVID-19 period, the B40 saw their employment rates fall and a decrease in labor force participation. Women experienced more significant declines. A sharp rise in the youth not in education, employment, or training (NEETs) is also observed for the B40. As a result, labor market gaps between the B40 and the rest widened. Informality rates declined slightly among the B40 but were still very high in 2019, suggesting that rising real earnings were not associated with movements to the formal sector (Figure A.15).

**Remittances played a secondary role in poverty reduction, slightly more so in rural areas, as the bulk of remittances does not reach the B40.** Consistent with the migration patterns, only 14 percent of the B40 households receive remittances compared to 23 percent among the top quintile (EHPM, 2019). In 2019, only 9 percent of the B40 lived in households with at least one emigrant, compared to 19 percent of the upper quintile (EHPM, 2019). In rural areas, the impact of remittances on poverty reduction is higher, as 26 percent of households received remittances compared to 17 percent in urban areas. Remittances also represent a larger share of household income (11 percent in rural versus 5 percent in urban).

**Even before the COVID-19 crisis, food insecurity was high for the lowest income quintile and in rural areas.** El Salvador ranks 66 of 113 on the Global Food Security Index. Food insecurity has not improved much since 2012.<sup>24</sup> In 2018, 17 percent of households in the lowest quintile indicated skipping at least one meal due to a lack of resources (EHPM, 2018). Urban-rural disparities are high.

22 The following definitions were used: Low-Skilled (Never attended Primary), Medium-Skilled (Secondary incomplete and complete), and High-Skill (Tertiary incomplete and complete).

23 Based on Huppi-Ravallion decomposition methods.

24 No data is available before 2012.

## Income Inequality

Income inequality declined in the pre-COVID-19 period, driven by pro-poor growth and improved shared prosperity, but the pace was slower than during the 2015 SCD period. The Gini coefficient fell from 0.418 in 2012 to 0.388 in 2019, well below the regional average (Figure A.16 Panel A).<sup>25</sup> However, El Salvador was only an average performer worldwide (Figure A.16 Panel B). During this period, there was stagnant or falling income for the top of the income distribution, underscoring the lack of economic transformation and limited job creation. This reduction in the Gini coefficient (0.03 points) represents a modest decline in inequality compared to the one observed in the 2015 SCD period (0.096 points).

Inequality fell more in rural areas, driven by private transfers and nonlabor income. While most of the reduction in urban areas was driven by labor income, in rural areas it was led by non-labor income (other than pension and remittances).<sup>26</sup> Pensions do not contribute to a reduction in inequality as they mainly go to the wealthiest quintile of households. Also, remittances do not contribute significantly to a reduction in inequality compared to labor income (Figure A.11, Panel B). The fiscal system has played a significant role in reducing inequality during this period, with education and health spending contributing to significant reductions in the Gini index. In comparison, labor income drove inequality reduction both in rural and urban areas in the 2015 SCD period. Labor income explained 72 percent of the inequality reduction in the 2015 SCD period, followed by remittances (7 percent) and transfers (3 percent).

## Vulnerability to Poverty and Middle Class

Households that moved out of poverty did not move too far from the poverty line, despite middle-class growth. The decline in moderate poverty from 2012 to 2019 translated primarily into an expanding vulnerable group,<sup>27</sup> reaching 48.2 percent of the population in 2019 (Figure 1.5), the largest in LAC, and an increase from 2000 and 2012. While they may have escaped poverty, this population is at risk of becoming poor after any adverse income shock. The share of the middle class grew from 17.2 percent in 2012 to 29 percent in 2019 but remained among the lowest in LAC (Figure 1.6). This is, however, an improvement compared to the 2015 SCD period, which saw a decline in the middle class.

High vulnerability to poverty is driven mainly by adverse income shocks. A forward-looking measure of vulnerability to poverty shows that close to one-fourth of the population is likely to be poor *ex-ante*: 23.7 percent in 2019, slightly higher than the proportion of the population that is poor (below US\$5.5/day).<sup>28</sup> There is a significant overlap with poverty, but a large fraction of the non-poor are vulnerable. Vulnerability to poverty is much higher in rural areas than in urban areas (41.2 vs. 13.5 percent), and is primarily risk-induced rather than poverty-induced. The risks households face are mainly idiosyncratic (at the household level) as opposed to covariate (at the municipality level), especially for urban households, which means that vulnerability is primarily driven by random risks faced by individuals instead of joint risks affecting whole

25 Official measures likely understate the true extent of inequality. Incomes and consumption surveys do not fully capture households at the top end of the income distribution and estimates of inequality based on income or consumption could be understating true inequality.

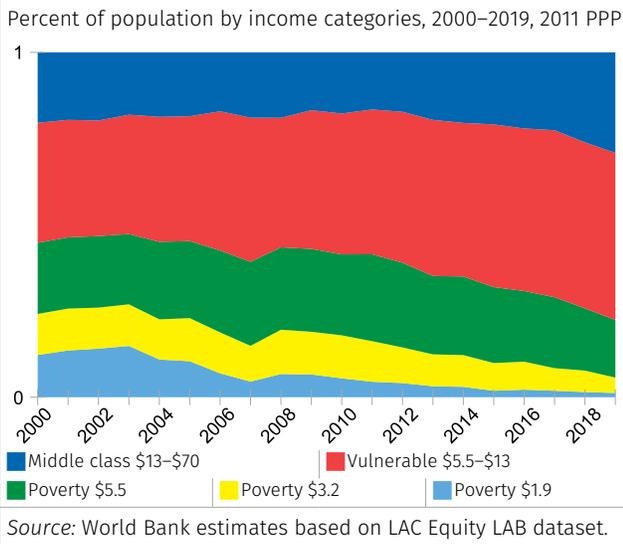
26 Non-labor income includes private transfers, capital income, and implicit rent.

27 Vulnerable population using operational definition (those earning between USD 5.5 and 13 a day).

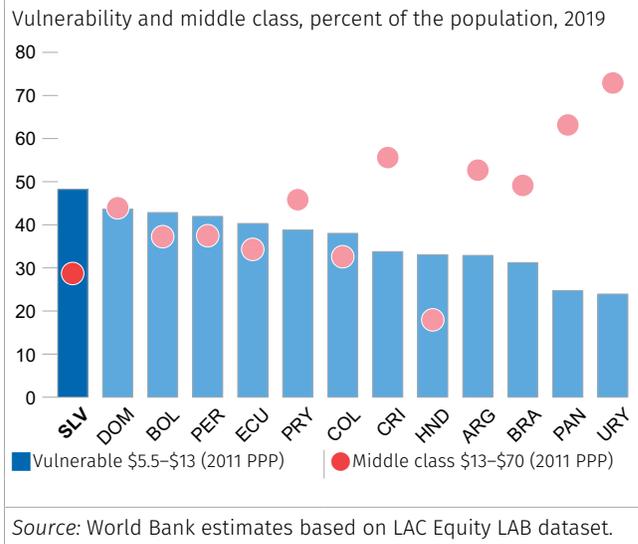
28 This is different from the operational measure of vulnerability, as it captures those that are more likely to be poor in the future as a result of shocks across the welfare distribution (including the current poor and the non-poor).

communities (Annex 3.3). Several groups also experience vulnerability due to historical disenfranchisement, systemic discrimination, and lack of voice and participation. For example, multidimensional poverty shows that persons with disabilities in El Salvador have one of the highest household deprivations rates in the region (44 percent) (Garcia Mora et al. 2021). Crime, violence, and different forms of social and economic exclusion compound the risks for these groups (Annex 7.1).

**Figure 1.5. Vulnerability to poverty rose significantly in the pre-COVID-19 period, the highest in LAC by 2019**



**Figure 1.6. The middle class is still small, the second-lowest share of the population in LAC**



### The COVID-19 Crisis and Prospects for Growth, Poverty, and Equity

El Salvador succeeded in containing the worst effects of the COVID-19 crisis but at high costs. The country entered the COVID-19 crisis with a fragile fiscal situation: it had the largest debt (73.6 percent of GDP) and the third-largest budget deficit (-3.1 percent of GDP) in Central America in 2019. As a result, the country’s fiscal response of nearly 15 percent of GDP, had to be financed by debt (Figure A.17). The response cushioned the fall in economic activity but undermined fiscal sustainability as the deficit, and the debt reached 9.2 and 91.8 percent of GDP by the end of 2020.

The country needs to restore fiscal sustainability without hurting recovery or the poor. Under a no-policy change scenario, fiscal forecasts put the country in a challenging fiscal situation as a result of a large wage bill (11.9 percent of GDP in 2020) and increasing interest payments (4.4 percent of GDP in 2020). In the absence of a credible adjustment program, spreads on its sovereign external bonds, which are above 1,000 basis points, will be on the high side, making it harder to cover financing needs, especially in 2023 and 2025, when two large bonds will mature.

The COVID-19 crisis is expected to reverse hard-won gains in poverty reduction, inequality, shared prosperity, and the middle class. While the fiscal response<sup>29</sup> prevented some welfare losses, the B40 is unlikely to have recovered quickly as mitigation measures were not well-targeted, and most remittances did not go to the B40.<sup>30</sup> Simulations suggest the crisis pushed large segments of the population into poverty, shrank the middle class, and increased inequality, even when mitigation measures are considered (Figure A.18 Panel A).

Recent job gains have been uneven and fall short of what is needed. Data from the 2020 and 2021 HFS show that job recovery has been uneven, with men regaining employment faster than women. This is largely because women work in low-productivity, low-wage services, and other sectors critically hit by the COVID-19 crisis.<sup>31</sup>

The pandemic has exacerbated food insecurity. The loss of income affected food insecurity; about 40 percent of households were food-insecure at the beginning of the pandemic (Figure A.18 Panel B), and rural households were disproportionately affected. Recent HFS data for late 2020 and 2021 suggest some recovery, but levels remain well above reported pre-pandemic levels.

The key goal for boosting growth in El Salvador is to promote policies that can enhance productivity. On the human capital side, the greatest payoffs are in expanding Early Childhood Education, which yield the largest gain in education investment and also supports greater female labor force participation. Introducing a systemwide learning evaluation with feedback loops will allow for greater overall education quality, and together with the expansion of technical and vocational education, could reduce school drop-out rates and improve the quality of the workforce, a major problem faced by businesses. Productivity can grow with higher investment, especially from high-quality public investment from improved public investment management and from FDI. The highest yielding reforms come from trade facilitation regulations to foster competition and attract private investment to infrastructure.

A stable macroeconomic environment with the fiscal resources to provide public services and address infrastructure gaps is essential for productivity. El Salvador has had low inflation since the dollarization, and external accounts, although in deficit, have been financed by FDI and portfolio inflows. The major macroeconomic weakness has been fiscal policy. The country had had persistent deficits, which has led to higher debt. In order to ensure sustained fiscal sustainability, it needs to revise laws and policies that grant automatic wage increases above inflation and address imbalances and other problems in the pension system, such as low coverage. On the revenue side, there is room to increase progressivity and revenues by introducing property tax, revising tax expenditures, and relying more on environmental taxation, in addition to gains in tax administration efficiency. All of this has to be done under a revised Fiscal Responsibility Law, the current one has been suspended since the pandemic, with fewer rules and targets but with built-in correctional mechanisms and foundations for better policies such as a medium-term debt strategy and a medium-term expenditure framework.

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29 Measures included: (i) suspension of utility fees for three months; (ii) temporary cash compensation; and (iii) distribution of food baskets. The HFS show broader coverage of COVID-19 programs than existing ones; but, the poverty impacts were limited for lack of a strong targeting.

30 Microsimulations using administrative data from *Instituto Salvadoreño de Seguridad Social* on formal employment and wages (based on health contributions), 2019 household survey data (EHPM), and remittances flows from the Central Bank.

31 Official estimates of employment losses from the 2020 household surveys suggest that the crisis had a small impact on unemployment (0.6 percentage points), but methodological differences make difficult the direct comparisons with 2019.

## 2. Sources of Vulnerability and Emerging Priorities

*Household Vulnerability: Fostering human capital accumulation, access to jobs, and strengthening the effectiveness of the social protection system*

Priority Area 1: Fostering human capital accumulation

**Table 2.1. Comparing the changes in core human capital indicators, 2015 SCD versus SCD Update**

	2015 SCD, circa 2000–12			SCD Update, circa 2012–20			
	2000	2012 (a)	2000–12 (avg. annual rate)	2019 (b)	2020 (c)	pre-COVID-19 period, (avg. annual rate)	post-COVID-19 period, (annual change)
Pre-primary enrollment (gross percent)	44.2	62.6	2.9	66.7	NA	1.1	NA
Primary enrollment (gross percent)	112.1	112.4	0.0	94.8	NA	-2.8	NA
Out-of-school ratio (ages 0–18, percent)	NA	7.0	NA	17.0	NA	15.9	NA
Tertiary enrollment (gross percent)	21.4	28	2.3	29.4	NA	0.8	NA
Learning-adjusted years of schooling	NA	NA	NA	7.6	6.8	5.0	-0.8
Education spending (percent of GDP)	2.8	3.7	2.3	3.6	NA	-0.5	NA

Sources: Ministry of Education, Science and Technology of El Salvador, WB Human Capital Index, and WDI.

Notes: (a) All years are 2012, except the year of the out-of-school rate, which is 2014. (b) The latest year for all indicators is 2018 and for out-of-school rates and learning-adjusted years of schooling it is 2019. (c) The learning-adjusted years of schooling data point for 2020 are based on a simulation.

As highlighted in the SCD, lack of human capital accumulation undermines the growth of households' income over their lifecycle. According to the HCI, a Salvadoran child born today will only be 55 percent as productive as the scenario where they enjoyed complete education and full health. Productivity losses are driven primarily by quantity and quality of education. A Salvadoran child is expected to complete 10.9 years of schooling, but adjusted for the quality of learning, these are equivalent to only 7.6 years (Figure A.19). The years of schooling increased between 2000 and 2012 (from 9.9 to 11.3) but have fallen since. Girls' years of schooling are only slightly higher than boys', even when adjusted for quality (7.8 vs. 7.5). Poor children have worse outcomes, with around 20 percent unable to read or write a single word by third grade (USAID, 2018).

**Access to education is among the lowest and most inequitable globally, and rising youth out-of-school rates are concerning.** Enrollment rates for early childhood care centers (ECCE) are extremely low,<sup>32</sup> and gross primary and secondary school enrollment rates have been declining since 2000 and 2013, respectively. Out-of-school rates for youth (12–16) increased between 2014 and 2018 (Figure A.20). Inequalities in access to education for the poor and non-poor are narrow in early ages, but significant gaps emerge later. In addition, the country has the highest gap in LAC in school attendance at primary level between students with and without disabilities (Garcia Mora et al., 2021). Household surveys suggest dropout rates for students ages 13–15 are associated with a lack of interest in studying (suggesting a perception that returns to education are low), and family or health problems. Underlying structural factors such as migration, violence, and gender norms in girls may also undermine attendance (Fundación para la Educación Superior, 2019). Enrollment rates are lower in rural than urban areas (EHPM, 2019).

**Crime further deteriorates human capital accumulation by reducing years of schooling.** The Ministry of Education estimates that: (i) about two-thirds of schools suffered from gang problems, and (ii) approximately 36,000 students left the educational system in 2016, around 15,000 of whom left because of gang violence. Gangs recruit children in school and impact the total years of schooling (Sviatschi, 2019 and 2020).

**The COVID-19 pandemic negatively affected human capital accumulation.** Lack of digital connectivity presents a barrier to education for specific groups and contributes to wide disparities in access to remote learning opportunities; this was felt particularly keenly during the COVID-19-related school closures. The Survey of Education Continuity (ENCPE) found that online education faced significant challenges (low connectivity, insufficient support to children, insufficiently trained teachers, and poor content of online courses). WB simulations suggest that school closures may have reduced schooling by more than one learning-adjusted year, and learning losses could cause a 4.5–8.5 percent reduction of future incomes (Figure A.21).

**Three sets of actions can support human capital accumulation.** These are: (i) investing in ECD, particularly for children at risk; for example the number of children under six in one household is correlated with poverty, according to our Probit estimates (Annex 3.4) and the literature (Almond et al., 2018); (ii) promoting equitable access to primary and secondary education and curtailing drop-out rates. A better understanding of drivers is required, but some policies (financial incentives to promote enrollment among vulnerable children and tackling teen pregnancy) could help address access and drop-out, and (iii), improving the overall quality of education and, in particular, introducing a continuous and systematic learning assessment system that feeds into education policies. There are complementarities between these actions and reforms on workforce development proposed on Priority Area 5, as an individual with higher human capital tends to benefit more from workforce development training.

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32 About 95 percent of children below four years old do not attend an educational center (EHPM, 2019).

## Priority Area 2: Promoting access to jobs

**Table 2.2. Comparing the changes in core labor market indicators, 2015 SCD versus SCD Update**

	2015 SCD, circa 2000–12			SCD Update, circa 2012–20			
	2000	2012 (a)	2000–12 (avg. annual rate)	2019	2020	pre-COVID-19 period, 2012–19 (avg. annual rate)	post-COVID-19 period, 2019–20 (% point change)
Informal employment rate (percent) - agriculture	NA	97.5	NA	96.5	96.6	-0.2	0.1
Informal employment rate (percent) - non-agriculture	NA	62.8	NA	63.8	63.3	0.3	-0.5
Labor force participation rate, female (percent of female pop. ages 15+) (modeled ILO estimate)	45.4	46.6	0.2	45.4	NA	-0.4	NA
NEET (female, percent)	41.7	39.6	-0.4	39.8	NA	0.1	NA
NEET (bottom 20, percent)	45	36.1	-1.8	43.4	NA	2.7	NA
Unemployment rate (bottom 20, percent)	8.6	10.6	1.8	14.2	NA	4.3	NA

*Source:* Informality from ILOSTAT; NEET (Female) and LFP from WDI; indicators for bottom 20 from World Bank estimates based on household surveys. NEET = not in employment, education, or training.

**Productive employment was not prioritized in the SCD, but is a central issue in the current context.** This is particularly the case as labor market outcomes for the poor and vulnerable deteriorated during the pre-COVID-19 period, and high levels of female inactivity and informality remain.

**Rates of inactivity and NEETS increased for the B20 over this period, which exacerbated the shortage of labor at the bottom.** Faster real wage growth among those with low and middle-skill levels (completed complete secondary and below) suggests a tighter labor market for workers with low and middle-skills as is consistent for an economy with limited structural transformation and relatively high growth for low and middle-skill labor. There is also, a scarcity of these workers due to a changing workforce composition toward more educated workers and older workers associated with demographics, migration, and dropping labor force participation among the unskilled (see Annex 6 for details).

**This low and declining labor force participation among the B40 is likely associated with remittances, but other factors may be at play.** Recent evidence shows that remittances disincentivize labor force participation in El Salvador, and that this effect is strongest for the second and fourth income quintile. The higher is the level of remittances, the higher is the reservation wage of the individual, and the lower is the likelihood that he or she participates in the labor force. Demographic factors (demographic presence of children at home, sex and education) and a lack of good job opportunities both discourages some people from searching for employment.

**Female labor force participation is among the lowest in LAC.** In 2019, the female labor force participation rate was 45.4 percent, vs. 75.7 percent for males. The determinants of female participation have not been well studied but possibly include childcare responsibilities, social norms, labor market restrictions, and lack of working experience (Annex 3.5). Remittances can also increase the reservation wage. In particular, women

living in households that receive remittances were 13 percentage points less likely to seek a job (Sousa and García-Suaza, 2018).

**People from the B20 who participate in the labor market are increasingly less likely to find a job, suggesting that employment barriers and mismatches also play a critical role.** Unemployment among the B20 increased by 3.6 percentage points in the pre-COVID-19 period. The labor market for low and middle-skills is tighter despite rising unemployment because many of the unemployed are not available for jobs that need to be filled, given significant mismatches and barriers that disproportionately affect those at the bottom.

**Low skills and skill mismatches are critical barriers to employability.** Education choices do not correlate with labor market demands and experience requirements. (World Bank, 2020b). Policies that increase human capital promote inclusive growth and poverty reduction over the medium term by increasing labor productivity and wages; however, unemployment is not reduced significantly, and employment growth can be limited unless these policies are combined with additional policies that incentivize formal-sector job creation (SIMLAB, Annex 3.1), such as those presented in Priority Area 5.

**Rigid labor market regulations, limited mobility associated with gang violence, the digital divide urban-rural, and lack of access to child and elder care hold back economic opportunities.** The labor regulations rigidity index in El Salvador is high compared to LAC (Figure A.22). While temporary contracts exist, they are not easy to enforce, adjustments to an individual work schedule are complex, and part-time jobs are penalized. Restrictions on labor mobility imposed by crime (Melkinov et al., 2020 and Hayatama et al., 2020) and the urban-rural digital divide (Figure A.23 and Figure A.24) affect access to jobs in certain areas. When the additional challenges of limited child and elder care, adverse social norms, and the high rate of teen pregnancy are factored in, it is particularly difficult for women and youth to find jobs. The high minimum to median wage ratio creates barriers for these two groups and the unskilled in the formal sector

**El Salvador's large informal sector has low productivity; there have been only minor improvements among the bottom income quintile, suggesting that the quality of jobs is also an issue.** Informality rates are among the highest globally and in LAC, especially for the B20 (more than 80 percent of workers are informal; EHPM, 2019). The informal sector accounts for around 43 percent of GDP and about 70 percent of total employment, of which 60 percent is self-employment (Ulku, 2021). Productivity in the informal sector is 20 percent lower than in the formal sector. Social programs do not serve the informal sector, and regressions show that informality is highly correlated with the probability of being poor (Annex 3.4). Informality rates for the B20 experienced minor improvements during the pre-COVID-19 period.

**High labor taxation and a large public-sector wage premium reduce incentives to work in the formal private sector.** El Salvador's tax wedge is high, particularly among low-income countries, and it is less progressive than in other countries (World Bank, 2020b). A high tax wedge reduces labor supply by discouraging work<sup>33</sup>, particularly among low-wage earners and women, and labor demand by increasing labor costs. High and increasing public-sector wage premiums also discourage work in the formal private sector.

**The COVID-19 crisis exposed these vulnerabilities.** The COVID-19 crisis increased poverty as a result of substantial job losses, particularly in the service sector and among low-skilled individuals. Women and

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33 This is especially the case for low-wage earners and women.

youth have been disproportionately affected. B20 earnings gains that were achieved prior to COVID-19 have likely eroded as these gains were in sectors most affected by the crisis. Low internet access and computer ownership among the poor severely restrict their ability to work from home.

**Promoting more and better jobs, and tackling barriers to women and youth are the best means of addressing poverty reduction.** Prior to COVID-19, labor income growth was key to reducing poverty, more than social transfers, remittances, and demographic changes; employment status is also the main determinant of poverty (Annex 3.4). In this context, policies that encourage steady growth in formal employment and rising productivity can substantially impact poverty reduction.

**The reform agenda could focus on removing barriers to employment.** Vulnerable groups that typically fall outside safety nets<sup>34</sup> need to be prioritized. Boosting employability requires a comprehensive and age-sensitive approach, including enhancing access to affordable child and eldercare, promoting flexible work, boosting active labor market policies (ALMP) and policies to help the school-to-work transition, building relevant skills across the lifecycle (PAs #1 and #6), and enabling geographic mobility, particularly in areas affected by gangs. Improving labor market information, particularly in rural areas, can help address job mismatches. Finally, the design of tax rates and public-sector pay and compensation system needs to be improved.

### Priority Area 3: Strengthening the effectiveness of the social protection system

**Table 2.3. Comparing the changes in social protection indicators, 2015 SCD versus SCD Update**

	2015 SCD, circa 2000–12			SCD Update, circa 2012–20			
	2007 (a)	2012	2007–12 (avg annual rate)	2019	2020	pre-COVID-19 period, 2012–19 (avg annual rate)	post-COVID-19 period, 2019–20 (% point change)
B20 social pension coverage (percent) (a)	NA	1.2	NA	2.3	NA	1.1	NA
B20 Beneficiary incidence all social programs (percent)	30.6	20.8	-7.4	21.3	NA	0.3	NA
B20 Contributory pension coverage (percent)	1.5	2.0	6.1	3.1	NA	6.3	NA
B20 Beneficiary incidence, social assistance (percent)	35.7	21.0	-10.0	21.6	NA	0.4	NA
T20 Coverage of social safety net programs (percent)	6.9	76.9	61.9	66.8	NA	-2.0	NA

Source: ASPIRE Database.

Note: (a) The social pensions program started in 2009 so there is no data for 2007 or before (Pension Basica Universal).

As highlighted in the SCD, the social safety net (SSN) has low progressivity; coverage of pensions and the CCT program is low. B20 beneficiary incidence by social and labor programs decreased during the 2007–12 period and increased only slightly in the pre-COVID-19 period. El Salvador could perform better

<sup>34</sup> Survivors of gender-based violence; migrants, refugees; LGBTI people; persons with disabilities; and Indigenous Peoples and Afro-descendants.

on the incidence of social assistance programs for the poorest quintile, as it ranks low globally and in LAC. Overall SSN expenditure is not small, at about 1.3 percent of GDP in 2019, however, most spending goes to weakly-targeted programs where eligibility is not based on income, but on other household characteristics. In 2019, about 36 percent of all SSN beneficiaries belonged to the T40. The CCT program is well-targeted but has negligible B20 coverage, partly due to low budget allocation (Figure A.25). Coverage for social and contributory pensions barely increased during the pre-COVID-19 period and is still extremely low worldwide (benchmarking exercise).

**The current social protection system cannot address existing and emerging shocks.** COVID-19 and the fact that most vulnerability to poverty is risk-induced underscore the need for adaptive social protection. This requires: (i) good targeting systems to identify households with limited ability to absorb and cope with shocks, these tend to be the poorest households, but could be the vulnerable non-poor (Annex 3.3); (ii) good inter-institutional coordination across social protection, climate change, and disaster risk management authorities, and a strategy to address the increased risks from climate change; (iii) regulations for social programs that allow rapid scalability; (iv) good information systems: an integrated social registry and efficient payment systems to increase program coverage in affected areas linked to early warning systems; and (v) budget mechanisms, potentially with trigger rules, to release additional funds as needed.

**Problems with social protection program delivery constrain administrative efficiency.** The CCT registry is not integrated with most social programs and is not interoperable with administrative databases. The system lacks harmonized targeting criteria, and outdated household information further restricts targeting. The digital payments system is out-of-date and requires urgent upgrading, in its current state it leads to increased transaction costs and susceptibility to error, fraud, and corruption. These factors undermine efficiency and hinder the provision of effective responses during crises, especially for the most vulnerable.

**Non-contributory pensions are pro-poor, but pensions in the defined contribution system are not; both are financially unsustainable.** Non-contributory pensions are among the most progressive programs in El Salvador and are pro-poor, but they have limited impact on poverty given their low coverage and low payments.<sup>35</sup> Contributory pensions are regressive and not pro-poor: this system excludes a large share of the poor and informal sector, also limiting impacts on poverty.

**The COVID-19 crisis highlighted the existing shortcomings of the SP system.** El Salvador relied partly on existing SP mechanisms and partly on new temporary mitigation measures to respond to the COVID-19 crisis, which helped mitigate its impact. A stronger SP system is needed now for a resilient and inclusive recovery. Reforms include: (i) improving the targeting of categorical<sup>36</sup> and indirect subsidies to create the fiscal space for expanding the CCT and other policies to promote human capital; (ii) increasing coverage and benefit levels of well-targeted social programs such as the CCT; and (iii) enhancing adaptiveness of the SP system to respond to natural disasters and other shocks.

**As the demographic bonus fades, the dependent population will age, requiring a more financially sound and equitable pension system.** An important first step is to actuarially balance the Solidarity Guarantee Account that pays for social pensions. Past pension reforms did not fully address certain significant issues:

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35 Source: Oliva and Robayo-Abril (forthcoming). A transfer is “pro-poor” if the proportion received in absolute terms decreases as income rises. This is measured by a negative concentration coefficient.

36 Based on individual characteristics, not income.

low retirement ages, growing public debt, and low pension coverage (Figure A.26). The following measures are needed to increase adequacy and coverage of contributory pensions: increasing retirement age and contribution rates; improving asset management; increasing coverage; and abstaining from ad hoc unfunded increases in minimum pension.

### *Firm Vulnerability: Fostering a more dynamic and competitive private sector by enhancing labor productivity, FDI, and trade integration*

#### Priority Area 4: Enhancing private and public investment

**Table 2.4. Comparing the changes in investment indicators, 2015 SCD versus SCD Update**

	2015 SCD, circa 2000–12			SCD Update, circa 2012–20			
	2000	2012	2000–12 (avg. annual rate)	2019	2020	pre-COVID-19 period, 2012–19 (avg annual rate)	post-COVID-19 period, 2019–20 (% point change)
Gross fixed capital formation (percent of GDP)	17.7	16.6	-0.005	17.8	17.4	0.010	-0.42
Public investment (percent of GDP)	3.7	3.7	-0.001	3.2	2.8	-0.020	-0.4
Foreign direct investment (percent of GDP)	1.5	2.0	0.026	2.7	0.8	0.042	-1.87

Source: WDI and BCR.

**Savings and investment rates are low, despite remittances.** The investment-to-GDP ratio was only 16.4 percent (2013–19), which is low relative to structural and aspirational peers (21.3 and 21.8 percent, respectively). Domestic savings are a huge constraint to investments as the consumption-to-GDP ratio averaged 100.3 percent from 2013 to 2019. However, external flows (particularly remittances, but some FDI) have been used to finance investments. Net transfers from abroad brought national (as opposed to domestic) savings to 13.5 percent of GDP on average between 2013 and 2019.

**El Salvador has the lowest FDI levels in the region and among peers.** FDI averaged only 2 percent of GDP from 2013 to 2019, while structural and aspirational peers attracted on average 5.2 and 4.5 percent of GDP, respectively. FDI's lagging performance is partly explained by the small size of the domestic market, but mostly by weaknesses in the business environment, which is also reflected in the country's low participation in global value chains (GVC).

**Private financing for infrastructure is hindered by regulatory issues.** The PPIAF database registered only one infrastructure project with private participation during the 2015 SCD period and nine during the pre-COVID-19 period with CAPEX of US\$385 million and US\$1,180 million, respectively; the latter was driven by a large single project in 2018.<sup>37</sup> There are many opportunities for private financing of infrastructure in El

<sup>37</sup> The PPI database records contractual arrangements for public infrastructure projects that have reached financial closure, in which private parties assume operating risks. Please see <https://ppi.worldbank.org/en/methodology/ppi-methodology> for more details on the methodology.

Salvador. Public-private partnerships (PPP) have not been used widely given restrictive legislation that requires contracts to be approved twice by parliament and that prohibit international arbitration. The lack of regulatory agencies in water and sanitation is also an obstacle.

**Public investment is low and relatively inefficient.** Central government investments declined from 2.8 to 2.4 percent of GDP between the 2015 SCD period and the pre-COVID-19 period, lower than its structural and aspirational peers for both periods. The former declined from 6.3 to 4.2 percent of GDP and the latter from 4.4 to 3.7 percent of GDP. A review of public investment management (Korea Eximbank, Korean Ministry of Strategy and Finance & IDB, 2017) found shortcomings, such as poor planning and budgeting, deficient pre-investment studies, incomplete bidding processes, poor coordination and communication within executing units, and an overall lack of technical capacity. The government also needs to broaden the focus of public investment management to consider long-term measures for disaster risk analysis given El Salvador's exposure to natural disasters, and to ensure that infrastructure is resilient enough to cope with the predicted increase in natural disasters as a result of climate change.

**Crime is another factor that affects low public and private investment rates.** The Central Bank estimated crime-related costs to the economy of 16 percent of GDP in 2014, the highest in CA (BCR, 2016), similar to the estimate obtained by the IMF (Plotnikov, 2020). Crime diverts significant public spending to public security that could otherwise be used to increase public investment.

**Specific reforms to increase the level and quality of public and private investments are key for recovery.** First, to increase investments, a credible medium-term fiscal consolidation is needed to evaluate trade-offs and to decide how fiscal space will be created. In parallel, key public investment management shortcomings also need to be addressed; improving the legal and regulatory framework for PPPs could also help boost investments over time. Second, to attract FDI, El Salvador must improve its business environment and sharpen its FDI process: small countries generally need to improve their business environment to lure efficiency-seeking FDI. Suggested reforms include updating the strategic framework for FDI attraction, prioritizing services of aftercare and advocacy, and strengthening inter-institutional coordination. Given scarce public resources, El Salvador would benefit from a cost-benefit analysis to identify how to make tax incentives more effective and, if possible, reduce tax expenditures.

## Priority Area 5: Fostering a more dynamic, competitive, and innovative private sector

**Firms in El Salvador grow very little over time and rarely export consistently.** Registration of new businesses in El Salvador is low, the share of young formal businesses (with at most three years in operation) is only 0.7 percent of the total number of registered firms, compared with 1.3 percent in Central America and 3.2 percent in LAC (WB, 2021). Firm's export survival rates declined from 0.40 to 0.32 between 2012 and 2019, and there is a large gap between the 1st year survival rate (0.35 in 2017), the 2nd (0.22) and 3rd (0.16). Additionally, female-owned businesses faced more barriers to growth, for example, only 35 percent of women have access to entrepreneurial networks (as opposed to 50 percent of men), decreasing their odds of success. As a result, labor productivity growth was negative (-2.3 vs 2.9 percent), and sales growth was practically zero (-0.1 vs. 3.7 percent) in female-owned firms compared with male-owned ones.

**Table 2.5. Comparing the changes in business environment and trade indicators, 2015 SCD versus SCD Update**

	2015 SCD, circa 2000–12			SCD Update, circa 2012–20			
	2000	2012	2000–12 (avg. annual rate)	2019	2020	pre-COVID-19 period, 2012–19 (avg.annual rate)	post-COVID-19 period, 2019–20 (% point change)
Informal output (percent of GDP)	45.8	42.0	-0.007	40.8	N.A.	-0.004	N.A.
Trade flow (percent of GDP)	59.3	77.7	0.023	77.5	69.4	0.000	-8.11
Exporter survival rate (percent)	42.7	39.5	-0.006	32.2	N.A.	-0.029	N.A.
Expenditure on research and development (percent of GDP)	0.1	0.0	-0.09	0.2	N.A.	0.29	N.A.
Trademark applications (number)	5,388	7,496	0.03	8,121	N.A.	0.01	N.A.
Education attainment, at least tertiary (percent of pop.)	10.6	10.2	0.00	8.0	N.A.	-0.03	N.A.

Sources: WDI and BCR.

Note: (a) Latest informal output data is from 2017, and the earliest export survival data is from 2007. (b) The initial and the latest data for expenditure on research and development and education attainment, respectively, are from 1998 and 2006; and 2017, while the initial data for trademarks are from 1997.

**An unfavorable business environment for formal firms undermines productivity.** The 2019 Global Competitiveness Report ranks the country 111th in business dynamism.<sup>38</sup> Key constraints for new and existing firms include regulatory barriers and high administrative costs, both of which limit job creation. Discretion in implementing business regulations provides an opportunity to well-connected firms, creating barriers to market entry.

**Trade integration is low as a result of internal barriers like poor trade facilitation and low quality transport infrastructure.** Tariffs are not high, the simple mean tariff in El Salvador was 3.37 percent in 2019, with only Lithuania, Bosnia, and Albania having a lower tariff among peers. In addition, the country has ten free trade agreements (compared to 5.6 and 21.3 from structural and aspirational peers), and the number and coverage of provisions in trade agreements are higher than in both structural and aspirational peers. However, the cost of non-tariff barriers is the highest among all Central American countries. On the WB Logistics Performance Index, El Salvador's performance in 2018 is below the average for structural peers (2.58 versus 2.62), it also received the lowest scores on the efficiency of the clearance process by border agencies and the quality of trade and transport-related infrastructure. Seamless border crossings are essential for higher participation in GVC, this would increase growth and job potential in the food and beverage, wood, and apparel sectors.

<sup>38</sup> Business dynamism is the 11th pillar of the Global Competitiveness Index and it is composed of eight variables: cost of starting a business, time to start a business, insolvency recovery rate, insolvency regulatory framework, attitudes towards entrepreneurial risk, willingness to delegate authority, growth of innovative companies, and companies embracing disruptive ideas.

**Regulatory protection is high for incumbents in network sectors, leading to allocation distortions and lower productivity.** The World Economic Forum's (WEF) domestic competition index, which measures the distortive effect of taxes and subsidies on competition, the extent of market dominance, and competition in services, is lower for El Salvador (46.6) than for structural (49.1) and aspirational (52.5) peers. For example, uncompetitive markets in road freight services increase trade costs. Another barrier to competition is government involvement and protection of incumbent companies in network sectors. According to WB and OECD Product Market Regulation (PMR) indicators, El Salvador scores high (lower is better) on: (i) government involvement in the network sector (2.8), above that of Jamaica (2.03) and Lithuania (2.62), and (ii) in barriers to entrepreneurship (2.64), well above aspirational peers (1.61), but below structural peers (3.25).<sup>39</sup> It is one of the worst performers (overall) in the regulatory protection of incumbents in network sectors (3.79).<sup>40</sup>

**Another source of vulnerability is the unfair competition from informal firms.** Informality in El Salvador (40.8 percent of official GDP in 2017) is higher than in structural (30.2 percent) and aspirational peers (35.2 percent).<sup>41</sup> Sixty-nine percent of Salvadoran formal firms compete against informal firms, and 43.7 percent of formal firms consider this competition to be a major constraint, according to the WB Enterprise Survey. Informal firms inhibit the growth of the formal sector and reduce overall productivity as they tend to employ more low-skilled workers and have more restricted access to funding, services, and markets, all of which lack economies of scale.

**Extortions are a pervasive characteristic of firms' operating environments.** In the 2016 Enterprise Survey, 47 percent of firms consider crime, theft, and disorder to be major constraints, and 27 percent of firms have experienced loss due to theft and vandalism (the highest among peers for both), which cost firms 4.5 percent of sales (third-highest) and led 78 percent of firms to pay for security (the highest among peers), this represents 3.4 percent of sales (the second-highest). Extortions imposed by gangs are high: 42 percent of the SMEs report suffering extortion (21.5 percent), fraud (14.8 percent), and theft (12.8) (FUSADES, 2016). To avoid extortion, some firms prefer to stay small. Extortions increased from 15 to 20 percent after a gang truce as gangs gained monopoly power (Zach et al., 2021).

**Although not highlighted in the SCD, firm innovation in El Salvador is lagging behind.** The country ranked 92 out of 131 in the 2020 Global Innovation Index (GII) due to low quality of education and infrastructure; low technology adoption, lack of linkages for innovation (university-industry collaboration, joint venture deals), low levels of R&D investment, and poor regulatory and business environments.

**The lack of an educated workforce is the first constraint to firms' capacity to innovate.** One-fourth of firms in the 2016 Enterprise Survey stressed they are constrained by general low education among the workforce. In El Salvador, only 7 percent of people aged 25 and above have completed tertiary education, compared to 9.4 percent in structural peers and 27.4 percent in aspirational peers. Research skills are also low, with only 71.2 researchers per million people in El Salvador vs. 471.3 and 596 in structural peers like Bosnia and Jordan, respectively.

39 Koske, I. et al. (2015). The PMR indicators value from zero (least restrictive) to six (most restrictive). Data is available for El Salvador, Honduras, Jamaica, Bulgaria, and Lithuania all from 2013 or 2014.

40 The cost of mobile broadband (3 percent of GNI per capita) is in line with structural peers (3.4 percent) but higher than aspirational peers (1.4 percent). The cost of fixed broadband (8.4 percent of GNI per capita) is higher than in structural (7.1 percent) and aspirational peers (2.1 percent).

41 Measured by dynamic general equilibrium (DGE) model estimates of informal output (percent of official GDP) (Elgin et al., 2021).

The country lags in digital infrastructure, the second constraining factor to innovation and growth. El Salvador is below the LAC average in all five components of the digital development index: infrastructure, public platforms, financial system, e-commerce, and skills. Eighty percent of SMEs lack an internet connection, and firms lack the skills to use e-commerce.

The third constraint to firms' capacity to innovate is slow government support. Well-designed interventions like access to equipment and adoption of technology can remove constraints, but the Minister of Economy (MINEC), El Salvador's Development Bank (BANDESAL), and the National Commission of the Small- and Micro-Enterprise (CONAMYPE) have only one program each in these areas. There are gaps and duplications in programs to promote entrepreneurship and innovation, and very few programs offer technology extension services, early-stage advisory, or support to adopt technology in general. Many programs have very few beneficiaries, and little is known about the impact of government support programs, as only three have implemented impact evaluations.

Key reforms to support a more dynamic and productive private sector include: (i) improving trade facilitation by simplifying and consolidating rules and procedures in consultation with the private sector, scaling up electronic single windows, and improving border procedures, and (ii) simplifying the regulatory framework and protecting SMEs against corruption and crime. Legal and institutional reforms in competition, labor markets, and infrastructure-sharing will reduce the power of incumbent companies and foster entry to new companies. Strengthening enforcement mechanisms, and upgrading the technical capacity of the regulators will also support competition.

Two key reforms could help El Salvador address innovation and entrepreneurial constraints: (i) training programs: improvements to education will help yield a more productive labor force in the long term, and workforce training programs and technical and vocational training can help increase productivity in the medium term; and (ii) government support services will all benefit from improved coordination and scaling up training to micro and small firms. Extension services to firms, especially on technology adoption, should also be expanded. Rigorous impact analysis from SMEs in Mexico showed that training programs that combine traditional coursework (cost, business plan, marketing, etc.) with psychology-based personal initiative training increased the profitability and survival rate of female-owned firms.

### *State Vulnerability: Ensuring sustainable and equitable fiscal policy, natural disaster risk management, and strengthening governance and institutions*

#### **Priority Area 6: Promoting a sustainable and equitable fiscal policy**

The SCD highlighted challenges to the medium-term fiscal framework. El Salvador entered the COVID-19 crisis with a delicate fiscal situation, which was aggravated by the fiscal response to the crisis. Public debt is expected to be at 87.9 percent of GDP by end-2021, high interest (4.2 percent of GDP) and wage (12 percent of GDP) bills mean the deficit will stay elevated (Figure A.27). Revenue mobilization at 17.4 percent of GDP in the pre-COVID-19 period is below its structural and aspirational peers (19.1 and 18.1 percent of GDP respectively), but has limited upside potential without tax policy reform. Difficult debt dynamics (low potential growth rate of 2.5 percent, combined with high average real interest rates of 5.3 percent) suggest that only a sustained fiscal consolidation can stabilize the debt-to-GDP ratio. Sovereign spreads were as high as 1,900 basis points in early 2022, and the country's sovereign rating is the highest in LAC after Argentina, and excluding countries in default.

**Table 2.6. Comparing the changes in fiscal indicators, 2015 SCD versus SCD Update**

	2015 SCD, circa 2000–12			SCD Update, circa 2012–20			
	2000	2012 (a)	2000–2012 (avg. annual rate)	2019	2020 (b)	pre-COVID-19 period, 2012–2019 (avg. annual rate or percentage point change)	post-COVID-19 period, 2019–2020 (% point change and change in impact)
Fiscal deficit (percent of GDP)	-3.4	-3.9	1.1	-3	-9.2	-3.7	-6.2
Primary deficit (percent of GDP)	-1.4	-1.4	0	0.7	-3.0	1.3	-3.7
Public debt (percent of GDP)	40.9	67.8	4.3	73.6	91.8	1.2	18.2
Average Interest Rate on Debt (percent)	N.A.	5.1	NA	5.5	5.5	1.0	0
Fiscally induced poverty change (ppts, US\$5.5)	NA	2.1	NA	3.3	1.6	1.2	-1.8
Fiscally induced inequality change (Gini points)	NA	-0.092	NA	-0.073	-0.0911	0.019	-0.0181

Sources: Oliva and Robayo-Abril (forthcoming) and El Salvador Central Bank.

Note: (a) c.2012 corresponds to the year 2012 for fiscal deficit and public debt, and 2011 for Equity of Fiscal Policy indicators; Change in poverty corresponds to change from market income to consumable income (in percentage points) and change in Gini from Market Income + Pensions to Final Income (b) Based on simulations of COVID-19 crisis and emergency mitigation measures. Children dropping out of school as a result of COVID-19 are not included in the simulations.

**Fiscal policy reduced inequality in the 2015 SCD period, and it did so again in the pre-COVID-19 period.** El Salvador's direct taxes are more progressive than most countries for which data are available. Direct transfers (e.g., the CCT) are progressive and have positive but small redistributive impacts; health and education spending have the largest redistributive impacts. Indirect taxes increase inequality, like many other countries, but overall fiscal policy improves income distribution (Figure A.28). In 2019, fiscal policy reduced inequality by 0.073 Gini points, compared to 0.092 in 2012, suggesting a weaker redistribution effect.

**However, the design of fiscal policy in El Salvador increases poverty.** For 2019, the combination of taxes and social spending increased the poverty rate (US\$5.5) by 3.3 percentage points, a greater impact than most other countries (Figure A.27). Culprits include social security contributions and VAT. Negative poverty impacts are only partially compensated for by direct government transfers: the lowest decile of the distribution is a net receiver of social benefits, while starting at the second decile, households are net payers in the fiscal system (Figure A.29). Direct transfers represent a non-sizable share of household income outside the first two deciles, reflecting weak targeting. In-kind health and education benefits are sizable for most deciles, declining gradually along the income distribution.

**Fiscal consolidation is needed, but policy mix and timing are critical.** Fiscal consolidation needs to be implemented in a growth- and poverty-friendly way, by increasing the efficiency of public service delivery to avoid widening existing gaps. Additionally, the composition of revenue and expenditure measures should be calibrated to ensure sustainability and to mitigate the negative impact on output and welfare. As mentioned in PA #3, there is scope to generate savings and reduce poverty by improving targeting and phasing out subsidies at the same time as increasing the generosity and coverage of well-targeted social programs. The 2019 poverty maps can improve the targeting efficiency of programs that use geographically based

targeting. The impact of tax reforms on growth and poverty must also be factored in carefully; however, it is likely that broadening tax bases, introducing property taxes, and simplifying tax compliance will improve fairness, equity, and competition.

## Priority Area 7: Improving the resilience of the country to disaster risk and pandemics

**Table 2.7. Comparing the changes in hazard indicators, 2015 SCD versus SCD Update**

	2015 SCD, circa 2000–12			SCD Update, circa 2012–20			
	2000	2012	pre-COVID-19 period, 2000–12 (change in ranking)	2019	2020	pre-COVID-19 period, 2012–19 (change in ranking and avg. annual rate in index)	post-COVID-19 period, 2019–20 (% point change in index)
ND Gain Index (ranking)	117	104	-13.0	108	NA	4.0	NA
Inform Risk Index (points)	NA	4.1	NA	4.5	4.3	1.3	-0.2

Source: Notre Dame Global Adaptation Initiative.

El Salvador is considered one of the most vulnerable countries globally due to disaster risk, which was also one of the development challenges in the 2015 SCD. The country's geography, soil formation, climate, and land use are the main drivers of natural disaster risks, threatening 88.7 percent of its territory, 95.4 percent of its population, and 1.37 million poor. The country was placed at the top of the Global Climate Risk Index (IDA 2009) and took 108th place on the ND Gain Index in 2019 (ND Gain), a slight improvement to 2000 (117th place), but it has fallen compared to 2012 (104th place).

The economic impacts of disasters in the country are significant. The impact of climate and hydro-meteorological events was estimated at 4 percent of GDP. Earthquakes and floods represent the two highest proportional costs, accounting for 59 percent and 17 percent of all sectors' total average annual losses (AAL) (World Bank, 2016b). AAL are estimated at 60 percent of average annual public investment (2001–11) (UNISDR, 2015). Disaster losses represent a serious erosion of public infrastructure in a country already saddled with very low investment capacity.

The poverty impacts of disasters are less known. The risk to well-being losses and assets are among the highest globally (4.2 and 2.7 percent of the GDP, respectively) (Hallegatte et al., 2017).<sup>42</sup> Similar estimates for the poor only are not available. Municipalities with high poverty rates do not tend to have higher exposure to hazards, but poor people are more likely to lose a larger fraction of their wealth and have a lower ability to cope with and recover from disaster effects (Hallegatte et al., 2017), better disaster risk management can contribute to reducing poverty.

El Salvador is the driest country in Central America, with some regions suffering from water shortages and others from heavy rainfalls, floods, and landslides. Sixty-six percent of El Salvador's territory is exposed to high or severe drought risk (Desinventar, 2020). El Salvador has registered little and declining water storage capacity (World Bank, 2020g), and its water crisis has adverse effects on household well-being, negatively

<sup>42</sup> Risk to assets is defined as the annual average of asset losses. Risks to wellbeing are measure as the expected asset losses as a share of socioeconomic resilience. This latter is defined as the ratio of asset losses to wellbeing (consumption) losses.

affecting human health. An additional challenge in El Salvador is severe and growing water contamination. The unsafe water quality index is 0.8 out of 1, higher than Panamá, Nicaragua, and Costa Rica (World Bank, 2021). Additionally, the country's coastal region, and top tourist destination "Surf City," is the area most susceptible to significant flooding.

**El Salvador is well equipped to detect epidemics early on, but this does not translate into adequate prevention, or a fast response and mitigation strategy.** The country ranks slightly above the average scores for LAC in the Global Health Security Index (GHSI). Although it fares well on preparedness to detect and report epidemics early on (benchmarking exercise), this does not translate into a rapid response and mitigation strategy, as it only ranks in the 6th decile when compared regionally. Its health system is also not robust enough to treat the sick and protect its health workers, it is in the 7th decile when compared to LAC. On the overall pandemic preparedness score, it ranks in the 6th decile compared to the rest of the world, suggesting clear room for improvement.

**Improvements should be made to the legal and institutional framework for disaster risk financing.** While the government has increased its commitments in investments to enhance fiscal resilience against disaster risk, there is still room for improvement. The country's delicate fiscal position requires it to upgrade its disaster risk financing policies and mechanisms. Debt issuance for relief or reconstruction should be left as a residual option. Thus, better use of policies to deal with relief (e.g., spending reallocation) and reconstruction (insurance) is needed. Introducing green and resilient considerations in public investment selection is also key for sustainable development. El Salvador Disaster Risk Financing Strategy, approved on May 2021, is a great first step in this direction. Investments in green and grey hydraulic infrastructure are needed to reduce flood risks, improve water quality, and store water to buffer against periods of limited water availability.

**Similarly, Disaster Risk Management (DRM) should be improved at preparedness and response stages.** El Salvador's DRM and the health systems focus on response, but have little focus on risk prevention, mitigation, and preparedness. It is therefore essential to improve key DRM elements, such as risk-alert mechanisms, updated post-disaster damage, loss assessment tools, methodologies, and emergency response plans to suit the type and magnitude of a given event. Digital technologies can enhance climate resilience of critical infrastructure by providing a faster and more accurate assessment of asset conditions and by supporting decision-making and adaptation. Emergency procurement and investment guidelines could be streamlined and could allow for transparency and accountability. Greater capacity for disaster management at local levels is also essential.

**Tools for helping poor households cope with disasters and pandemics will increase resilience.** Policy action in the past focused mainly on the provision of post-disaster relief and recovery, however, action must also be taken ex-ante to build up resilience, especially among the poor. These include strategies for ensuring household assets and sources of income (e.g., housing, farming) and investments in health and public infrastructure needed for the continuity of key public services (schools, hospitals, water, etc.) when pandemics and disasters hit. Other policy actions could include reducing hazards through public works focused on reforestation, and reductions in vulnerability with increased income diversification through productive inclusion. For pandemic resilience, handwashing is the first line of defense, as such, investments to improve access to a reliable supply of clean water in homes, healthcare facilities, and public buildings are critical.

## Priority Area 8: Strengthening governance and institutions

**Table 2.8. Comparing the changes in core governance indicators, 2015 SCD versus SCD Update**

	2015 SCD, circa 2000–12			SCD Update, circa 2012–20			
	2006 (a)	2012 (b)	2006–12 (avg. percentage point change per year) (c)	2019 (d)	2020	Pre-COVID-19 period, 2012–19 (avg. percentage point change per year)	Post-COVID-19 period, 2019–20 (percentage change)
Status Index (BTI)	7	7.2	0.2	6.8	NA	-0.8	NA
Governance Index (BTI)	6.2	6.8	0.8	6.5	NA	-0.6	NA
OBI Score	28	43	3.6	45.0	NA	0.7	NA
Regulatory Quality (WGI)	54.9	59.72	0.7	56.25	50.96	-0.9	-5.29
Rule of Law (WGI)	32.06	29.58	-0.7	23.56	22.12	-3.2	-1.44

Source: Worldwide Governance Indicators, Bertelsmann Transformation Index (BTI), and Open Budget Index (OBI).

Note: (a) BTI<sup>43</sup> data is collected every two years. BTI estimates for Status Index and Governance Index were published in 2006 and correspond to 2005 (reference year); WGI indicators correspond to the year 2006. OBI indicators correspond to the year 2005. (b) BTI estimates for Status Index and Governance Index were published in 2012 and correspond to 2011 (reference year); WGI indicators correspond to 2012. OBI indicators correspond to the year 2011. (c) Changes for WGI for the period under analysis are indicative but not statistically significant, as the margin of error is high. (d) BTI estimates for Status Index and Governance Index were published in 2020 and correspond to 2019 (reference year); WGI indicators correspond to 2019. OBI indicators correspond to the year 2018.

Quality of institutions and governance declined in the pre-COVID-19 period, reversing the positive trend observed in the 2015 SCD period. As in countries throughout Central America, El Salvador experienced a weakening in the quality of institutions and governance between 2012 and 2019, evidenced by several governance indicators, especially in areas like government capacity and effectiveness (BTI and WGI), the rule of law (WJP), regulatory quality (WGI), and control of corruption (WGI) (Figure A.30). This decline reversed the positive trend of improving institutional quality in the 2015 SCD period.

An institutional benchmarking analysis along nine institutional dimensions shows that the country could perform better compared to peers, its distance-to-frontier (DTF) score ranking was at the bottom or middle quartile. Service delivery institutions, which measure the use of price controls, command and control regulation, and governance of state-owned enterprises and banks, are the closest to the frontier. However, the country is still at the bottom end of the distribution, along with some Central American neighbors. Conversely, labor institutions, public sector performance, legal institutions, accountability and corruption, business and trade environment, and social institutions are the farthest from the frontier (Figure A.31 and Annex 2.3).

Legal institutions are marked by significant institutional weaknesses. The lower courts are swamped by backlogs of pending cases, access to justice, especially in rural areas, is still a problem. Inefficiency is compounded by corruption and insufficient funding. As a result, impunity is widespread, and the judicial system is perceived as not delivering timely and equal justice for all (BTI, 2020). The World Justice Project

43 The Bertelsmann Stiftung's Transformation Index (BTI) analyzes and evaluates whether and how developing countries and countries in transition are steering social change towards democracy and a market economy. The BTI aggregates the results into two indices: The Status Index and the Governance Index. The first identifies where each country stand on its path towards democracy under the rule of law and a social market economy. The Governance Index assesses the quality of political leadership with which transformation processes are steered.

(2021)<sup>44</sup> highlights how the criminal justice system is marked by corruption, partiality, and weak due process compared to LAC and globally (Figure A.32).

**The rule of law needs to be strengthened to combat corruption and state capture; doing so needs to avoid eroding public trust and values of social institutions.** As the justice system weakened over the past five years (World Justice Project, 2021), a growing sense of impunity has emerged especially among wealthy elites (BTI, 2020). Strong accountability mechanisms are needed to prevent officials in the legislative branch from using their position for private gains (World Justice Project, 2021), or to influence policy-making. Discretion in the decisions of public officials and the extent of undue influence has grown (Global Competitive Index, 2018). Without effective accountability mechanisms, the government's growing discretion and limited ability to address abuses of power create a public perception of state capture by elite interests (Figure A.33), further eroding public trust (see Annex 3.6 for drivers of trust). Finally, accountability institutions such as the supreme audit institution (Corte de Cuentas) have been accused of supporting the existing system of impunity as it often clears officeholders of any wrongdoings (BTI, 2020).

**Weak public sector performance, accountability, and political and social institutions translate into uneven quality and distribution of public services.** Weak state institutions whose management of public resources is not always transparent have a direct impact on the quality and accessibility of public services (BTI, 2020). Data shows that geographic coverage of key public services such as education, water, and waste management is limited (Institutional Profiles Database, 2018). There is a gap in the quality of education services between urban and rural areas, with the rural areas lagging behind (Institutional Profiles Database, 2018). Citizens also report declining satisfaction with the delivery of services, such as roads, public schools, and health, since 2012 (LAPOP, 2018).

**El Salvador needs reforms to modernize the public sector and make public resource management more transparent.** As part of the Cuscatlan plan, one of the main lines of work of the current government is to modernize public institutions. Strengthening and modernizing the public sector by enhancing interagency coordination, improving access and transparency of public services, and better human resource management through Govtech solutions can begin to address the country's long-term institutional challenges.

**Strengthening the rule of law is also critical to addressing growing crime and impunity.** The justice system needs to be modernized to enhance efficiency, transparency, fairness, and accessibility. Digital innovations are increasingly important tools to support better management of justice, as well as greater and fairer access to justice. The government should also address the pressing issue of underqualified judges and legal staff; better access to high quality education and training will promote a better quality of justice services.

**Accountability in public resource management is essential for addressing corruption and state capture.** The accountability and integrity systems used by civil servants and elected officials need to be strengthened and made more effective. Citizen engagement channels and platforms need to become more open and inclusive, particularly in the current context of citizens' declining trust toward institutions and democracy. One starting point would be to develop a robust system to deal with conflicts of interest for civil servants and elected officials, and to ensure credibility among the public. The Supreme Auditing Institution needs to make its decisions more transparent and demonstrate that they are not influenced by political interests.

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<sup>44</sup> World Justice Project data and methodology is available here: <https://worldjusticeproject.org/rule-of-law-index/country/2021/El%20Salvador/>

## 3. Four Priority Areas

### Tier 1 Priorities

Addressing fiscal imbalances and inequities (PA #6), resilience to disasters and pandemics (PA #7), jobs (PA #2), and ineffective safety nets (PA #3) should take precedence to address the urgent need to increase fiscal space, tackle barriers to employability, enact social protection measures to mitigate the negative impacts of the COVID-19 crisis, and reduce risk and losses for a sustainable economic recovery.

These Tier 1 priorities pass the time horizon and complementarity filter:

- › **PA #6.** Allocating budget resources for priorities without jeopardizing fiscal sustainability should go first. Fiscal consolidation, efficiency savings, and phasing out indirect subsidies can have short-term impacts. Prioritizing education spending and making education more efficient will contribute to human capital accumulation (PA #1). Increasing spending efficiency through improved targeting will increase the quality of the safety net (PA #3).
- › **PA #7.** Strengthening resilience to disasters, whether climate-related or pandemics, and refining preparedness systems will address weaknesses and promote short-term sustainable recovery. Some disaster-preparedness actions like building a more resilient infrastructure have medium-term impacts, others are more short-term like executing loss assessment tools and emergency response plans in response to disaster. This PA also complements the ability of the SP system to shield people against shocks and enhance fiscal resilience.
- › **PA #2.** Improving access to jobs is essential: reducing restrictions on part-time work, for example can have short-term, more immediate impacts; providing access to childcare for working adults or updating labor market information will require more time, but should be designed to create lasting impacts. Short-term measures are urgently required to tackle current low levels of employment among the poor and vulnerable in the post-COVID-19 recovery. Carefully designed and well-executed plans to increase labor force participation, combined with pension reforms (PA #3), can help reverse the impact of demographic pressures on the health and pension systems.
- › **PA #3.** Reforms also span short- to long-term impacts. Increasing coverage of some programs and improving their targeting can help people in the short-term; enhancing the adaptiveness of the SP system takes more time. Improving SSN can contribute to the equity and sustainability of fiscal policy (PA #6) and improve the SP system's ability to respond to shocks, complementing PA #7, but should have far-reaching and long-lasting results. Well-targeted programs can incentivize investment in human capital investments and protect those investments from shocks. Recent evidence shows that expansion of the well-targeted CCT program in El Salvador has been associated with rising school enrollment and early attainment for five-year-olds (Chico, 2020).

**Public opinion surveys and the SCD survey show political support for the Tier 1 priorities, informing the feasibility filter.** The Latinobarometro (2018) shows that unemployment and economic problems are the second most important issues affecting welfare, crime and security are most important. Reducing economic insecurity for households will require policy reforms supporting PA #2, PA #3, PA #6, and PA #7, focusing on access to productive employment, expanded social protection, a more equitable fiscal policy, and improving household resilience to shocks. Improving access to jobs and strengthening social safety nets need to help reduce poverty and vulnerability at the same time as securing political support for fiscal reforms. The SCD survey shows that Salvadorans perceived policies to address these four constraints as feasible, and that they have sufficient political support to succeed (Annex 4.2).

**These four priorities can also contribute to reducing crime and helping the country maximize benefits from migration.** Tackling crime demands a multisectoral approach, however, priorities that focus on expanding economic opportunities, particularly among vulnerable and at-risk groups, and protecting them from falling into poverty should also reduce violence (Acosta and Monsalve, 2021).<sup>45</sup> Measures to increase resilience to disaster risk can help households cope with the negative impacts of shocks experienced during and after natural disasters or pandemics; this will also have an impact on migration decisions, as weather shocks and the ability of a household to recover after a natural disaster are an important push factor for emigration (Ibanez et al., 2021). The emerging push factors for emigration are violence, insecurity, poor quality of life, and poor job prospects. Migrants earn significantly more in the United States than they could earn in El Salvador, even after adjusting for the cost of living (Arayavechkit, Scott & Sousa, forthcoming). This supports the idea that measures to improve job prospects and strengthen institutions while tackling crime can incentivize some workers to stay. Similarly, well-designed labor market policies can facilitate returnees' reintegration, and for households receiving remittances from overseas effective SP programs can relax credit constraints and allow them to redirect remittances towards productive investments, with a longer-term aim.

## **Tier 2 Priorities**

**Reforms to tackle low public and private investment (PA #4), poor business environment, low trade integration and lack of innovation skills (PA #5), human capital (PA #1), and institutions (PA #8) should follow.** These priorities support institutions, skills, and job creation for a resilient post-COVID-19 recovery, but most will take more time to materialize. Actions to promote private sector development (i.e., business climate reforms) may take more to materialize than those promoting access to jobs (i.e., reduce restrictions of part-time work, etc.), but addressing both supply and demand-side factors are equally important for creating productive employment among the poor and vulnerable). Support for skill acquisition should start at early ages, as these investments are more long-term, and those in the labor force should receive ongoing training. Most measures to modernize the public sector (PA #8) have medium-term impacts; and reforms to increase public investment (PA #4) complement reforms to promote fiscal consolidation and equity (PA #6). The SCD survey also shows that many adults perceive reforms in these areas as feasible and that they have sufficient political support to be effective (Annex 4.2).

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<sup>45</sup> The paper finds a robust and significant negative impact of the Temporary Income Support Program on most types of crime in the municipalities with the intervention.

Reforms in these four priorities do not need to be carried out together in a “big push,” nor do they need to precede other reforms. The Update recognizes that reforms in all priority areas will help the country achieve the twin goals; however, Tier 1 priorities have a larger payoff, but the four Tier 1 priorities are not a *sine qua non* condition for addressing the other priorities, they also do not need to be carried out in a “big push.” In this sense, all reform efforts work should be productive.

### *Knowledge and Data Gaps*

The Update revisited the knowledge and data gaps identified in the SCD. This review identified gaps that have been addressed, confirmed those that still exist, and identified new ones. Stocktaking of the evidence since the SCD is presented in Table A.9. The full list of knowledge and data gaps are in Table A.11. Data gaps include: (i) an assessment of the push and pull factors that determine migration and the domestic policy levers that might reduce the relative gains to a citizen from working domestically rather than overseas or, within the domestic economy: engaging in legal versus illegal activities; (ii) updated Population Census data, the last one was in 2007; (iii) the constraints to trade, investments, and competition, including the potential distributional impacts of greater trade integration and competition; (iv) an assessment of the productivity drivers in public and private sectors using firm-level and government administrative data; (v) the impacts of migration on poverty through the human capital and labor market channels; drivers behind school dropouts and the readiness of graduates to join the labor market; (vi) sectoral and economy wide analysis of climate change implications, and mitigation and adaptation policies; (vii) an integrity assessment of the Anti-Money Laundering and Combating the Financing of Terrorism framework; (viii) determinants of public expenditure efficiency, including an assessment of fiscal needs of municipalities and decentralization strategies to improve public services, and (ix) an evaluation of new technologies such as fintech, and distributed ledger to improve financial access and the efficiency of payments (Table A.11).

### *Next Steps and Moving Forward*

The Update built upon the SCD by incorporating the new country context. It broadened the lens of analysis, and reran the prioritization framework, which yielded eight priorities, four of which have a higher payoff and four that have been brought from the SCD. The Update incorporated the changes that were needed following the response to the COVID-19 crisis and the unprecedented alignment between the legislative and the executive power. It broadened the analysis to carry out the prioritization process from a vulnerability perspective as poverty has decreased, however, vulnerability has increased since the SCD. In addition, this vulnerability lens, which looks at households, firms, and the state, allows more granularity in the analysis and recommendations, and was able to add new entry points for policy reforms. The Update ran the prioritization process of the SCD with the three filters used (impact on twin goals, time horizon and complementarity, and feasibility) but added a fourth filter: impact on crime and migration. The Update also improved the prioritization process by running it in two steps and using more rigorous data-driven methods such as the country benchmarking to give more transparency. As a result, the Update found eight priority areas, of which four were assessed to have higher payoffs and four that overlap with priorities identified in the SCD.

Persevering with reforms will allow the country to reduce vulnerability, expand the middle class, and foster income convergence. El Salvador has achieved substantial progress in eradicating poverty and

boosting shared prosperity since the SCD. The middle class is expanding, but vulnerability is large and growing. To sustain the gains in poverty reduction and expand the middle class, policies aimed at reducing vulnerabilities must be prioritized. El Salvador can create a virtuous cycle of growth, led by productivity, that could be reinforced by further reforms.



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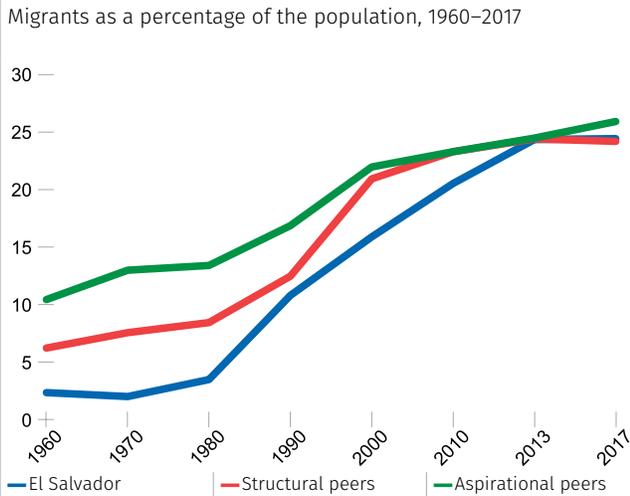
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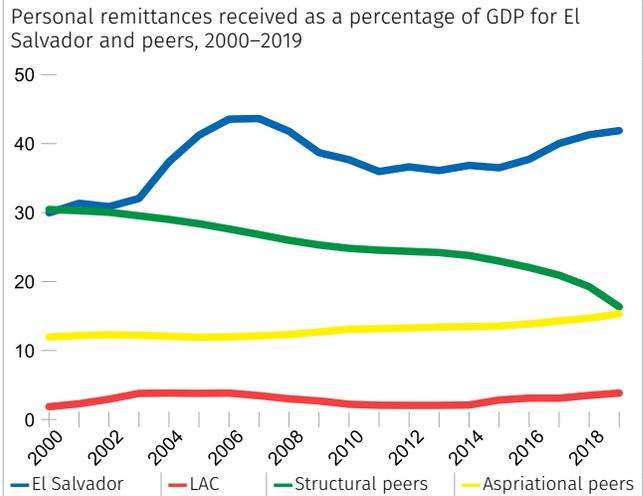
Annex 1. Additional Charts

**Figure A.1. Migration rose faster than peers, but stabilized after 2013**



Sources: World Bank staff based on KNOMAD (Global Knowledge Partnership on Migration & Development) and World Development Indicators (World Bank, 2019a). No more recent data is available.

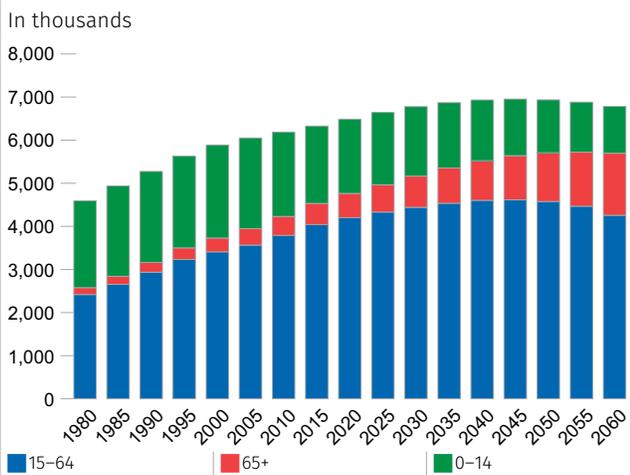
**Figure A.2. Remittance inflows are high relative to LAC**



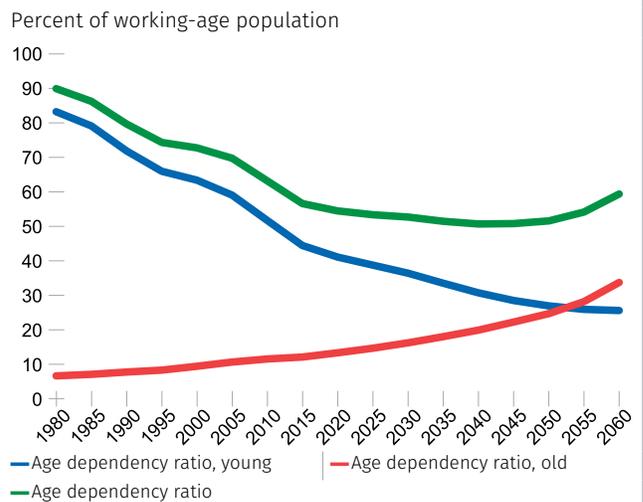
Sources: World Bank staff estimates based on IMF balance of payments data, and World Bank and OECD GDP estimate.

**Figure A.3. The demographic dividend will be over in the next decade or two**

**Panel A. Population by age, 1980–2060**

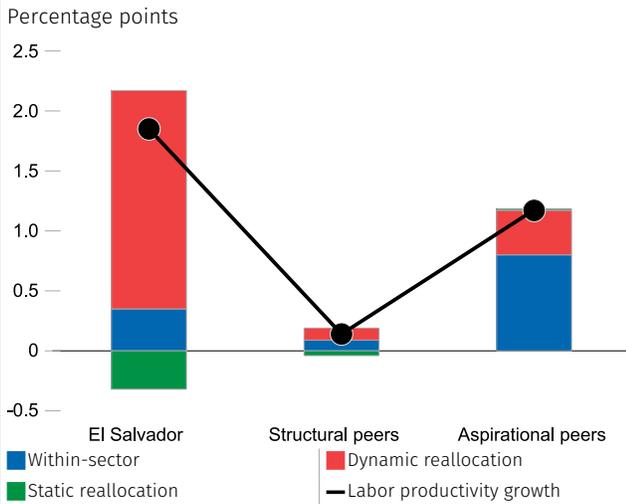


**Panel B. Observed and projected dependency ratios, 1980–2060**



Source: United Nations 2019.

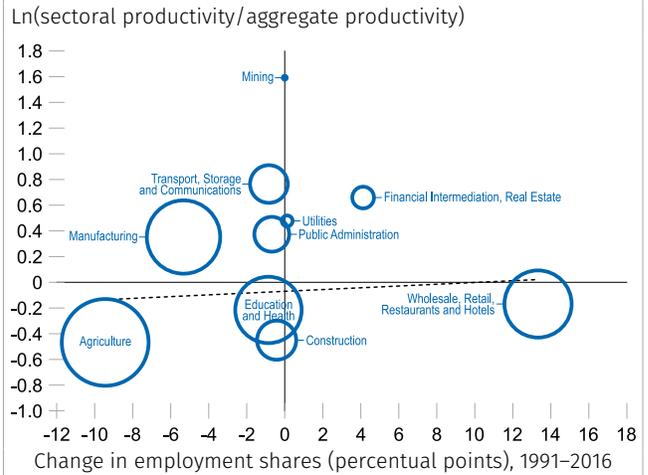
**Figure A.4. Productivity growth has come mainly from static reallocation**



Source: World Bank staff elaboration using data from WDI. Ulku,Hulya; Zaourak,Gabriel Roberto. Unleashing Central America's Growth Potential: Synthesis Report (English). Unleashing Central America's Growth Potential Washington, D.C.: World Bank Group. <http://documents.worldbank.org/curated/en/782621618992892153/Synthesis-Report>

**Figure A.5. Productivity growth has been weakly correlated with increases in employment**

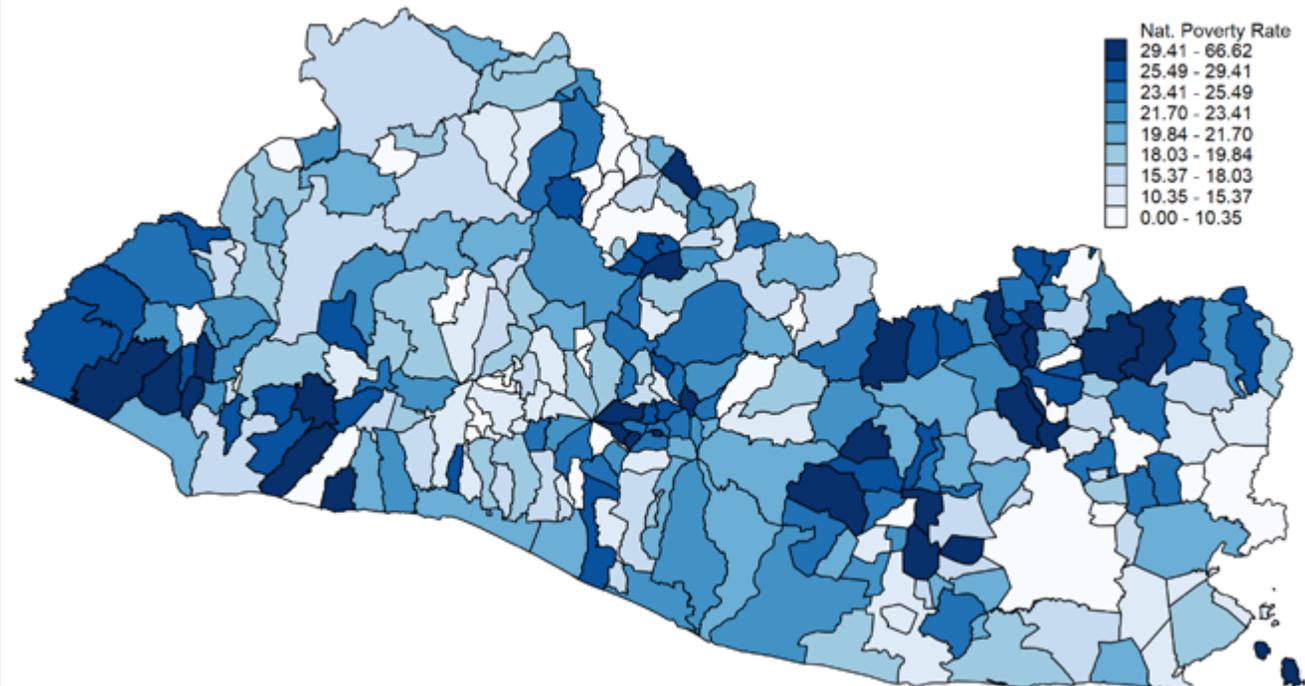
Log of productivity growth, percent change in employment share



Source: World Bank staff using data from the United Nations and the ILO.

**Figure A.6. Wide heterogeneity in monetary poverty across municipalities**

National Moderate Poverty Rate, percentage of households, small-area estimates of poverty rates at the municipality level using national urban and rural poverty lines

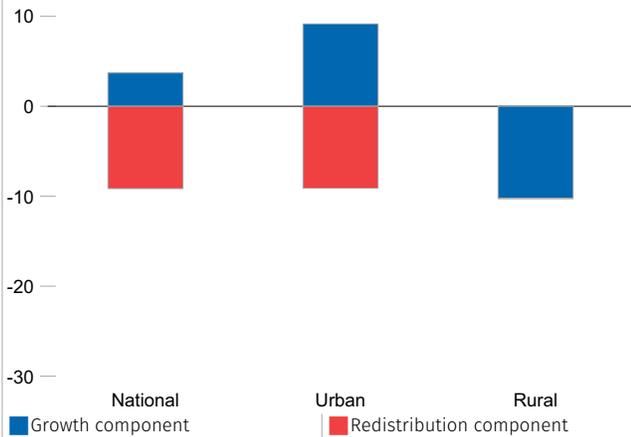


Sources: Small-area estimates using a Fay-Harriot Model based on EHPM (2019) and Population Census (2007) using national urban and rural poverty lines.

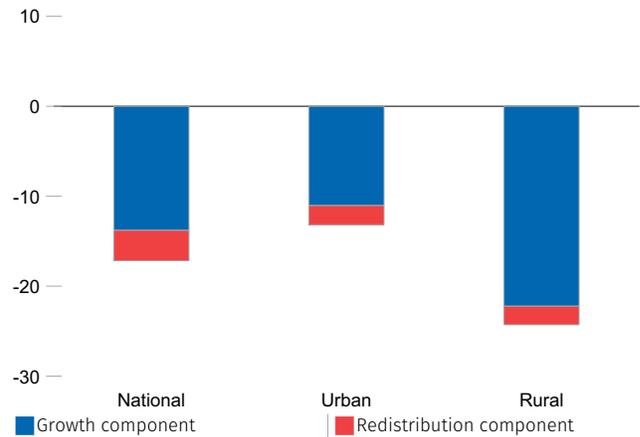
**Figure A.7. Decomposing poverty changes (growth vs. redistribution), 2015 SCD period vs. pre-COVID-19 period**

Datt-Ravallion decompositions, poverty line USD 5.5

**Panel A. Period 2000–2012**



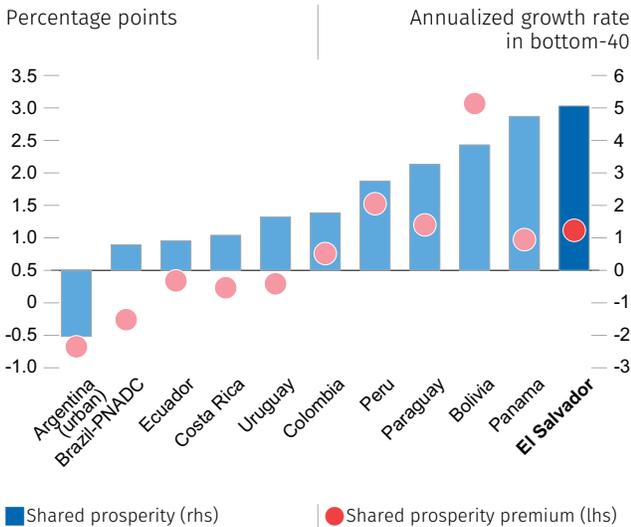
**Panel B. Period 2012–2019**



Source: World Bank estimates based on EHPM (2000–2012) and EHPM (2012–2019).

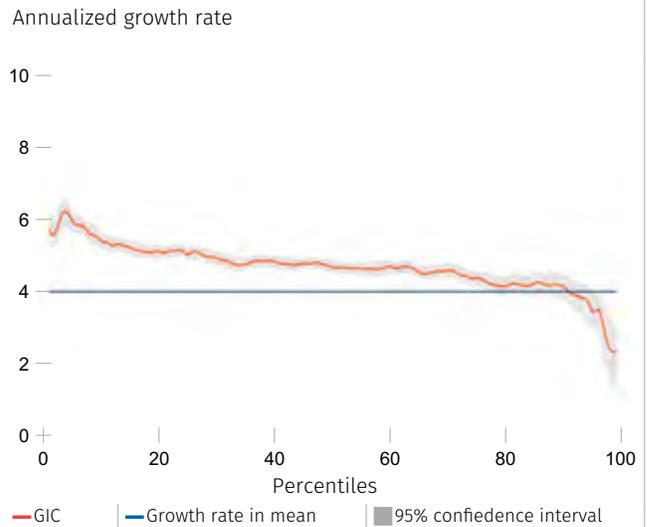
**Figure A.8. Growth in the income of the bottom 40 percent has been substantial compared to other LAC countries.**

Shared prosperity and shared prosperity premium, circa 2012–2019, selected LAC countries



**Figure A.9. Growth has benefitted those at the bottom of the distribution more**

Growth incidence curves, annualized growth of income by centile, percent 2012–2019



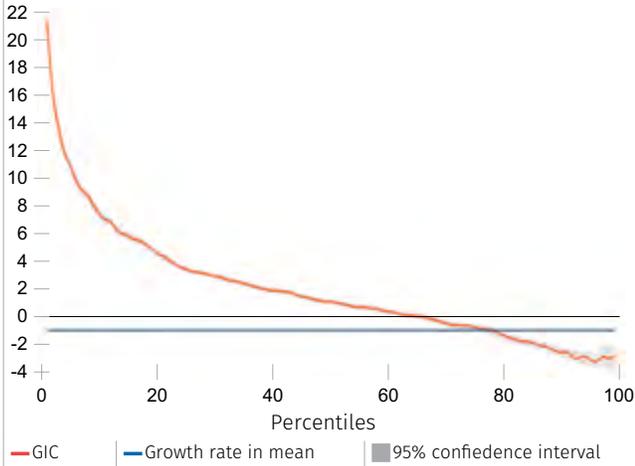
Sources: SEDLAC (CEDLAS and World Bank) and World Bank estimates based on 2012 and 2019 Salvadoran household surveys (Encuesta de Hogares de Propósitos Múltiples).

Note: Shared prosperity focuses on the poorest 40 percent of a population (the B40), and it is defined as the annualized growth rate of their mean household per capita income. Shared prosperity premium is the difference between the growth of the B40 and the entire population. For growth incidence curves, welfare aggregate is household per capita income—the growth rate in mean (green)= 4.02 percent annually.

Figure A.10. Growth incidence curves, 2015 SCD period vs. pre-COVID-19 period

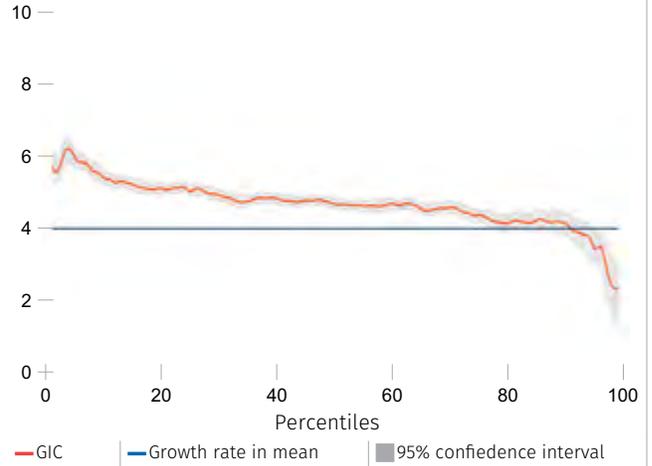
**Panel A. Period 2000–2012, national**

Annualized growth rate



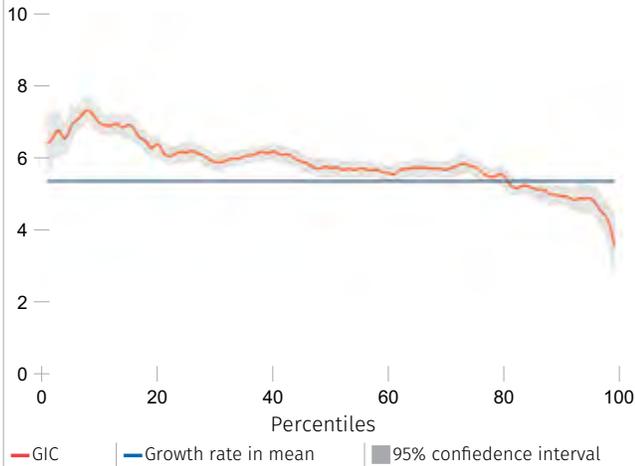
**Panel B. Period 2012–2019, national**

Annualized growth rate



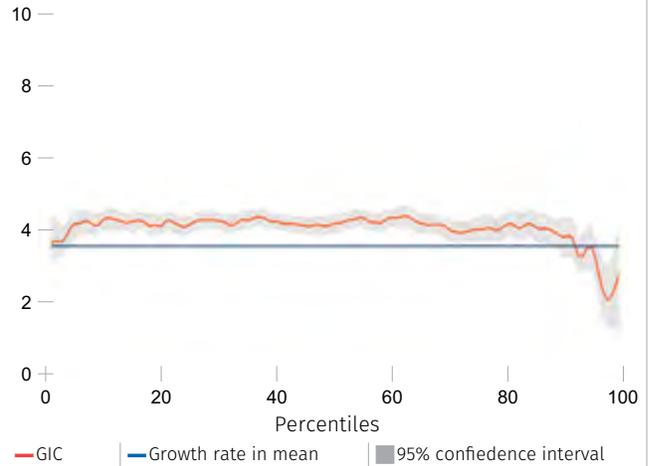
**Panel C. Period 2012–2019, rural**

Annualized growth rate



**Panel D. Period 2012–2019, urban**

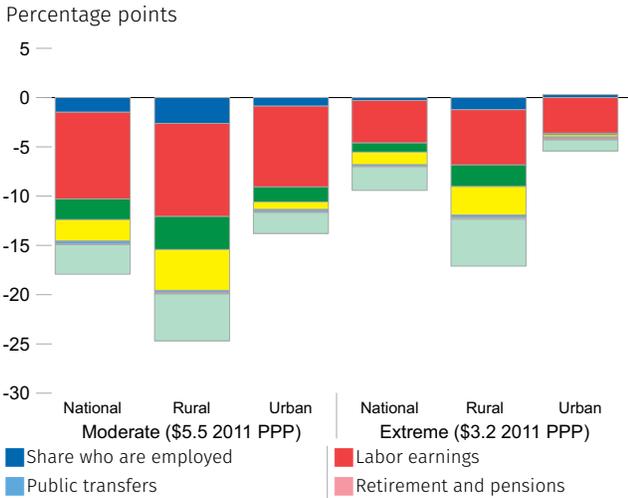
Annualized growth rate



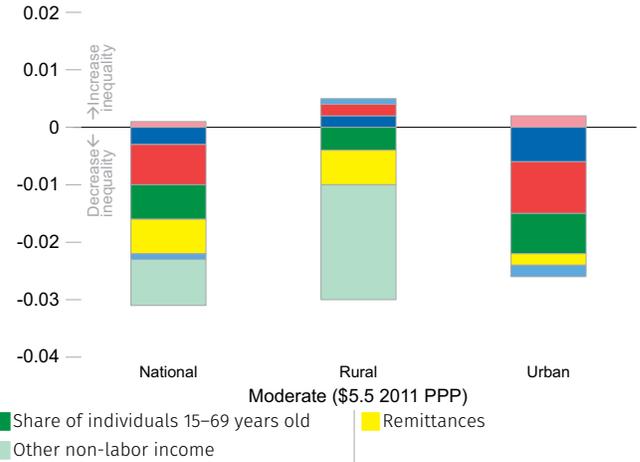
Source: World Bank estimates based on EHPM (2000–2012 and 2012–2019).

Figure A.11. Shapley decomposition of poverty and income inequality changes, pre-COVID-19 period

Panel A. Decomposition of the change in poverty rates (moderate and extreme) by income source, and urban/rural, 2012–2019



Panel B. Decomposition of the change in Gini coefficient by income source, and urban/rural, 2012–2019

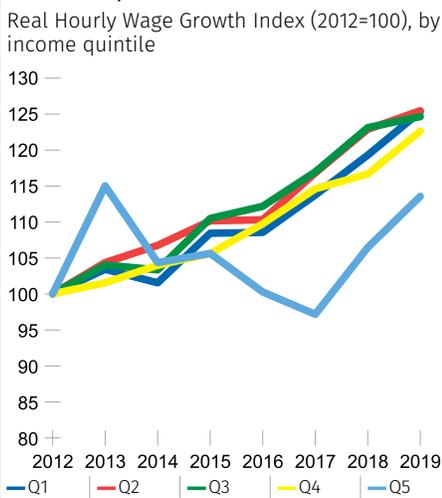


Source: World Bank staff estimates based on 2012 and 2019 Salvadoran household surveys (Encuesta de Hogares de Propósitos Múltiples).

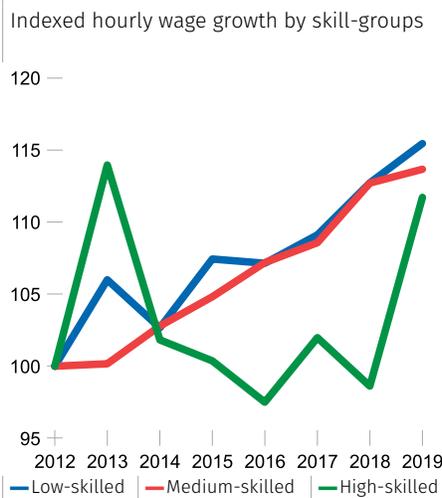
Note: The Shapley decompositions above follow the methodology proposed by Azevedo et al. (2013). Non-labor income includes private transfers, capital income, and implicit rent. This method takes advantage of the additivity property of the welfare aggregate to construct a counterfactual unconditional distribution by changing one component at a time to calculate their contribution to the observed changes in poverty.

Figure A.12. Evolution of labor earnings and their role in poverty reduction

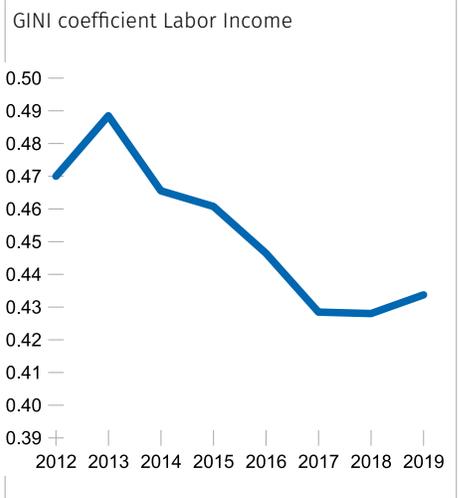
Panel A. Rapid real wage growth among bottom three quintiles



Panel B. Real hourly wage growth index (2012=100), by skill level



Panel C. Falling earnings inequality

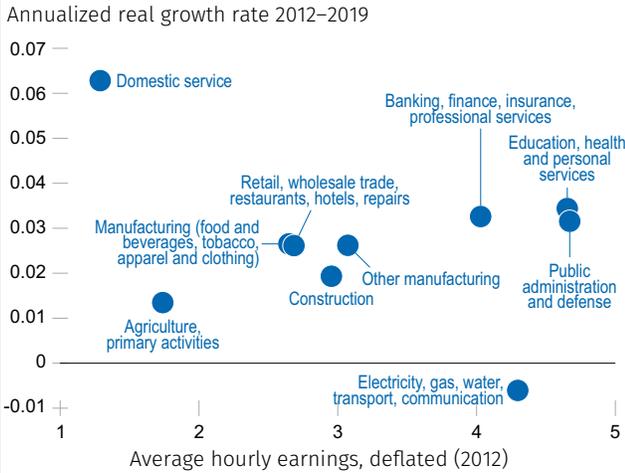


Source: World Bank estimates based on 2012–2019 ECHPM.

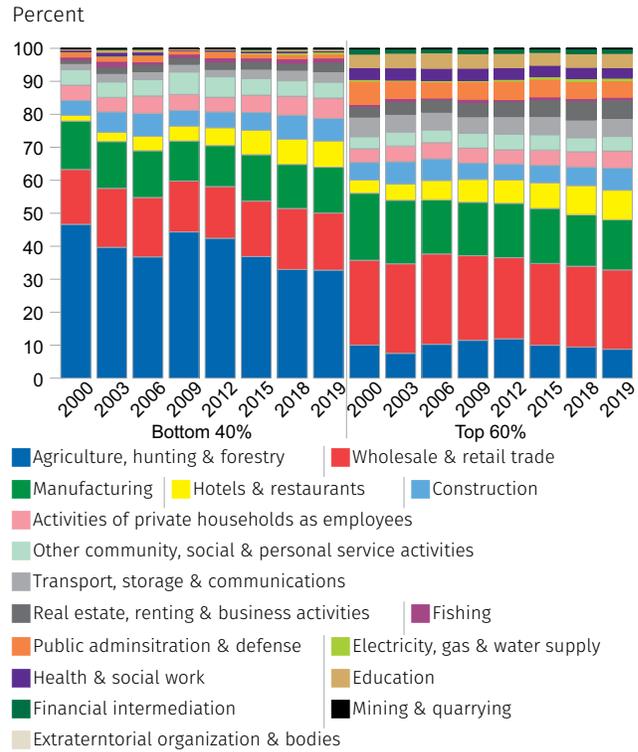
Note: The following definitions were used: Low-Skilled (Never attended Primary), Medium-Skilled (Secondary incomplete and complete), and High-Skill (Tertiary incomplete and complete).

Figure A.13. Shift in employment among bottom 40 from agriculture to higher growth low wage service sectors

Panel A. Real earnings vs. annualized real wage growth



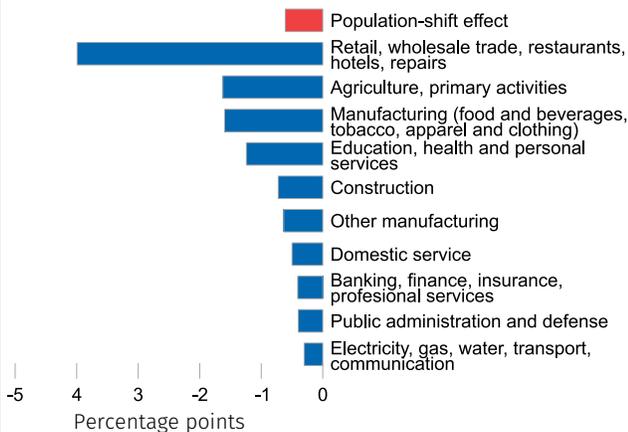
Panel B. Employment by sector and bottom 40 or top 60 percent of the income distribution, 2000-19



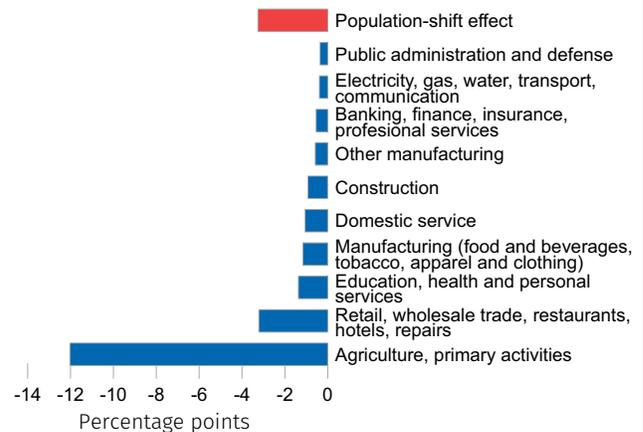
Source: World Bank estimates based on EHPM 2000-19.

Figure A.14. Labor income poverty reduction was driven by rising earnings in the retail sector in urban areas and in agriculture in rural areas; sectoral shifts played a secondary role

Panel A. Huppi Ravallion 2012-2019, urban



Panel B. Huppi Ravallion 2012-2019, rural

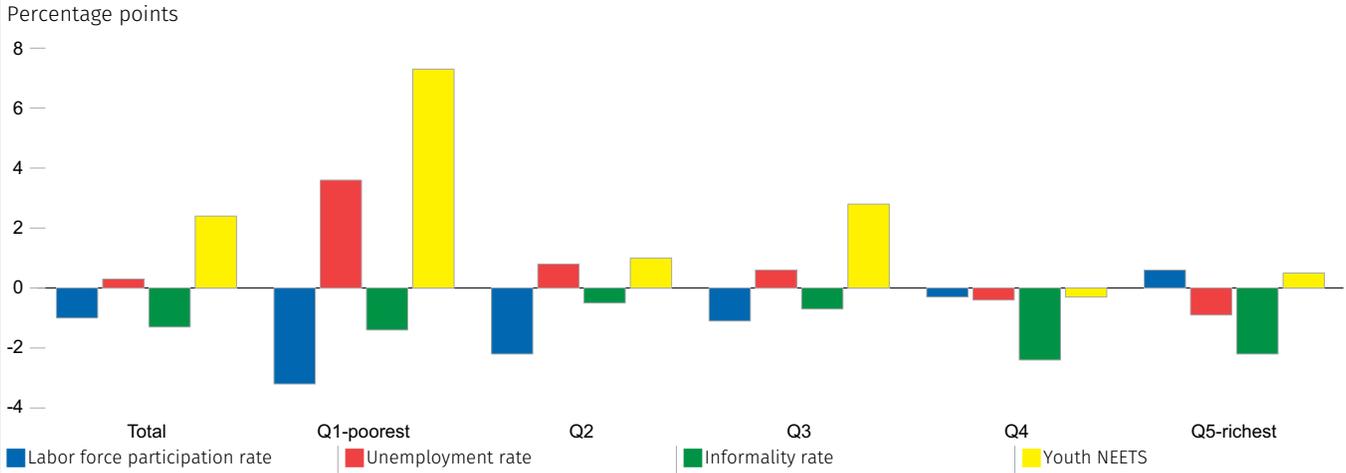


Source: World Bank estimates based on 2012-2019 ECPM.

Note: Estimates based on Ravallion and Huppi (1991) allow decomposing changes in labor income poverty over time into intrasectoral effects and population shifts. The decomposition calculates the change in poverty in this set of households that was due strictly to changes in labor income. This approach abstracts from the effects of changes in non-labor income in the Shapley Decompositions. The intrasectoral component refers to the sector of employment of the primary earner in the households.

Figure A.15. Worsening employment outcomes among the poorest quintile

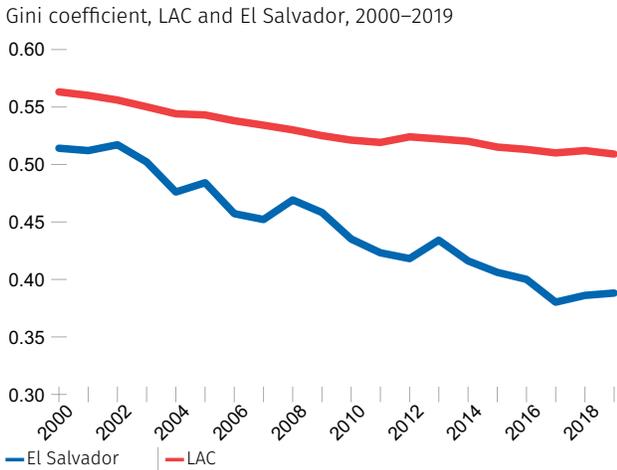
Changes in core labor market outcomes, total and by quintile, 2012–2019



Source: World Bank estimates based on 2012–2019 EHPM.

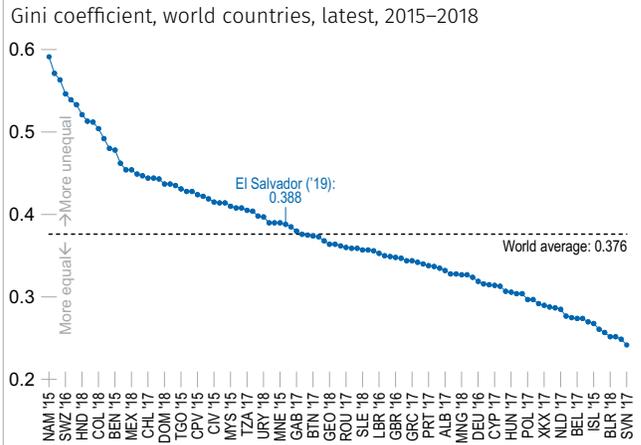
Note: Informality based on SEDLAC definition. Under this definition, a worker is considered informal if all the following criteria hold: (i) Does not contribute to pensions; (ii) Does not contribute to social security (health); (iii) Does not have paid leave and do not have “Aguinaldo.”

Figure A.16A. Income inequality declined, reaching the lowest Gini coefficient in LAC...



Source: LAC Equity Lab-WB.

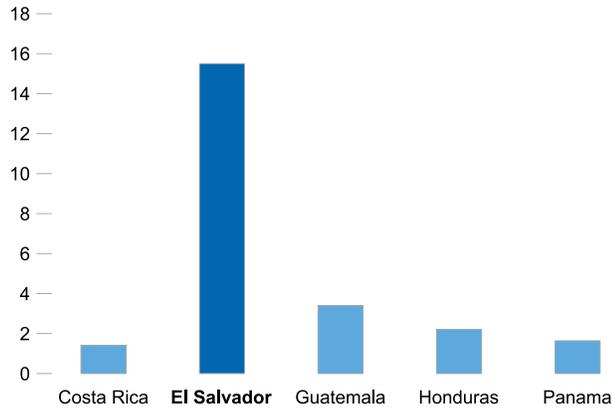
Figure A.16B. ...but average Gini for the world.



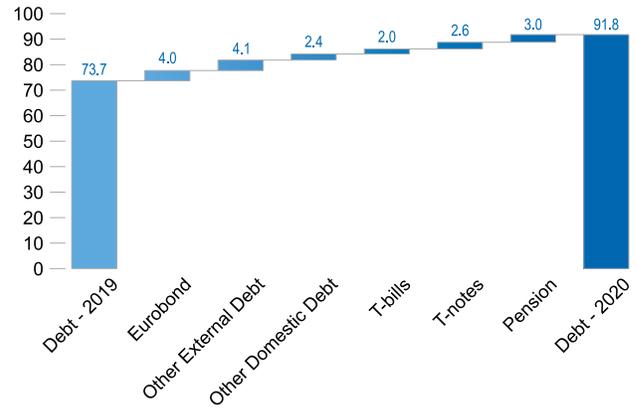
Source: World Bank, 2020a.

**Figure A.17. The fiscal response prevented a further decline in economic activity but weakened fiscal sustainability**

**Panel A. Fiscal cost of the COVID-19 government response in percentage points of GDP**



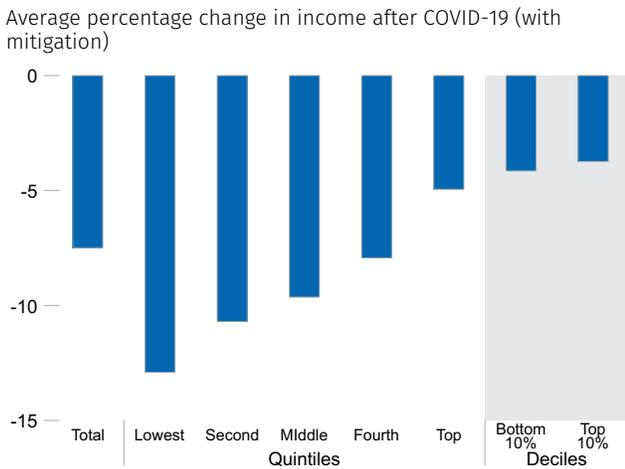
**Panel B. Change in debt stock as percent of GDP, 2019–2020**



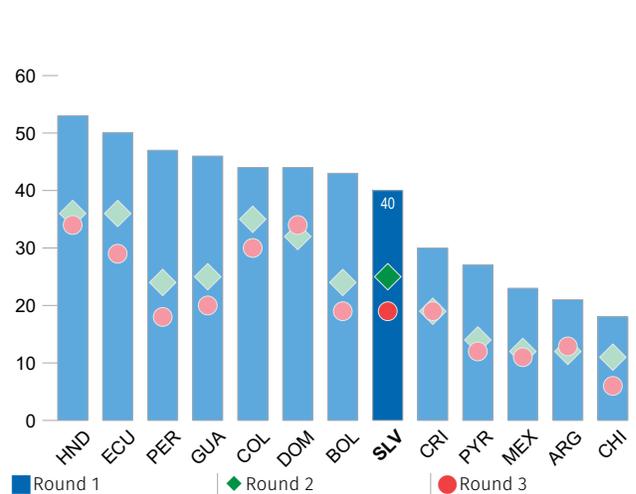
Sources: World Bank staff and BCR.

**Figure A.18. Impacts of COVID-19 on household welfare by quintiles and food insecurity are expected to be large**

**Panel A. Simulated average percentage change in income after COVID-19, with mitigation policies**



**Panel B. Percentage of households without food because of lack of money or other resources, 2020**



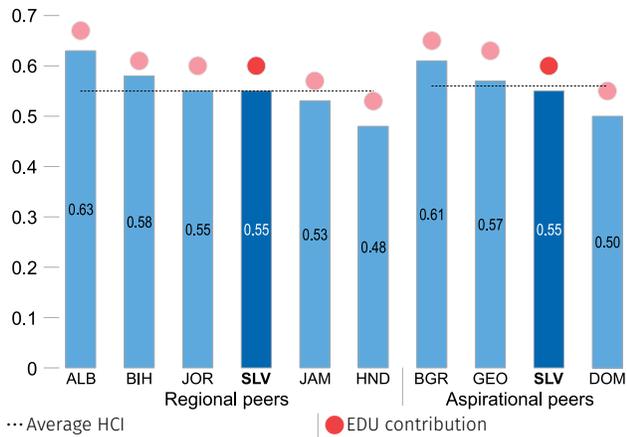
Sources: World Bank estimates based on microsimulations using 2019 EHPM, administrative data on formal-sector employment and wages from ISS, and Central Bank remittance data.

Source: World Bank (2020) High-Frequency Phone Survey, Rounds 1, 2 and 3.

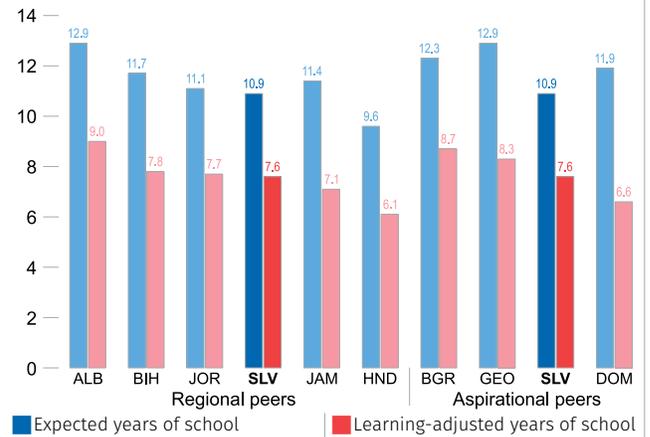
Notes: Waves 2 and 3 measure lack of access to food over the last seven days.

Figure A.19. Human Capital Index and learning-adjusted years of school

Panel A. Human Capital Index



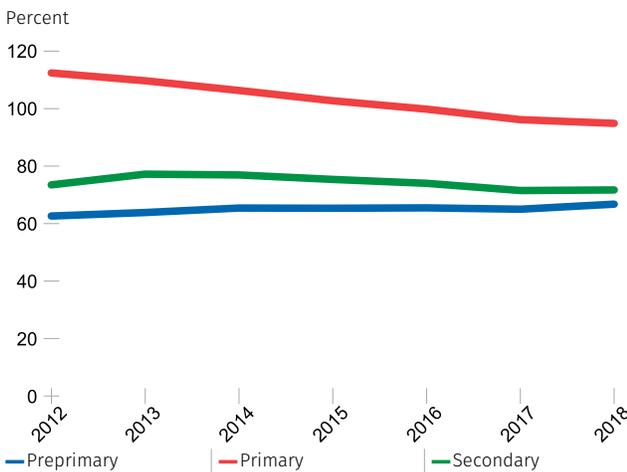
Panel B. Expected and learning-adjusted years of school (difference: learning gaps)



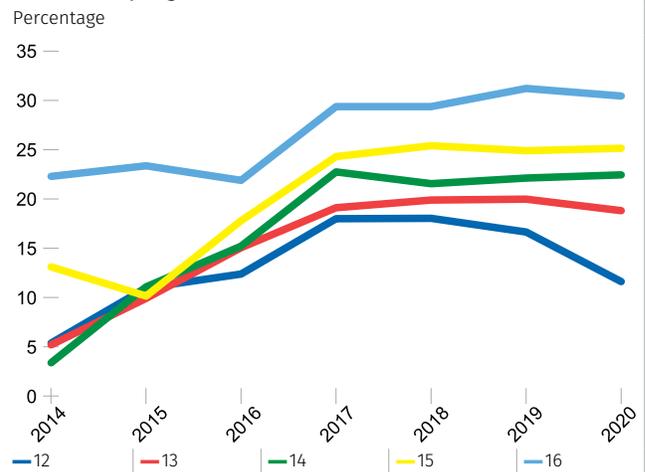
Source: World Bank, 2020 Human Capital Index.

Figure A.20. Declining school enrollment in primary and secondary levels, and rising out-of-school rates

Panel A. Gross school enrollment, 2010–18

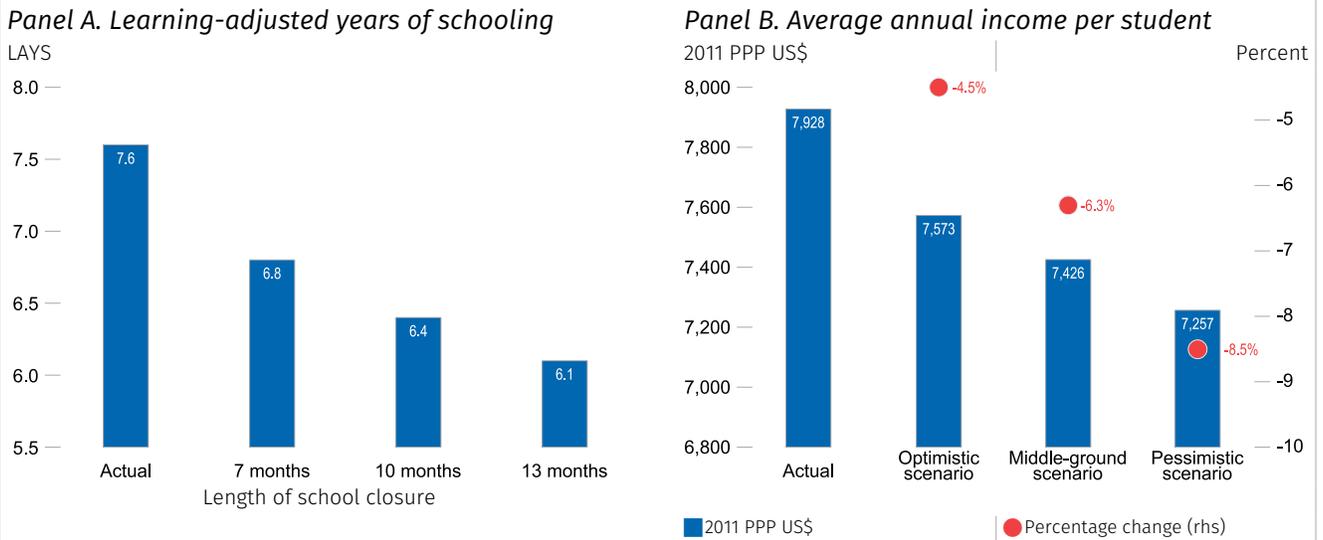


Panel B. Out-of-school rate for youth (ages 12–16), by age, 2014–20



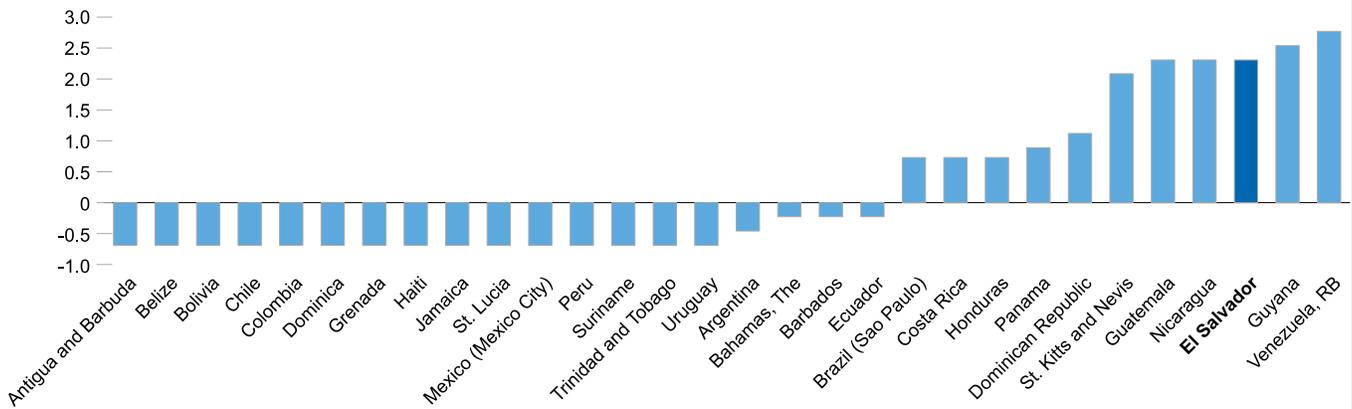
Sources: Panel A. World Development Indicators. Panel B. Ministry of Education, at Link Mined ([https://www.mined.gob.sv/EstadisticaWeb/indicadores/2020/trayectoria/1.2 Porcentaje de poblaci%C3%B3n no escolarizada por edad.pdf](https://www.mined.gob.sv/EstadisticaWeb/indicadores/2020/trayectoria/1.2%20Porcentaje%20de%20poblaci%C3%B3n%20no%20escolarizada%20por%20edad.pdf)).

Figure A.21. Impact on learning-adjusted years of schooling and average annual income of school closures



Source: World Bank (2021).

Figure A.22. The rigidity of labor legislations in Latin America (Rigidity of Hours Index)



Source: Maratou-Kolias, Packard, and Weber (forthcoming).

Figure A.23. Internet usage

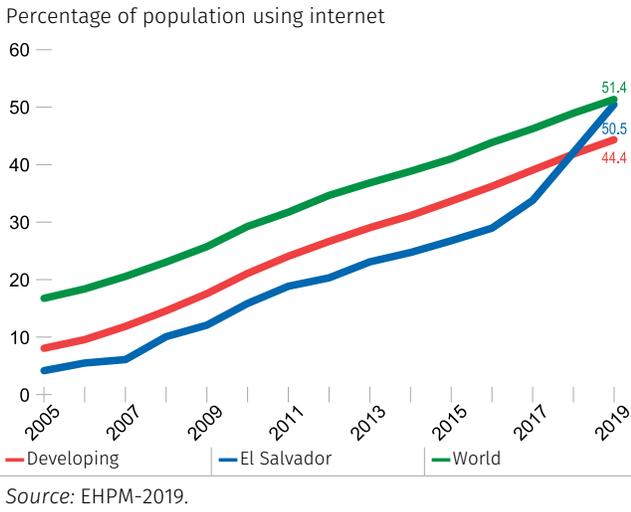


Figure A.24. Internet usage and access at home, El Salvador, 2019

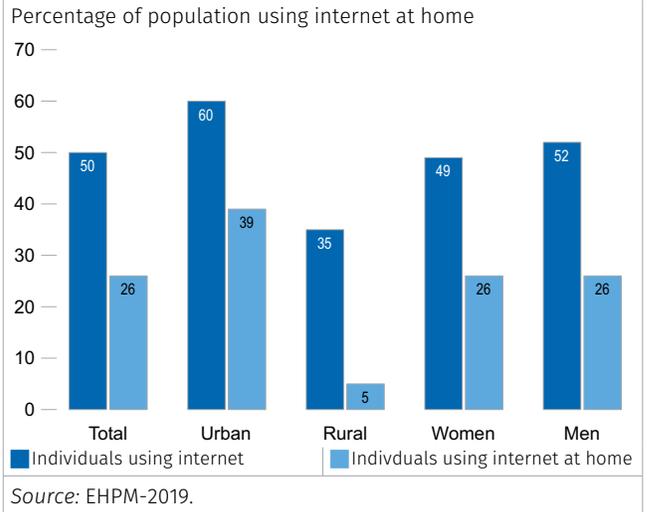
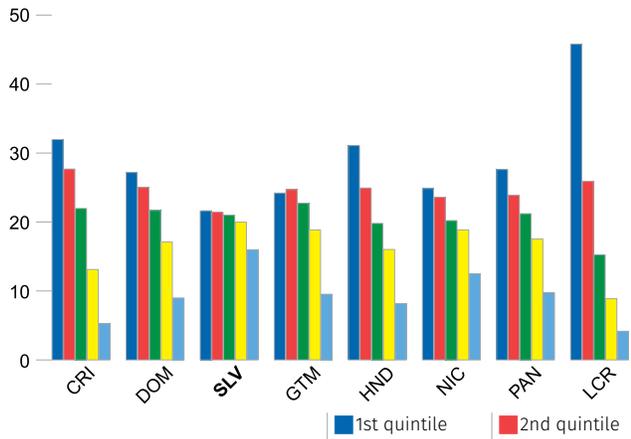
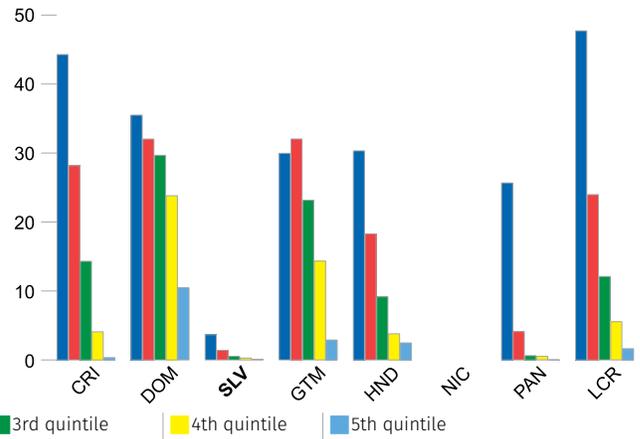


Figure A.25. Lack of progressivity and low coverage of the poverty programs

Panel A. Distribution of beneficiaries (beneficiary incidence), all social assistance, Central America (CA) and Latin America and the Caribbean (LAC), by quintiles, latest year available



Panel B. Coverage of conditional cash transfer programs, Central America (CA) and Latin America and the Caribbean (LAC), by quintiles, latest year available

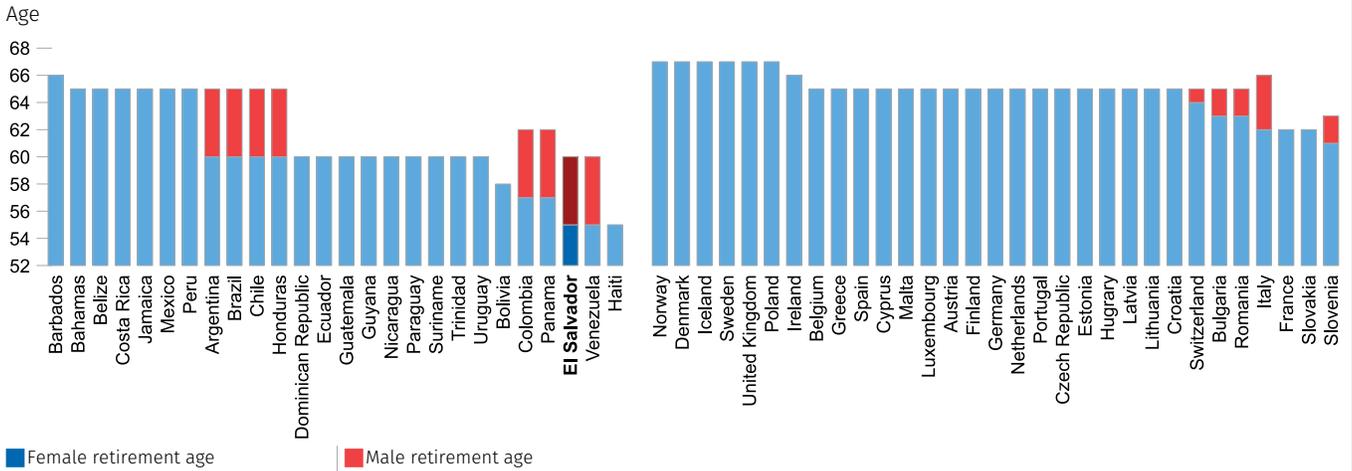


Source: ASPIRE performance indicators.

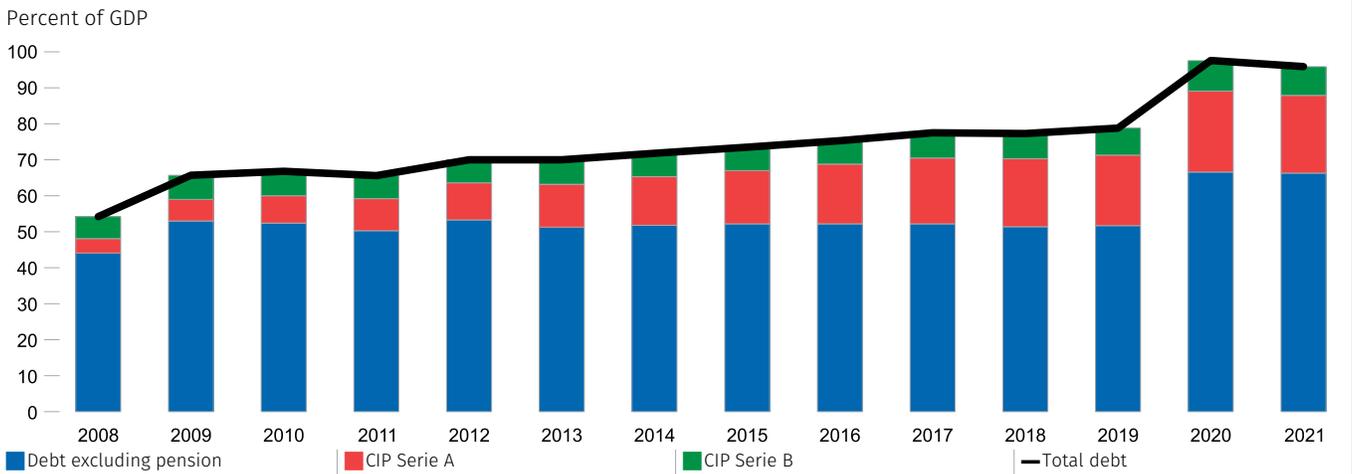
Note: Latest available year, for Costa Rica (CRI) 2019, Dominican Republic (DOM) 2019, Guatemala (GTM) 2014, Honduras (HND) 2017, Nicaragua (NIC) 2014, Panama (PAN) 2019, and El Salvador (SLV) 2019. For Latin America and the Caribbean 2010–19 weighted average.

Figure A.26. Despite pension reforms, significant issues remain in the pension system

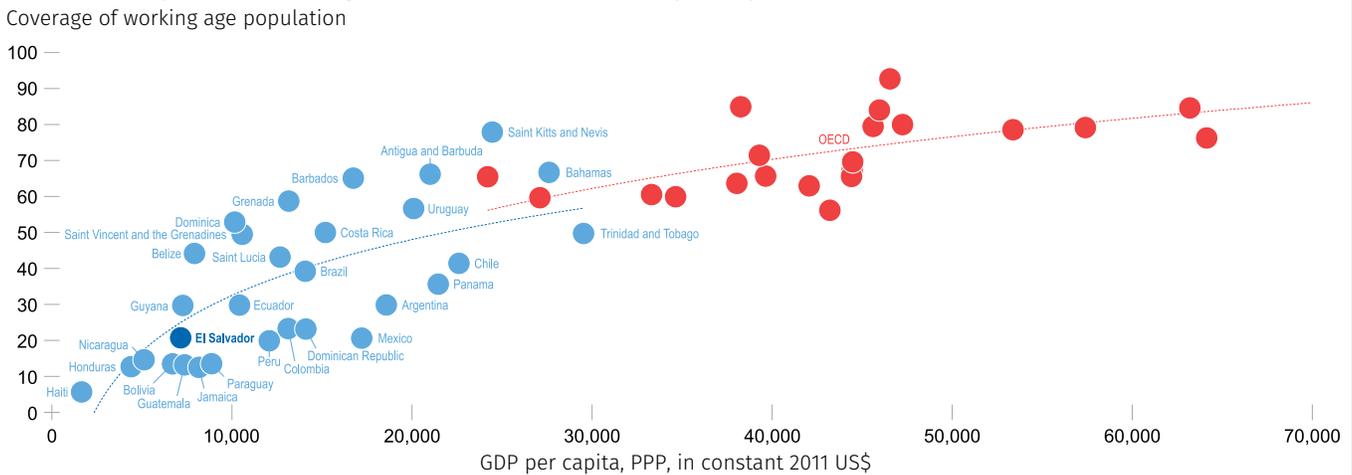
Panel A. Retirement age, by sex, El Salvador and selected countries



Panel B. Debt of the Non-Financial Public Sector (NFPS)

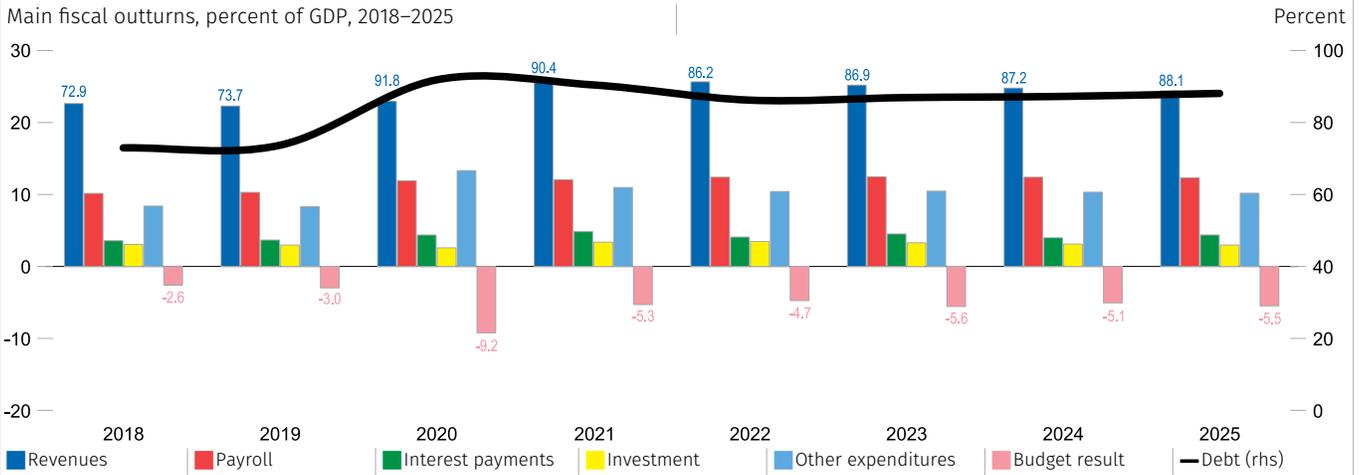


Panel C. Low pension coverage, but consistent with GDP per capita levels



Source: World Bank pensions database and staff calculations.

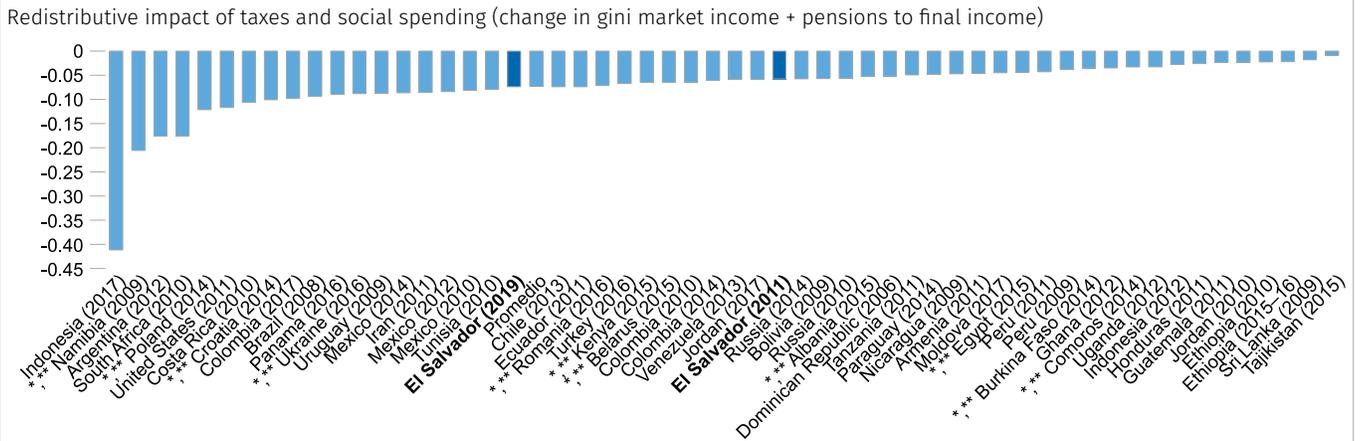
Figure A.27. Forecast under a no-policy change show a continuous deteriorating fiscal situation



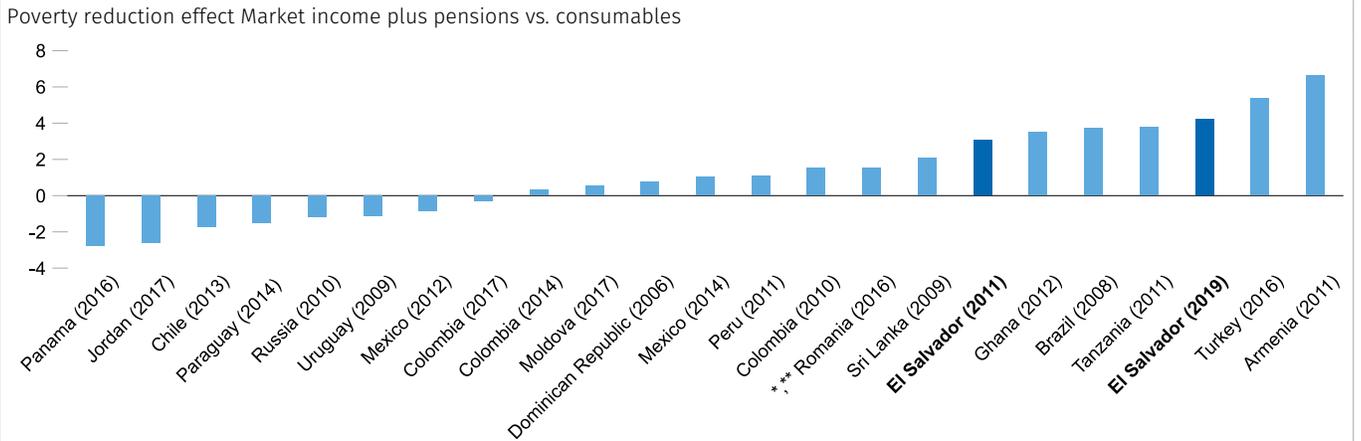
Source: BCR and World Bank staff forecasts.

Figure A.28. Despite contributing to inequality reduction, fiscal policy significantly increases poverty in El Salvador

Panel A. Impact of the fiscal system on Gini coefficient, changes from market income plus pensions to final income, Gini points, selected countries



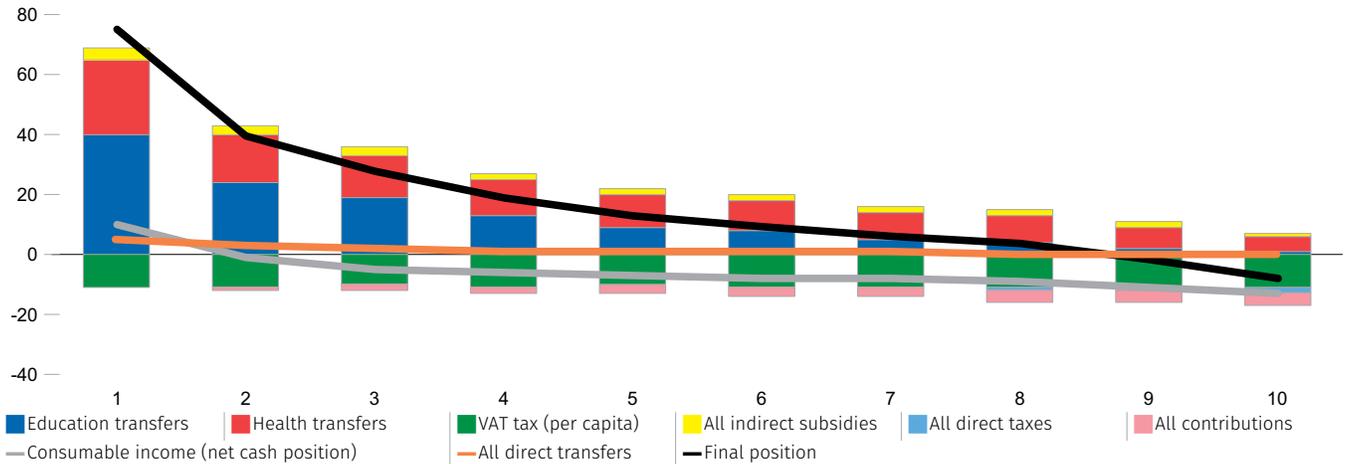
Panel B. Impact of fiscal system on poverty rates (US\$5.5 line), changes from market income plus pensions to consumable income, percentage points, selected countries



Source: Oliva and Robayo-Abril (forthcoming).

**Figure A.29. The indirect tax burden is high and direct transfers are insufficient**

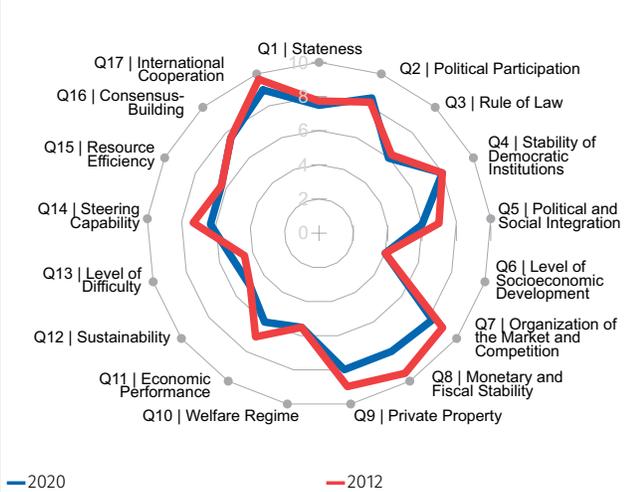
Fiscal incidence with respect to original income (non-anonymous)



Source: Oliva and Robayo-Abril (forthcoming).

**Figure A.30. Declining quality of institutions in recent years**

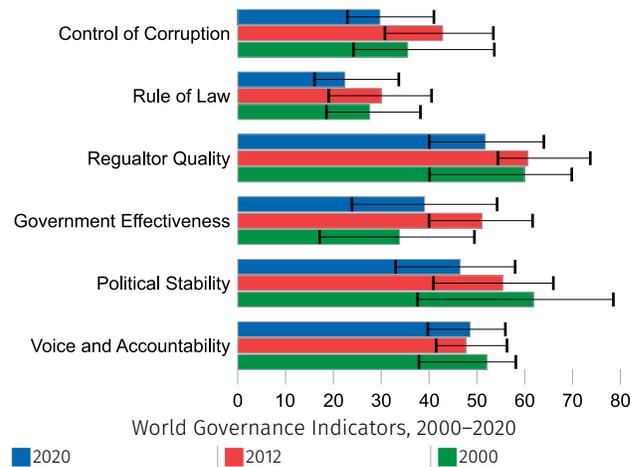
**Panel A. Bertelsmann Transformation Index, 2012–20**



Source: BTI Transformation Index, <https://www.bti-project.org/en/home.html?&cb=00000>.

Note: The red line indicates values for 2012, while the blue and green lines indicate the values for 2020.

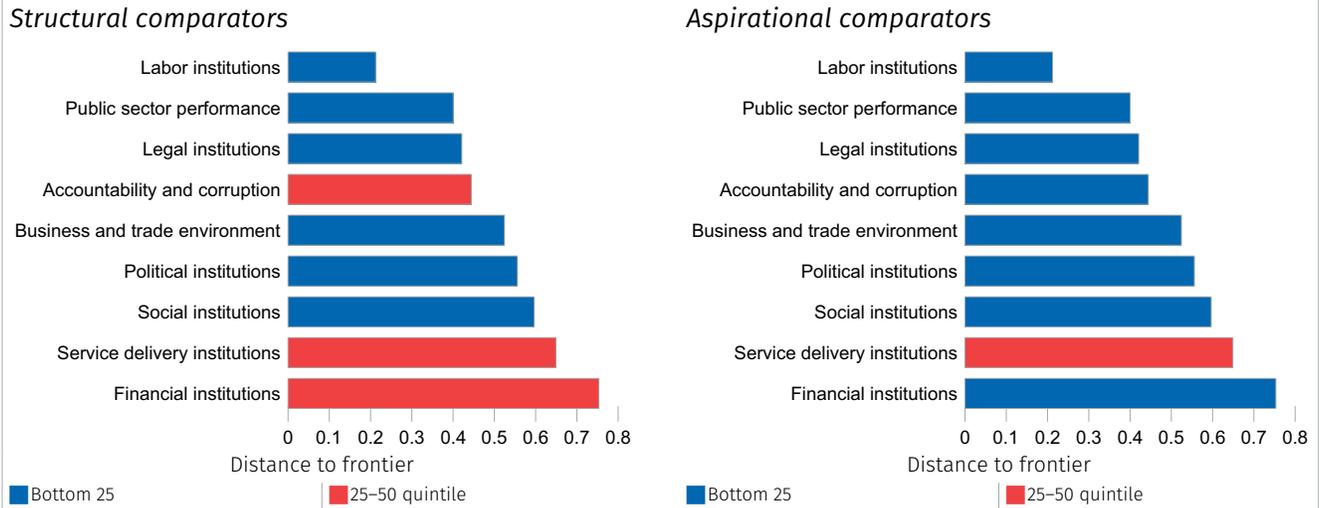
**Panel B. Worldwide Governance Indicators, Six Governance Dimensions, 2000–20**



Source: Worldwide Governance Indicators, <https://info.worldbank.org/governance/wgi/Home/Documents>.

Note: The six governance dimensions include: 1. Voice and Accountability; 2. Political Stability and Absence of Violence; 3. Government Effectiveness; 4. Regulatory Quality; 5. Rule of Law; 6. Control of Corruption.

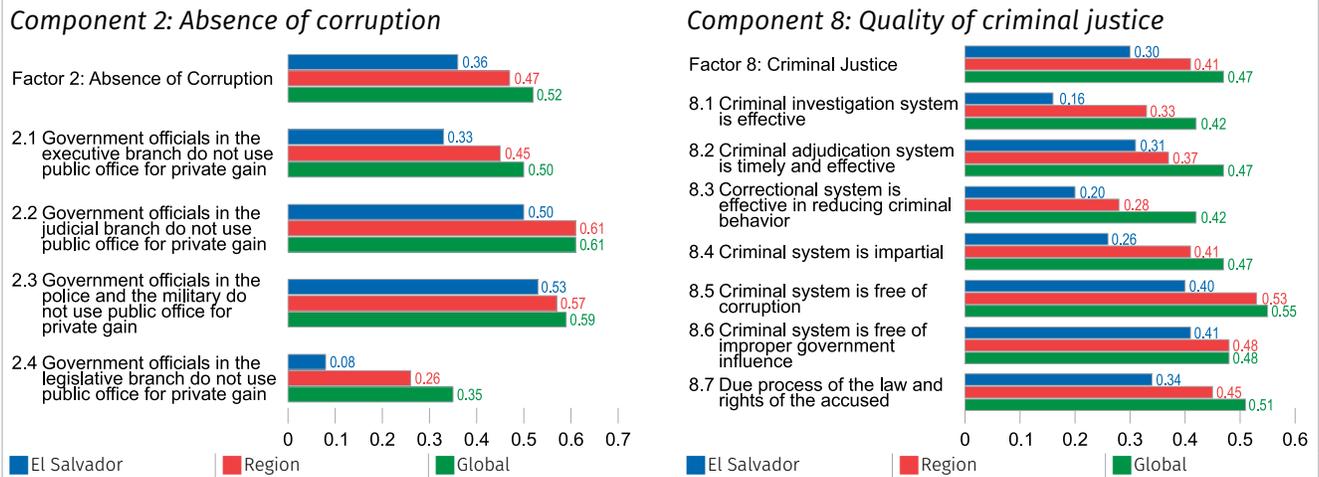
Figure A.31. Institutional benchmarking



Source: World Bank estimates based on Institutional Benchmarking analysis.

Notes: Distance to frontier=0 worst score; distance to frontier=1 best score.

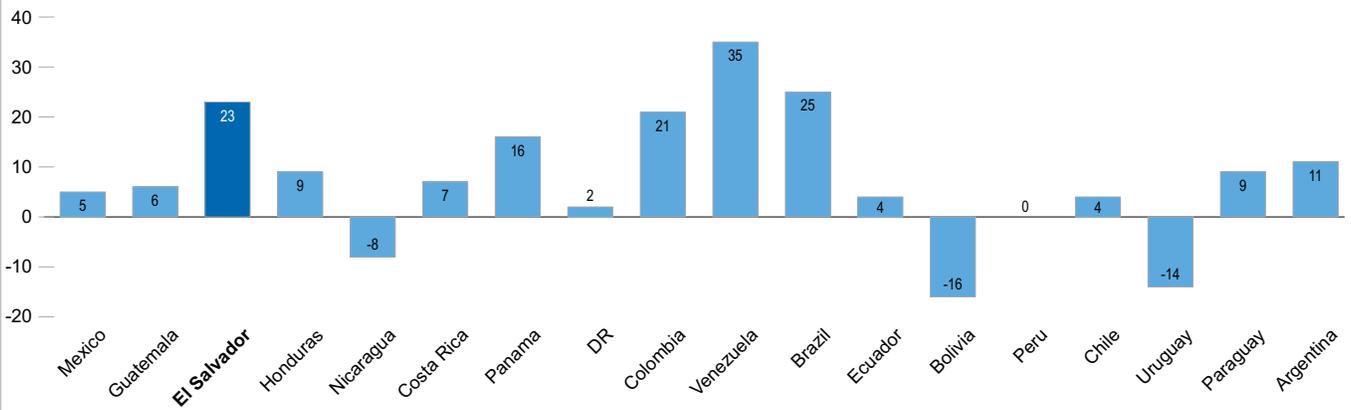
Figure A.32. Extent of corruption and quality of criminal justice system, World Justice Project (2020)



Source: World Justice Project.

Figure A.33. Growing perception of state capture by elite interests

Changes in perceived capture



Source: 2014-2018 Latinobarometro surveys.

Notes: Percentage points change in respondents who think the country is governed by the powerful elite for their own benefit.

## Annex 2. Benchmarking Tools

### Annex 2.1. Dynamic Benchmarking: Structural and Aspirational Peers

We use a dynamic benchmarking tool to identify structural and aspirational peers based on a set of structural characteristics.<sup>46</sup> The tool determines comparators (peers) based on a uniform, objective formula that can be applied to an infinite number of criteria. The tool also captures the dynamic (across time) evolution of any country relative to its peers for any period between 1960 and 2019. For this exercise, we include the following structural characteristics: GDP Per capita, Remittances/GDP, Population, natural resources rent/GDP, and landlocked.<sup>47</sup>

**Identification of Structural Peers:** We defined structural peers as countries with similar characteristics to El Salvador along the selected dimensions in the most recent period (2012–2018). This classification delivers the following group of countries: **Albania, Bosnia and Herzegovina, Honduras, Jamaica, and Jordan**. This methodology leads to a similar selection of structural peers as those selected in the previous SCD and adds aspirational countries.<sup>48</sup>

**Identification of Aspirational Peers:** Based on the rankings, we defined aspirational peers as countries that possess similar structural characteristics as El Salvador during the initial period 2012–2019 but grew (in per capita terms) significantly faster over time.

#### Selection criteria:

- ▶ Countries that had similar GDP per capita and had similar socio-economic features as the country of interest during the initial period (remittances/GDP, population, natural resources rent/GDP, and landlocked, etc.).
- ▶ Countries with a median GDP per capita growth that was at least two percentage points (pp) higher than the median per capita growth of the country of interest over the entire period of analysis.

This classification delivers the following aspirational countries: the **Dominican Republic, Georgia, Bulgaria**.

Note: we are also comparing El Salvador with LAC, Lower-Middle Income countries, and the World in the complimentary benchmarking exercise described next.

### Annex 2.2. Benchmarking Development Performance and Measuring Progress

**Monitoring and evaluation based on clearly defined indicators are integral to the development of sound policies.** They help policymakers evaluate the extent to which policy objectives have been met and provide a solid basis for identifying strengths and weaknesses. Monitoring can ensure better coordination and consistency between policies. When carried out on a comparative basis with peers, it can provide further

46 Developed by Samer Matta, MTI, West Africa (August, 2020) Contact: smatta@worldbank.org

47 Similar criteria were used in the first SCD: Population 3–12M, GDP per capita, positive net migration and remittance inflow.

48 In the first SCD, structural peers were Armenia, Bosnia, Dominican Rep, Georgia, Serbia, Tunisia.

support for reform. Quantitative indicators have proven highly effective in drawing attention to the challenges for inclusive growth and poverty reduction, identifying priorities for reform, and communicating success and progress. The use of a standard ‘scorecard’ also facilitates public-private consultations.

In this context, we develop an Index to perform a benchmarking exercise that allows a comparison of El Salvador’s performance with other economies across a broad set of dimensions and across time. Comprehending El Salvador’s most recent performance across several development areas is essential since it enables us to track progress or lack of progress on key indicators and broader development areas to determine critical areas where the country is lagging. This quantitative exercise also informs the prioritization of policy reforms in the country.

## Methodology

We construct an Index to identify, assess and monitor several dimensions of development outcomes for El Salvador, in comparison with countries in three main reference groups: The World, Lower-Middle Income (LMI) countries, and Latin America and the Caribbean (LAC) countries. Since the Index does not include policy indicators, it provides an objective basis for discussing the underlying contextual drivers. However, we recognize that some of the indicators may be affected by previous policies, and therefore, can reflect positive or negative outcomes of past developments.

The Index includes 16 dimensions and 256 indicators, and ranks countries according to their performance in each dimension. The indicators have been selected based on data availability for several countries and their social and economic relevance. We relied upon global databases, including the World Development Indicators, TCdata360, International Financial Statistics, ASPIRE, and other datasets covering most countries in the World. This provides a snapshot of where each country stands regarding some fundamental outcome indicators in these priority areas. The Index is constructed using a five-step process, outlined below.

### *STEP 1: Compute the average of variables over time*

First, we compute averages for each variable for the periods circa 2011–2014 and 2015–2018. The use of averages responded to the need to avoid distortions caused by outlier values and to overcome the lack of information for a certain data point.

### *STEP 2: Standardize variables*

The variables require modification, as the scales and direction of the variables can differ considerably. The direction of all indicators included in a composite index needed to be homogenous (i.e., all variables would have a positive sign, i.e., the higher value would indicate being closer to a ‘desirable situation’ or better performance and same scale). The magnitude of the difference between El Salvador and the best achievers in each domain is assessed using the normalized distance to the best-performing country. Accordingly, we standardized the variables according to the following formula for country *I* in period *t*:

$$SVar_{Country\ i,t} = (var_{BP,t} - var_{Country\ i,t}) / (var_{BP,t} - var_{WP,t})$$

The standardization is like the ones used for the North Macedonia, Colombia, and Chile SCDs (World Bank 2017, 2015, 2017). This way, El Salvador obtains a score of 0 when it is the best performer in one specific variable and one if it is the worst performer. The variables are standardized, and distance to the best performer for each variable is calculated by assigning countries to one specific decile. We create deciles (1 for the best performers, 10 for the worst). When El Salvador gets a score of 1, it is among the best performers in the relevant group, and when it receives a score of 10 is among the worst performers.

## Using the Index to Inform Prioritization

Based on the results of the benchmarking exercise, we apply a criterion to identify emerging priority areas. A priority level is assigned to each indicator according to the criteria described in Table A.1. Priority areas of importance are where El Salvador lags compared to the best performer within the LAC region, LMI, and the World. Moreover, to determine the ranking of each, the average performance across all comparison groups has been calculated.

**Table A.1. Criteria for selecting priority levels**

<i>Priority Level</i>	<i>Normalized Gap to Top Performer in the Group</i>
1 (lowest priority)	Less than 10 percent
2	10 to 20 percent
3	20 to 30 percent
4	30 to 40 percent
5	40 to 50 percent
6	50 to 60 percent
7	60 to 70 percent
8	70 to 80 percent
9	80 to 90 percent
10 (highest priority)	90 percent or more

The benchmarking exercise supports identifying emerging constraints to inclusive growth, vulnerability, and poverty reduction in El Salvador. We use the results of the benchmarking analysis to identify a preliminary set of key areas in which El Salvador's performance is lagging. This method for identifying emerging constraints has advantages as well as drawbacks. Benchmarking offers a simple, intuitive, and consistent method for establishing El Salvador's performance in certain areas. However, it does not explain *why* El Salvador outperforms or underperforms. Also, deeper gaps (relative to the best performer) do not necessarily imply a more significant impact on inclusive growth and the twin goals. Therefore, this exercise needs to be complemented by a deeper diagnostic that digs deeper into the hypothesis around the constraints. The benchmarking exercise relies on a careful decision of several inter-related areas, such as what types of comparators to include (e.g., structural peers, aspirational peers, income group peers, regional peers), what criteria to select for comparators, what indicators to benchmark, and how to measure the distance or gaps. Despite potential shortcomings, the benchmarking exercise yields critical insights into El Salvador's growth and inclusion challenges. The table below summarizes the full results of the benchmarking exercise for El Salvador. The lagging areas are "red," indicating a large distance to the best performer.

Table A.2. Results benchmarking exercise, gap to best performer

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
<b>Macroeconomics and Fiscal</b>						
Current account balance (% of GDP)	9	5	9	5	5	6
Foreign direct investment, net inflows (% of GDP)	10	10	9	9	10	10
Personal remittances, received (% of GDP)	6	5	4	4	2	4
Short-term debt (% of total external debt)	2	3	4	4	4	5
Total debt service (% of GNI)	3	4	4	4	6	7
Inflation, consumer prices (annual %)	1	1	2	1	1	1
Central government debt, total (% of GDP)	4	3	8	5	4	3
Net lending (+) / net borrowing (-) (% of GDP)	10	7	10	7	6	4
Revenue, excluding grants (% of GDP)	10	9	10	9	5	5
Expense (% of GDP)	8	8	8	8	5	6
Final consumption expenditure (% of GDP)	5	5	6	6	1	2
Gross fixed capital formation (% of GDP)	9	8	9	9	8	8
GDP per capita growth (annual %)	7	4	8	5	4	4
Gross savings (% of GDP)	9	5	10	8	9	7
GDP per person employed (constant 2017 PPP \$)	10	10	6	7	9	9
Research and development expenditure (% of GDP)	10	10	10	8	10	9
Tax revenue (% of GDP)	9	5	9	6	6	6
Time to prepare and pay taxes (hours)	2	2	3	2	2	1
General government final consumption expenditure (% of GDP)	2	2	2	2	4	4
Gross national expenditure (% of GDP)	6	6	8	8	1	1
Domestic general government health expenditure (% of GDP)	7	7	5	5	7	7
<b>Poverty and Equity</b>						
Income share held by highest 10%	5	4	6	4	3	1
Income share held by lowest 10%	7	6	7	6	1	1
Poverty headcount ratio at \$1.90 a day (2011 PPP) (% of population)	1	1	1	1	2	2
Gini index (World Bank estimate)	5	5	7	5	2	1
Poverty headcount ratio at \$3.20 a day (2011 PPP) (% of population)	2	2	2	2	4	3

**Table A.2. Results benchmarking exercise, gap to best performer (continued)**

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
Poverty headcount ratio at \$5.50 a day (2011 PPP) (% of population)	5	4	5	3	5	6
Poverty gap at \$5.50 a day (2011 PPP) (%)	2	2	3	2	4	4
Survey mean consumption or income per capita, bottom 40% of population (2011 PPP \$ per day)	10	9	6	5	8	8
Annualized average growth rate in per capita real survey mean consumption or income, bottom 40% of population (%)	NA	4	NA	2	NA	2
World Bank MPM, adult school attainment deprivation rate	NA	4	NA	5	NA	10
World Bank MPM, child school enrolment deprivation rate	NA	1	NA	2	NA	2
World Bank MPM, electricity deprivation rate	NA	1	NA	1	NA	4
World Bank MPM, sanitation deprivation rate	NA	1	NA	2	NA	3
World Bank MPM, drinking water deprivation rate	NA	1	NA	1	NA	4
World Bank MPM, poverty headcount ratio (% of total population)	NA	4	NA	4	NA	8
<b>Human Capital - Education and Health</b>						
Survival Rate from Age 15-60	3	4	2	3	7	7
Expected Years of School	5	3	5	4	10	6
Harmonized Test Scores	NA	7	NA	6	NA	6
Learning-Adjusted Years of School	NA	6	NA	5	NA	8
Probability of Survival to Age 5	1	2	1	1	1	2
Fraction of Children Under 5 Not Stunted	3	3	2	2	3	3
School enrollment, preprimary (% gross)	7	7	5	5	8	7
Trained teachers in preprimary education (% of total teachers)	2	1	2	1	2	1
School enrollment, primary (% gross)	6	6	4	7	7	6
School enrollment, primary (% net)	2	3	2	5	4	8
School enrollment, primary, female (% net)	2	3	2	4	4	7
School enrollment, primary, male (% net)	2	3	2	4	4	7
Trained teachers in primary education (% of total teachers)	1	1	2	1	2	1
Primary education, teachers	10	10	10	10	10	10
Children out of school (% of primary school age)	2	2	2	3	3	5

Table A.2. Results benchmarking exercise, gap to best performer (continued)

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
School enrollment, secondary (% gross)	6	6	4	4	7	8
School enrollment, secondary (% net)	4	4	4	5	6	7
School enrollment, secondary, female (% net)	4	4	4	5	6	7
School enrollment, secondary, male (% net)	4	5	4	5	6	7
Trained teachers in secondary education (% of total teachers)	2	1	2	1	2	2
Secondary education, teachers	10	10	10	10	10	10
Adolescents out of school (% of lower secondary school age)	1	2	2	2	2	4
Pupil-teacher ratio, primary	7	8	NA	NA	2	1
Pupil-teacher ratio, secondary	8	6	NA	NA	3	1
Prevalence of anemia among children (% of children under 5)	3	3	1	3	3	3
Cause of death, by communicable diseases and maternal, prenatal and nutrition conditions (% of total)	2	2	2	2	3	2
Cause of death, by injury (% of total)	3	3	9	8	3	8
Cause of death, by non-communicable diseases (% of total)	7	7	8	8	8	6
Low-birthweight babies (% of births)	3	4	3	3	5	5
Prevalence of obesity, female (% of female population ages 18+)	5	5	6	6	4	4
Prevalence of obesity, male (% of male population ages 18+)	3	3	5	5	5	5
Prevalence of overweight, weight for height (% of children under 5)	3	NA	4	NA	3	NA
Domestic general government health expenditure (% of GDP)	7	7	5	5	7	7
Domestic general government health expenditure (% of general government expenditure)	5	4	1	1	5	4
Out-of-pocket expenditure (% of current health expenditure)	5	4	5	4	5	4
<b>Labor Markets</b>						
Female-Aggregate bands: Total-Discouraged job-seekers (THOUSANDS) annual	1	1	1	1	1	1
Male-Aggregate bands: Total-Discouraged job-seekers (THOUSANDS) annual	1	1	1	1	1	1
Total-Aggregate bands: Total-Discouraged job-seekers (THOUSANDS) annual	1	1	1	1	1	1

Table A.2. Results benchmarking exercise, gap to best performer (continued)

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
Firms competing against unregistered firms (% of firms)	8	7	7	9	8	6
Informal Employment rate (%)-Agriculture	10	10	8	10	10	10
Informal Employment rate (%)-Non-agriculture	7	7	5	7	6	7
Informal Employment rate (%)-Total	7	7	5	7	7	8
Employment to population ratio, 15+, total (%) (modeled ILO estimate)	6	6	6	6	5	5
Labor force participation rate for ages 15-24, total (%) (modeled ILO estimate)	6	6	6	6	6	5
Labor force with basic education, female (% of female working-age population with basic education)	6	6	6	5	5	8
Labor force with basic education, male (% of male working-age population with basic education)	3	3	3	2	3	4
Labor force participation rate, female (% of female population ages 15+) (modeled ILO estimate)	5	6	6	6	7	7
Labor force participation rate, total (% of total population ages 15+) (modeled ILO estimate)	6	6	6	6	6	5
Unemployment, youth total (% of total labor force ages 15-24) (modeled ILO estimate)	2	2	2	2	2	2
Unemployment with basic education (% of total labor force with basic education)	1	1	2	2	2	1
Unemployment with intermediate education (% of total labor force with intermediate education)	3	2	4	2	3	2
Share of youth not in education, employment or training, female (% of female youth population)	5	6	7	7	6	9
Share of youth not in education, employment or training, male (% of male youth population)	3	3	4	3	3	4
Share of youth not in education, employment or training, total (% of youth population)	4	6	7	6	5	8
Unemployment, female (% of female labor force) (modeled ILO estimate)	1	2	2	1	1	1
Unemployment, total (% of total labor force) (modeled ILO estimate)	2	2	2	2	2	2
Female-15+Time related underemployment	3	3	2	3	1	2
Male-15+Time related underemployment	3	3	4	4	3	3
Total-15+Time related underemployment	3	3	3	3	2	3

Table A.2. Results benchmarking exercise, gap to best performer (continued)

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
<b>Social Protection and Gender</b>						
Coverage in 1st quintile (poorest) (%) - Social Pensions (preT)	10	10	10	10	10	10
Coverage (%) - All Social Assistance (preT)	5	1	5	1	5	1
Coverage (%) -All Social Protection and Labor (preT)	5	1	5	1	5	1
Beneficiary incidence in 1st quintile (poorest) (%) -All Social Protection and Labor (preT)	5	6	5	6	3	10
Beneficiary incidence in 1st quintile (poorest) (%) - All Social Assistance (preT)	6	9	6	8	7	10
Coverage in 1st quintile (poorest) (%) - All Social Assistance (preT)	3	1	3	1	4	1
Coverage in 1st quintile (poorest) (%) -All Social Protection and Labor (preT)	3	1	3	1	4	1
Adolescent fertility rate (births per 1,000 women ages 15–19)	4	4	5	5	7	7
Coverage in 1st quintile (poorest) (%) - Contributory Pensions (preT)	10	10	10	10	10	10
Gender Inequality Index	5	5	4	4	4	3
<b>Financial Inclusion</b>						
Commercial bank branches (per 100,000 adults)	10	10	9	9	9	7
Domestic credit to private sector by banks (% of GDP)	9	8	6	7	6	5
Domestic credit provided by financial sector (% of GDP)	8	8	5	5	4	5
Domestic credit to private sector (% of GDP)	9	8	6	7	6	7
Account ownership at a financial institution or with a mobile-money-service provider, poorest 40% (% of population ages 15+)	9	9	9	10	9	10
Account ownership at a financial institution or with a mobile-money-service provider, older adults (% of population ages 25+)	8	8	8	9	9	10
Account ownership at a financial institution or with a mobile-money-service provider, young adults (% of population ages 15-24)	8	9	8	9	9	10
Depth of credit information index (0=low to 8=high)	2	2	2	2	2	2
Private credit bureau coverage (% of adults)	3	7	1	5	3	7

**Table A.2. Results benchmarking exercise, gap to best performer (continued)**

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
<b>Demographics</b>						
Population living in slums (% of urban population)	3	3	3	3	4	3
Population in the largest city (% of urban population)	8	8	8	8	8	9
Life expectancy at birth, female (years)	3	4	2	2	5	4
Life expectancy at birth, total (years)	4	4	2	2	6	5
Life expectancy at birth, male (years)	5	5	3	3	7	6
Fertility rate, total (births per woman)	2	2	2	2	4	5
Age dependency ratio, old (% of working-age population)	4	3	5	5	4	3
Age dependency ratio, young (% of working-age population)	4	4	5	4	6	6
Population growth (annual %)	2	5	3	4	5	7
Urban population growth (annual %)	8	6	7	6	4	3
Urban population (% of total population)	4	4	2	2	5	4
<b>Infrastructure</b>						
DAI Government Sub-index	5	5	4	4	5	6
DAI People Sub-index	7	6	3	4	6	6
Dec Cable Subscribers	10	10	10	9	10	10
Dec DSL Subscribers	10	10	10	10	10	10
Dec Household Penetration	10	9	5	4	9	8
Secure Internet servers (per 1 million people)	10	10	8	10	10	10
Individuals using the Internet (% population)	9	7	7	7	9	9
Logistics performance index: Efficiency of customs clearance process (1=low to 5=high)	7	7	3	6	5	7
Logistics performance index: Quality of trade and transport-related infrastructure (1=low to 5=high)	7	8	5	8	5	7
Logistics performance index: Ease of arranging competitively priced shipments (1=low to 5=high)	6	6	5	5	6	5
Logistics performance index: Competence and quality of logistics services (1=low to 5=high)	6	7	3	6	4	5
Logistics performance index: Overall (1=low to 5=high)	6	7	4	6	5	5

Table A.2. Results benchmarking exercise, gap to best performer (continued)

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
Logistics performance index: Frequency with which shipments reach consignee within scheduled or expected time (1=low to 5=high)	5	6	4	4	5	4
Logistics performance index: Ability to track and trace consignments (1=low to 5=high)	6	7	4	6	5	5
<b>Trade</b>						
Cost to export, border compliance (US\$)	1	1	1	1	1	1
Exports of goods and services (annual % growth)	8	4	8	7	2	4
Exports of goods and services (% of GDP)	10	9	9	9	10	9
Imports of goods and services (% of GDP)	9	9	8	8	9	7
International tourism, number of arrivals	10	10	10	10	10	10
International tourism, number of departures	10	10	10	10	10	10
International tourism, receipts (% of total exports)	9	9	8	8	9	9
International tourism, expenditures (% of total imports)	10	9	9	8	9	9
Agricultural raw materials exports (% of merchandise exports)	10	10	10	10	10	10
Manufactures exports (% of merchandise exports)	3	3	3	3	2	2
<b>Energy</b>						
Access to clean fuels and technologies for cooking (% of population)	3	2	3	2	3	2
Energy intensity level of primary energy (MJ/\$2011 PPP GDP)	1	2	1	2	2	2
Access to electricity, rural (% of rural population)	2	1	2	1	2	1
Access to electricity, urban (% of urban population)	1	1	1	1	1	1
Electricity production from renewable sources, excluding hydroelectric (kWh)	10	10	10	10	10	10
Electricity production from renewable sources, excluding hydroelectric (% of total)	3	5	1	3	1	2
Energy imports, net (% of energy use)	1	NA	1	NA	2	NA
Alternative and nuclear energy (% of total energy use)	9	NA	7	NA	6	NA
Energy use (kg of oil equivalent per capita)	10	NA	9	NA	10	NA
CO2 intensity (kg per kg of oil equivalent energy use)	3	NA	3	NA	4	NA

Table A.2. Results benchmarking exercise, gap to best performer (continued)

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
<b>Water and Sanitation</b>						
People using at least basic drinking water services, rural (% of rural population)	3	2	3	2	4	2
People using at least basic drinking water services, urban (% of urban population)	1	1	1	1	2	1
People using at least basic sanitation services, rural (% of rural population)	3	3	3	3	3	3
People using at least basic sanitation services, urban (% of urban population)	2	2	2	2	2	2
<b>Private sector development</b>						
Capacity for innovation, 1-7 (best)	9	5	7	3	8	1
Fixed broadband subscriptions (per 100 people)	10	9	7	7	10	9
HH Market Concentration Index	4	4	4	4	5	5
Public credit registry coverage (% of adults)	8	8	4	4	6	7
Power outages in firms in a typical month (number)	1	1	1	1	1	2
Firms experiencing electrical outages (% of firms)	6	5	6	3	5	3
Firms using banks to finance working capital (% of firms)	4	5	3	2	5	9
Firms using banks to finance investment (% of firms)	6	6	6	6	5	10
Bribery incidence (% of firms experiencing at least one bribe payment request)	1	1	1	1	2	2
Firms competing against unregistered firms (% of firms)	7	8	7	9	8	6
Informal payments to public officials (% of firms)	2	1	2	1	5	2
Losses due to theft and vandalism (% of annual sales of affected firms)	2	2	2	2	5	3
Firms with female top manager (% of firms)	5	7	4	6	6	1
Firms with female participation in ownership (% of firms)	6	6	7	6	7	9
Firms formally registered when operations started (% of firms)	4	4	6	6	9	8
Firms visited or required meetings with tax officials (% of firms)	4	7	5	10	3	6
Value lost due to electrical outages (% of sales for affected firms)	3	1	2	1	4	3
Firms that spend on R&D (% of firms)	6	8	6	7	4	10
Firms experiencing losses due to theft and vandalism (% of firms)	7	5	6	5	8	7

Table A.2. Results benchmarking exercise, gap to best performer (continued)

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
Firms offering formal training (% of firms)	3	3	2	3	1	4
Firms expected to give gifts in meetings with tax officials (% of firms)	1	1	1	1	1	1
Average number of visits or required meetings with tax officials (for affected firms)	3	2	7	2	10	1
<b>Governance</b>						
Control of Corruption	7	7	6	8	7	7
Rule of Law	7	7	6	8	7	6
Political Stability No Violence	4	5	4	4	5	6
Voice and Accountability	5	5	4	4	5	5
Government Effectiveness	6	6	3	5	5	5
Regulatory Quality	4	5	1	1	4	4
Q1   Stateness	3	3	3	3	5	5
Q4   Stability of Democratic Institutions	3	3	2	2	3	3
Q3   Rule of Law	5	5	3	3	6	6
Administrative Burden	4	3	5	5	3	2
E-Citizenship	7	7	5	4	8	8
Freedom of the Press	4	4	2	2	4	4
GR1_mobility	1	1	1	1	1	1
GR2_workplace	1	1	1	1	1	1
GR3_pay	3	3	3	3	4	4
GR4_marriage	3	3	3	3	4	4
GR5_parenthood	6	4	5	2	5	4
GR6_entrepreneurship	1	1	1	1	1	1
GR7_assets	1	1	1	1	1	1
GR8_pension	4	3	4	3	4	4
WBL_index	2	2	1	1	3	2
WJP rule of Law Index	7	7	4	4	6	6
<b>Sectors of Economic Activity</b>						
CO2 emissions from manufacturing industries and construction (% of total fuel combustion)	3	NA	3	NA	4	NA
Manufacturing, value added (current US\$)	10	10	10	10	10	10
Manufacturing, value added (current LCU)	10	10	10	10	10	10
Manufacturing, value added (constant 2010 US\$)	10	10	10	10	10	10

Table A.2. Results benchmarking exercise, gap to best performer (continued)

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
Manufacturing, value added (annual % growth)	8	4	9	7	5	3
Manufacturing, value added (constant LCU)	10	10	10	10	10	10
Manufacturing, value added (% of GDP)	7	7	6	5	7	7
Chemicals (% of value added in manufacturing)	7	5	4	5	5	3
Food, beverages and tobacco (% of value added in manufacturing)	9	2	9	2	8	2
Machinery and transport equipment (% of value added in manufacturing)	10	5	4	2	10	4
Other manufacturing (% of value added in manufacturing)	1	7	5	10	1	10
Medium and high-tech Industry (including construction) (% manufacturing value added)	8	8	6	6	6	7
Textiles and clothing (% of value added in manufacturing)	9	6	9	6	6	1
Services, value added (constant 2010 US\$)	10	10	10	10	10	10
Services, value added (% of GDP)	5	5	5	5	7	7
Child employment in manufacturing, female (% of female economically active children ages 7-14)	7	NA	7	NA	8	NA
Child employment in manufacturing, male (% of male economically active children ages 7-14)	3	NA	3	NA	5	NA
Child employment in manufacturing (% of economically active children ages 7-14)	4	NA	4	NA	7	NA
Tariff rate, applied, simple mean, manufactured products (%)	2	2	1	2	1	1
Tariff rate, most favored nation, simple mean, manufactured products (%)	2	2	2	2	1	1
Tariff rate, applied, weighted mean, manufactured products (%)	1	1	1	1	1	1
Tariff rate, most favored nation, weighted mean, manufactured products (%)	2	3	2	3	2	2
Manufactures imports (% of merchandise imports)	4	4	6	4	6	5
Medium and high-tech exports (% manufactured exports)	9	9	9	9	9	9
Manufactures exports (% of merchandise exports)	3	3	3	3	2	2
High-technology exports (% of manufactured exports)	9	10	8	10	9	9

**Table A.2. Results benchmarking exercise, gap to best performer (continued)**

	World as comparator group		LMI as comparator		LAC as comparator	
	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018	Ranking indicator (Baseline) circa 2011–2014	Ranking indicator (Recent) circa 2015–2018
<b>Climate and Natural Resources</b>						
Forest area (sq. km)	10	10	10	10	10	10
Forest area (% of land area)	9	9	9	9	9	9
CO2 emissions (kg per 2010 US\$ of GDP)	2	2	1	1	2	2
PM2.5 air pollution, population exposed to levels exceeding WHO guideline value (% of total)	10	10	10	10	10	10
Droughts, floods, extreme temperatures (% of population, average 1990–2009)	1	NA	NA	1	1	NA
CO2 emissions from residential buildings and commercial and public services (% of total fuel combustion)	3	NA	NA	3	6	NA
CO2 emissions from other sectors, excluding residential buildings and commercial and public services (% of total fuel combustion)	1	NA	NA	1	1	NA
Marine protected areas (% of territorial waters)	NA	10	10	NA	NA	10
Terrestrial and marine protected areas (% of total territorial area)	NA	10	10	NA	NA	10
Forest rents (% of GDP)	10	10	10	10	10	9
<b>Pandemic preparedness</b>						
1. Prevention of the emergence or release of pathogens	NA	8	NA	7	NA	8
2. Early detection and reporting for epidemics of potential international concern	NA	3	NA	NA	NA	NA
3. Rapid Response to and Mitigation of the spread of the pandemic	NA	7	NA	NA	NA	NA
4. Sufficient and robust health system to treat the sick and protect health workers	NA	7	NA	6	NA	7
5. Commitments to improving national capacity, financing and adherence to norms	NA	6	NA	5	NA	7
6. Overall risk environment and country vulnerability to biological threats	NA	6	NA	6	NA	6
7. Overall Pandemic Preparedness Score	NA	6	NA	2	NA	5

Note: Red and green color indicate large and small gap relative to best performer. Yellow indicates medium lag.

### Annex 2.3. Institutional Benchmarking

An institutional benchmarking analysis along nine institutional dimensions helps provide an overview of governance and institutional challenges faced by El Salvador. It groups several institutional and governance indicators into nine dimensions: service delivery, labor institutions, legal institutions, business and trade, public sector performance, accountability and corruption, financial institutions, social institutions, and political institutions. A distance to frontier is calculated for all countries in the sample, in which zero means the country is the furthest from the best performer. The ranking, based on the DTF indicator calculated with the whole sample, can be made with all countries, only LAC countries, or in this case, using the same structural and regional peers identified before. This is complemented by disaggregated data from multiple sources that focus especially on the institutional dimensions that emerged as the more vulnerable.

The table below provides the complete list of indicators included in the institutional benchmarking exercise, organized by institutional clustering, with a brief description of what is measured, the years available, and the reference to the source. All indicators are adjusted in order to ensure that higher values represent better performance. The list is not intended to be comprehensive, and it has been prepared with the primary purpose of informing this SCD. This means that indicators that were not available for El Salvador (despite being analytically relevant) have been excluded from the list.

**Table A.3. Global Institutional Database—indicators by clusters**

Indicator	Description	Years available	Source
<b>1. Political Institutions</b>			
Freedom in the world: political rights	Political rights include the right to vote freely for distinct alternatives in legitimate elections, compete for public office, join political parties and organizations, and elect representatives who have a decisive impact on public policies and are accountable to the electorate. Countries are graded between 1 (most free) and 7 (least free).	2006–2019	Freedom House, V-Dem
Freedom in the world: civil liberties	Civil liberties allow for the freedoms of expression and belief, associational and organizational rights, the rule of law, and personal autonomy without interference from the state. Countries are graded between 1 (most free) and 7 (least free).	2006–2019	Freedom House, V-Dem
Institutionalized democracy–institutionalized autocracy	The Autocracy indicator and the Democracy indicator range between 0 and 10. Autocracy is defined operationally in terms of the presence of a distinctive set of political characteristics: restriction or suppression of competitive political participation; chief executives chosen in a regularized process of selection within the political elite; few institutional constraints on the executive. The Democracy indicator is derived from codings of the competitiveness of political participation (PARCOMP), the openness and competitiveness of executive recruitment (XROPEN and XRCOMP), and constraints on the chief executive (XCONST).	1991–2018	Polity IV, V-Dem
Political stability and absence of violence/terrorism	It measures perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism	1996–2018	WB World Governance Indicators

Table A.3. Global Institutional Database—indicators by clusters (continued)

Indicator	Description	Years available	Source
Political power distributed by socio-economic position	0 represents countries where wealthy people enjoy a virtual monopoly on political power and, where average, and poorer people have almost no influence, and 4 represents countries where wealthy people have no more political power than those whose economic status is average or poor and political power is more or less equally distributed across economic groups.	1990–2018	V-Dem, Variety of Democracy database
Political power distributed by social group	A social group is differentiated within a country by caste, ethnicity, language, race, region, religion, or some combination thereof. (It does not include identities grounded in sexual orientation or socioeconomic status.) 0 represents countries where political power is monopolized by one social group comprising a minority of the population, and 4 represents countries where all social groups have roughly equal political power, or there are no strong ethnic, caste, linguistic, racial, religious, or regional differences.	1990–2018	V-Dem, Variety of Democracy database
Political power distributed by gender	0 represents countries where men have a near-monopoly on political power, and 4 represents countries where men and women have roughly equal political power.	1990–2018	V-Dem, Variety of Democracy database
Lower chamber gender quota	0 represents countries with no national-level gender quota, and 4 represents countries where there are reserved seats in the legislature for women.	1990–2018	V-Dem, Variety of Democracy database
Lower chamber female legislator	Share of female representatives in the lower (or unicameral) chamber of the legislature.	1990–2018	V-Dem, Variety of Democracy database
Order and Security	Crime is effectively controlled; civil conflict is effectively limited; people do not resort to violence to redress personal grievances.	2012–2019	World Justice Project, Rule of Law
Fundamental Rights	Equal treatment & absence of discrimination; the right to life & security of the person is effectively guaranteed; due process of the law and rights of the accused; freedom of opinion & expression is effectively guaranteed; freedom of belief & religion is effectively guaranteed; freedom from arbitrary interference with privacy is effectively guaranteed; freedom of assembly & association is effectively guaranteed; Fundamental labor rights are effectively guaranteed.	2012–2019	World Justice Project, Rule of Law
Constraints on Government Powers	Government powers are effectively limited by the legislature; government powers are effectively limited by the judiciary; government powers are effectively limited by independent auditing and review; government officials are sanctioned for misconduct; government powers are subject to non-governmental checks; transition of power is subject to the law.	2012–2019	World Justice Project, Rule of Law

**Table A.3. Global Institutional Database—indicators by clusters (continued)**

<i>Indicator</i>	<i>Description</i>	<i>Years available</i>	<i>Source</i>
<b>2. Legal Institutions</b>			
EFW index: integrity of the legal system	This assesses the strength and impartiality of the legal system and the popular observance of the law (based on the International Country Risk Guide Political Risk Component I for Law and Order).	1990–2017	Fraser Institute
Judicial independence	How independent the judicial system in the country is from influences of the government, individuals, or companies?	2018	World Economic Forum, Global Competitiveness Report
Efficiency of the legal framework in settling disputes	How efficient are the legal and judicial systems in the country for companies in settling disputes?	2008–2018	World Economic Forum, Global Competitiveness Index
Efficiency of the legal framework in challenging regulations	How easy is it for private businesses to challenge government actions and/or regulations through the legal system in the country?	2008–2018	World Economic Forum, Global Competitiveness Index
Judicial accountability	0 represents countries where judges, who have been found responsible for serious misconduct are never removed from their posts or otherwise disciplined; 4 represents countries, where judges found responsible for serious misconduct, are always removed from their posts or otherwise disciplined.	1990–2018	V-Dem, Variety of Democracy database
Rule of law	It captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.	1996–2018	WB World Governance Indicators
Civil Justice	People can access & afford civil justice; civil justice is free of discrimination; civil justice is free of corruption; civil justice is free of improper government influence; civil justice is not subject to unreasonable delay; civil justice is effectively enforced; alternative dispute resolution mechanisms are accessible, impartial, and effective.	2012–2019	World Justice Project, Rule of Law
Criminal Justice	Criminal investigation system is effective; criminal adjudication system is timely and effective; correctional system is effective in reducing criminal behavior; the criminal justice system is impartial, free of corruption, and free of improper government influence; due process of the law & rights of the accused are guaranteed.	2012–2019	World Justice Project, Rule of Law
Resolving insolvencies	This captures the time, cost, and outcome of insolvency proceedings involving domestic legal entities.	2003–2020	Doing Business
Enforcing contracts	The enforcing contracts indicator measures the time and cost for resolving a commercial dispute through a local first-instance court and the quality of judicial processes index, evaluating whether each economy has adopted a series of good practices that promote quality and efficiency in the court system.	2003–2020	Doing Business

Table A.3. Global Institutional Database—indicators by clusters (continued)

Indicator	Description	Years available	Source
Firms: Courts as a major constraint	Share of firms identifying the court system as a major constraint.	2006–2018	Enterprise Survey
<b>3. Accountability institutions</b>			
Voice and accountability	This measures the extent to which a country's citizens are able to participate in selecting their government and to enjoy freedom of expression, freedom of association, and free media.	1996–2018	WB World Governance Indicators
Control of corruption	This captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.	1996–2018	WB World Governance Indicators
Corruption perceptions index	The CPI Score relates to perceptions of the degree of corruption as seen by business people, risk analysts, and the general public and ranges between 100 (highly clean) and 0 (highly corrupt).	1995–2019	Transparency International, Global Corruption Barometer
Absence of corruption	Government officials in the executive branch, the judicial branch, the police & the military, and the legislative branch do not use public office for private gain.	2012–2019	World Justice Project, Rule of Law
Open government	Publicized laws & government data are publicly available; there is: right to information, civic participation, and complaint mechanisms.	2012–2019	World Justice Project, Rule of Law
Favoritism in decisions of government officials	To what extent do government officials show favoritism to well-connected firms and individuals in the country when deciding upon policies and contracts? [1 = show favoritism to a great extent; 7 = do not show favoritism at all]	2008–2018	WEF, Global Competitiveness Index
Irregular payments and bribes	How common is it for firms to make undocumented extra payments or bribes in this country connected with (a) imports and exports; (b) public utilities; (c) annual tax payments; (d) awarding of public contracts and licenses; (e) obtaining favorable judicial decisions? [1 = very common; 7 = never occurs].	2008–2018	WEF, Global Competitiveness Index
Diversion of public funds	How common is the diversion of public funds to companies, individuals, or groups due to corruption in this country? [1 = very commonly occurs; 7 = never occurs]	2008–2018	WEF, Global Competitiveness Index
Transparency of government policymaking	How easy is it for businesses in this country to obtain information about changes in government policies and regulations affecting their activities? [1 = extremely difficult; 7 = extremely easy]	2008–2018	WEF, Global Competitiveness Index
Rigorous and impartial public administration	This measures the extent to which public officials generally abide by the law and treat like cases alike, or conversely, the extent to which public administration is characterized by arbitrariness and biases (i.e., nepotism, cronyism, or discrimination). The question covers public officials that handle the cases of ordinary people. If no functioning public administration exists, the lowest score (0) applies.	1990–2018	V-Dem, Variety of Democracy database

**Table A.3. Global Institutional Database—indicators by clusters (continued)**

<i>Indicator</i>	<i>Description</i>	<i>Years available</i>	<i>Source</i>
Open Data Barometer Index	This measures how governments are publishing and using open data for accountability, innovation, and social impact (readiness and impact).	2012–2017	Open Data Barometer and World Wide Web Foundation
E-government Index	This considers website development patterns in a country as well as access characteristics, such as infrastructure and educational levels, to reflect how a country is using information technologies to promote access and inclusion of its people.	2003–2018	UN E-government Knowledgebase
E-participation Index	This represents the use of online services to facilitate the provision of information by governments to citizens (“e-information sharing”), interaction with stakeholders (“e-consultation”), and engagement in decision-making processes (“e-decision making”).	2003–2018	UN E-government Knowledgebase
<b>4. Public sector performance Institutions</b>			
Regulatory quality	This captures perceptions of the government’s ability to formulate and implement sound policies and regulations that permit and promote private sector development.	1996–2018	WB World Governance Indicators
Government effectiveness	This captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies.	1996–2018	WB World Governance Indicators
Efficient government spending	How efficient is the government in spending public revenue in this country? [1 = extremely inefficient; 7 = extremely efficient]	2008–2018	WEF, Global Competitiveness Index
Regulatory Enforcement score	Government regulations are effectively enforced; government regulations are applied & enforced without improper influence; administrative proceedings are conducted without unreasonable delay; due process is respected in administrative proceedings; the government does not expropriate without lawful process & adequate compensation.	2012–2019	World Justice Project, Rule of Law
Regulatory Governance score	This captures how policymakers interact with stakeholders when shaping regulations that affect business communities. It considers publication of forwarding regulatory plans; consultation on proposed regulations, and reporting back on the results of that consultation process; conducting regulatory impact assessment; and if laws are made publicly accessible.	2018	World Bank, Global Indicators of Regulatory Governance database
Public Procurement Score	This evaluates the legal and regulatory environments for public procurement, considering: needs assessment, call for tender, and bid preparation; bid submission; bid opening, evaluation, and award; content and management of procurement contract; performance guarantee; payment of suppliers.	2017	World Bank, Benchmarking Public Procurement

Table A.3. Global Institutional Database—indicators by clusters (continued)

Indicator	Description	Years available	Source
Level of influence of the center of government	Indicators on whether the center of government has full or shared responsibility for a series of functions: Preparation of Cabinet meetings; Policy coordination; Relations with parliament; Communication of government messages; Government program; Monitoring of government policy; Policy formulation; Strategic planning; Designing and implementing reform; Risk anticipation and foresight; Human resources strategy; Relations with sub-levels of government; International coordination; Policy analysis; Regulatory policy.	2015–2018	OECD Survey on Centre of Government
<b>5. Business environment and trade institutions</b>			
Starting a business	This measures the number of procedures, time, cost, and paid-in minimum capital requirement for a small- to medium-size limited liability company to start up and formally operate in each economy's largest business city.	2008–2018	Doing Business
Construction permits	This records all procedures required for a business in the construction industry to build a standardized warehouse, along with their associated time and cost.	2008–2018	Doing Business
Registering property	Assuming a standardized case of an entrepreneur who wants to purchase land and a building that is already registered and free of a title dispute, it examines the steps, time, and cost involved in registering property and the quality of the land administration system.	2008–2018	Doing Business
Protecting minority investors	This measures aspects such as the protection of shareholders against directors' misuse of corporate assets for personal gain, and the rights and role of shareholders in corporate governance.	2008–2018	Doing Business
Paying taxes	This records the taxes and mandatory contributions that a medium-size company must pay or withhold in a given year, as well as the administrative burden of paying taxes and contributions.	2008–2018	Doing Business
Trading across borders	This measures the time and cost (excluding tariffs) associated with three sets of procedures: (i) documentary compliance, (ii) border compliance, and (iii) domestic transport, within the overall process of exporting or importing a shipment of goods.	2008–2018	Doing Business
Property rights	To what extent are property rights, including financial assets, protected in this country? [1 = not at all; 7 = to a great extent]	2018	World Economic Forum, Global Competitiveness Report
Non-tariffs trade barriers	To what extent do non-tariff barriers (e.g., health and product standards, technical and labeling requirements, etc.) limit the ability of imported goods to compete in the domestic market in this country? [1 = strongly limit; 7 = do not limit at all]	2018	World Economic Forum, Global Competitiveness Report
EFW index: Controls of the movement of capital and people	Foreign ownership/investment restrictions (WEF, GCR), Capital controls (IMF), Freedom of foreigners to visit (Robert Lawson and Jayme Lemke (2012)).	1990–2017	Fraser Institute

Table A.3. Global Institutional Database—indicators by clusters (continued)

Indicator	Description	Years available	Source
Global Competitiveness Index	Combination of indicators organized into 12 “pillars”: Institutions; Infrastructure; ICT adoption; Macroeconomic stability; Health; Skills; Product market; Labour market; Financial system; Market size; Business dynamism; and Innovation capability.	2008–2018	WEF, Global Competitiveness Index
Extent of market dominance	How do you characterize corporate activity in this country? [1 = dominated by a few business groups; 7 = spread among many firms].	2008–2018	WEF, Global Competitiveness Index
Effectiveness of antimonopoly policy	How effective are anti-monopoly policies at ensuring fair competition in this country?	2008–2018	WEF, Global Competitiveness Index
Burden of government regulation	How burdensome is it for companies to comply with public administration’s requirements in this country (e.g., permits, regulations, reporting)?	2008–2018	WEF, Global Competitiveness Index
Burden of customs procedures	This measures business executives’ perceptions of their country’s efficiency of customs procedures.	1960–2019	WITS
Efficiency and transparency of border administration	Efficiency and transparency of border administration. This captures efficiency, transparency, and costs associated with importing and exporting goods. It includes an assessment of the range, quality, and comprehensiveness of key services offered by customs and related agencies and the average time, costs, and the number of documents required to import and export goods. It also assesses the time predictability of border procedures, as well as the transparency of the process and the prevalence of corruption.	2014, 2016	WEF, Enabling Trade Index
Efficiency of the clearance process by border control agencies, including customs	Efficiency of customs clearance processes (i.e., speed, simplicity, and predictability of formalities) by border control agencies, including customs	2007–2018	WB International LPI
Complexity of regulatory procedures	Simple average of two components: (i) Use of “one-stop-shops” and the “silence is consent” rule for issuing licenses and accepting notifications; (ii) the government’s communication strategy and efforts to reduce and simplify the administrative burden of interacting with the government.	2013, 2018	Product Market Regulation (PMR) Indicators
Administrative burdens on startups	Simple average of three components: (i) administrative burdens on creating a public limited company, (ii) administrative burdens on creating an individual enterprise, (iii) entry barriers to professional services, freight transport services, and retail distribution.	2013, 2018	Product Market Regulation (PMR) Indicators
Regulatory protection of incumbents	Simple average of three components: (i) pervasiveness of barriers to entry in 30 business sectors as a share of sectors in which there are explicit legal limitations on the number of competitors, (ii) scope of exemptions from competition law for public enterprises, (iii) entry barriers in 8 network sectors (gas, electricity, water, rail transport, air transport, road freight transport, postal services, and telecommunication) and degree of vertical separation in 3 network sectors (gas, electricity and rail transport).	2013, 2018	Product Market Regulation (PMR) Indicators

Table A.3. Global Institutional Database—indicators by clusters (continued)

Indicator	Description	Years available	Source
Explicit barriers to trade and investment	Simple average of two components: (i) restrictiveness of a country's FDI rules in 22 sectors in terms of foreign equity limitations, screening or approval mechanisms, restrictions on the employment of foreigners as key personnel, and operational restrictions (e.g., restrictions on branching and on capital repatriation or on land ownership), (ii) Simple cross-product average of effectively applied tariffs.	2013, 2018	Product Market Regulation (PMR) Indicators
Other barriers to trade and investment	Simple average of two components: (i) discrimination of foreign firms with respect to taxes and subsidies, public procurement, entry regulation, appeal and procedure, (ii) recognition of foreign regulations, use of international standards, and international transparency of domestic regulation.	2013, 2018	Product Market Regulation (PMR) Indicators
<b>6. Institutions for service delivery</b>			
Governance of state-owned enterprises	This measures the degree of political interference and the degree of insulation from market discipline. Higher values mean worse performance.	1998–2018	Product Market Regulation (PMR) Indicators
Price control	This measures whether tariffs are regulated and whether there are laws and regulations that limit competition. Higher values mean worse performance.	1998–2018	Product Market Regulation (PMR) Indicators
Use of command & control regulation	This measures the degree of autonomy of SOEs for taking market-related decisions, such as opening hours for retail distribution, if taxis are allowed to offer ride-sharing to customers, if air companies are free to choose which routes to serve, etc. It also measures whether SOEs (for utilities) are required to provide clear and transparent information to customers on tariffs and consumption. Higher values mean worse performance.	1998–2018	Product Market Regulation (PMR) Indicators
<b>7. Financial market institutions</b>			
Index of economic freedom: financial freedom	The extent of government regulation of financial services; the degree of state intervention in banks and other financial firms through direct and indirect ownership; the extent of financial and capital market development; government influence on the allocation of credit; openness to foreign competition. An overall score on a scale of 0 to 100 is given to an economy's financial freedom by deducting from an ideal score of 100.	1995–2019	The Heritage Foundation and the Wall Street Journal
EFW index: Credit market regulations	Ownership of banks, private sector credit, interest rate controls/negative real interest rates.	1990–2017	Fraser Institute
EFW index: Freedom to own foreign currency bank accounts	0 represents countries where foreign currency bank accounts are restricted both domestically and abroad; 10 represents countries where foreign currency bank accounts are permissible without any restrictions both domestically and abroad.	1990–2017	Fraser Institute

Table A.3. Global Institutional Database—indicators by clusters (continued)

Indicator	Description	Years available	Source
Access to credit	The legal rights of borrowers and lenders with respect to secured transactions through one set of indicators and the reporting of credit information through another, the first measures whether certain features that facilitate lending exist within the applicable collateral and bankruptcy laws. The second measures the coverage, scope, and accessibility of credit information available through credit reporting service providers such as credit bureaus or credit registries.	2004–2020	Doing Business
Efficiency of the banking supervisory authority	Perception data was collected through questionnaires. Answers range from 0 (minimum score) to 4 (maximum score).	2001–2016	Institutional Profiles Database
Efficiency of the financial market supervisory authority	Perception data was collected through questionnaires. Answers range from 0 (minimum score) to 4 (maximum score).	2001–2016	Institutional Profiles Database
Financial sector: competition regulation	Perception data was collected through questionnaires. Answers range from 0 (minimum score) to 4 (maximum score).	2001–2016	Institutional Profiles Database
<b>8. Labor market institutions</b>			
EFW index: Labor market regulations	Hiring regulations and minimum wage, hiring and firing regulations, centralized collective bargaining, hours, regulations, mandated cost of worker dismissal, conscription.	1990–2017	Fraser Institute
Collective bargaining coverage rate	Number of employees whose pay and/or conditions of employment are determined by one or more collective agreement(s) as a percentage of the total number of employees. Collective bargaining coverage includes, to the extent possible, workers covered by collective agreements in virtue of their extension.	2004–2016	ILO
Employment Protection Legislation Index, permanent workers	Composite indicator of employment protection legislation governing regular contracts, individual dismissals.	2012–2015	ILO
Employment Protection Legislation Index, temporary workers	Composite indicator of employment protection legislation governing temporary contracts, individual dismissals.	2012–2015	ILO
Trade union density	The number of union members who are employees as a percentage of the total number of employees. For the purpose of this indicator, in particular, trade union membership excludes union members who are not in paid employment (self-employed, unemployed, retired, etc.).	2004–2016	ILO
The ratio of minimum to mean wages	The ratio of minimum to mean wages.	2007–2019	ILO
<b>9. Social Institutions</b>			
Civil society participation index	Major CSOs are routinely consulted by policymakers (v2cscnsult); extent of the involvement of people in CSOs (v2csprtpt); women prevented from participating in CSOs (v2csgender); legislative candidate nomination within party organization highly decentralized or made through party primaries (v2pscnslnl).	1990–2018	V-Dem, Variety of Democracy database

**Table A.3. Global Institutional Database—indicators by clusters (continued)**

<i>Indicator</i>	<i>Description</i>	<i>Years available</i>	<i>Source</i>
Core civil society index	Government's control over entry and exit by CSOs into public life (v2cseeorgs); government attempts to repress CSOs (v2csreprss); Extent of the involvement of people in CSOs (v2csprtct).	1990–2018	V-Dem, Variety of Democracy database
Engaged Society	Wide and independent public deliberations when important policy changes are being considered. 0 represents countries where public deliberation is never, or almost never allowed; 5 represents countries where large numbers of non-elite groups, as well as ordinary people, tend to discuss major policies among themselves, in the media, in associations or neighborhoods, or in the streets, and grassroots deliberation is common and unconstrained.	1990–2018	V-Dem, Variety of Democracy database
Public trust in politicians	How do you rate the ethical standards of politicians in this country? [1 = extremely low; 7 = extremely high]   2016–17 weighted average	2008–2018	WEF, Global Competitiveness Index

## Annex 3. Economic Modeling and Analysis Tools

### Annex 3.1. SIMLAB: A Structural Macro-Micro Simulation Tool to Analyze Distributional Impact of Human Capital on the Labor Market and Poverty

The labor market and human capital are closely interrelated. Human capital policies have the potential to have important effects on employment, unemployment, and the size of the informal sector, they may also have effects on the distribution of productivity and wages. A structural model can help to assess ex-ante the medium-term impacts of these policies and compare the potential effects of alternative policies, this can be done in combination with other structural policies affecting the labor market.

SIMLAB is a structural model of the labor market capable of simulating a rich array of labor market and other relevant macroeconomic variables. The underlying model is a structural job search model with unemployment and two employment sectors: formal and informal. The parameters in the model are estimated using household-level data to replicate the current labor market structure of client countries. Its key objective is to capture the ex-ante effects of selected policy reforms, including human capital policies, public-sector employment policies, formalization, and labor market policies. Simlab can capture the micro-distributional as well as macroeconomic effects of selected policy reforms. The structural micro-simulation tool can be used to inform discussions across regions on tackling significant labor market challenges by providing ex-ante evidence on the potential employment, wage, and distributional impacts of selected policy reforms.

We quantify the compositional and distributional impact of human capital reforms, this can be done in combination with other policy reforms and use these counterfactuals to evaluate different policy packages and designs. In addition to policies affecting human capital and workers' productivity, the model can be applied more generally to assess a combination of policies with expected impacts on the labor markets, i.e., "formalization" policies, fiscal consolidation reforms, matching efficiency, and labor market policies.

#### Results

We use SIMLAB to simulate the aggregate, compositional, and distributional impact of human capital policies on labor market outcomes, poverty, and GDP per capita growth in El Salvador. Two types of human capital policies are evaluated: 1. "Education enhancing" policies affecting the accumulation and distribution of educational attainment; 2. "Productivity Enhancing" policies affecting the accumulation and distribution of productivity (for the same schooling levels). Below are the key results of the "Education enhancing" policies.

#### *Aggregate Labor Market and Macro Effects*

Results show that human capital policies that significantly increase human capital (educating half of the labor force with low educational attainment to achieve complete secondary or more) promote inclusive growth by inducing formalization and by generating significant productivity and wage growth in the formal and informal sectors while reducing wage inequality. However, unemployment is not reduced significantly, and employment growth can be limited unless these policies are combined with policies incentivizing formal-sector job creation. Human capital policies are expected to reduce the size of the informal sector,

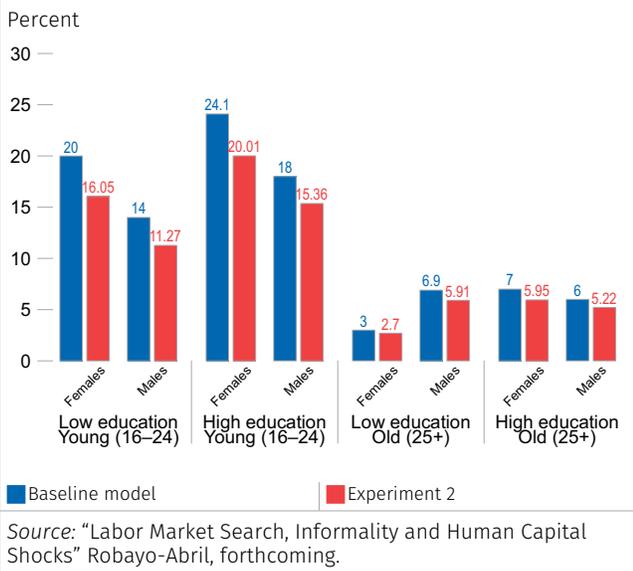
but unemployment is not reduced significantly unless firms open more vacancies, particularly in the formal sector.

*Poverty and Distributional Effects*

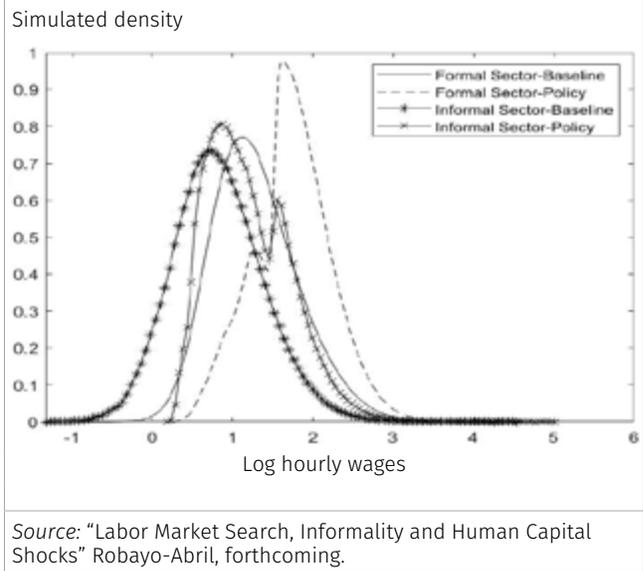
Formalization is observed across the human capital distribution, benefitting all workers, but more educated people generally benefit more, as a higher fraction of highly educated workers moves to formality. There are important changes in the incidence of unemployment among different types of workers. The unemployment rate among young workers, particularly females, decrease substantially. A significant fraction of young, uneducated females move out of unemployment to the formal sector (Figure A.34), and a higher fraction of highly educated workers move to formality and informality. As a result, the average level of education increases in both sectors, especially in the informal sector, since there is a shift in the incidence of unemployment towards low-educated workers. This reflects the greater availability of employment in the formal sector.

Higher educational attainment and productivity lead to higher wages in both sectors (mostly formal) (Figure A.35). In particular, the incidence of low wages is significantly reduced in both sectors, and poverty could be reduced considerably as a result of this human capital policy. Counterfactual microsimulations show that this policy may decrease the poverty rate (US\$5.5 line) by up to 4.6 percentage points in the medium term.

*Figure A.34. Rising educational attainment may lead to lower unemployment, particularly among the young...*



*Figure A.35. ...and rising wages in both formal and informal sectors.*



**Annex 3.2. Stochastic Frontier Analysis (SFA) Tool**

The Stochastic Frontier Analysis (SFA) tool helps assess the growth impacts of structural reforms, which informs the prioritization criteria of this SCD. Based on the literature studying the relationship between structural reforms and potential GDP growth, the SFA tool identifies the main structural determinants of potential GDP, grouped under seven pillars and represented by nine indicators, based on the classification

developed for the Global Competitiveness Index (WEF, 2018). Each reform can boost GDP growth through their impacts separately and collectively on; (i) capital accumulation, (ii) labor utilization, and (iii) total factor productivity. Productivity is proxied with an efficiency estimate using a stochastic frontier approach. This tool does not consider any demand-side impacts of these reforms.

The SFA tool, developed from the work of Rovo (2020), assumes that productivity is proxied by an estimate of technical efficiency based on a stochastic frontier analysis (SFA). Structural reform indicators could be very large, as such are selected and classified according to their interpretation and in line with the WEF competitiveness approach, based on the 12-pillar classification developed for the Global Competitiveness Index (WEF, 2018).

Many studies have found that the long-run effects of structural reforms on output are strongly positive. However, the actual impact of the reforms needs to be estimated, considering its potential impact on GDP growth. In this sense, the simulations of the tool aim to quantify the relative importance of each reform.

Productivity, i.e., how firms and the economy as a whole combine labor and capital inputs into ever-more-efficient uses can be measured at several levels and in several ways. It can be expressed as labor productivity (output per employee or per hour worked) or capital productivity (output per unit of capital). An alternative is to use the growth accounting approach to measure total factor productivity (TFP), which is defined as the difference between the growth of outputs and of inputs. A different approach is to estimate TFP growth via SFA. This approach has the advantage that the productivity is estimated as an indicator jointly with the other parameters of the growth equation and not as the result of a residual.

In this sense, the estimations of the tool assume the following stages:

- ▶ **First stage:** estimate a stochastic production frontier to get the distance between the target country and the country subject to the analysis. The distance between both can be a result of idiosyncratic factors and technical inefficiency.
- ▶ **Second stage:** inefficiency is modeled as a time-varying conditional inefficiency dependent on a vector of structural reforms (“Z”). The reforms are identified as simple positive or negative annual changes of the indicators based on different pillars (GCI). Then, the reform variable is defined as a dummy variable, which takes the value of 1 when there is a reform shock (i.e., a change in the indicator).

By using these estimations and the results from a baseline model on the estimated elasticities of efficiency, capital, and labor with respect to changes in structural variables, it is possible to compute the impact on GDP growth of the most significant changes in structural policy. It is particularly possible to derive additional annual GDP growth if the country subject to study were to close major structural gaps within a specific time horizon.

SFA results are consistent with the prioritization of the priority areas based on its impacts as it estimates higher impacts from reforms on government effectiveness, and business regulatory quality. The growth impact of each reform is obtained by choosing one country as the frontier, the size of the gap that will be covered, and the time will take to cover the gap. In this case, the US was chosen as the frontier for all reforms, and it is assumed that the full gap would be closed by the end of a 10, 20, or 30-year period depending on the size of the gap, with larger gaps being covered in longer periods. The three reforms

with the largest impact on annual real GDP growth are government effectiveness (4.5 percent), business regulatory quality (3.7 percent), and internet penetration (1.7 percent). The reforms with the smallest impact are top tax rates (0 percent), trade tariffs (0.2 percent), and financial development (0.4 percent). This result is consistent with the analysis above that highlighted the digital underdevelopment of El Salvador and low government effectiveness, with impact in several priority areas. The high impact of regulatory quality reforms, especially regarding competition, infrastructure, and other business regulations, is consistent with the previous analysis. The results from the SFA tool also support the conclusion that financial development and trade tariffs are not impactful constraints in El Salvador. Please see (World Bank, 2019) and (Rovo, 2020) for the more detailed methodology.

### Annex 3.3. Vulnerability to Poverty Tool

**Poverty analysis usually focuses on the current poor and the ex-post impact of past public interventions;** however, to establish an effective poverty reduction strategy, it is relevant to identify vulnerable households as those who are more likely to fall into poverty, which may or may not coincide with the current poor, and evaluate the ex-ante effects of policy reforms on those who are expected to be poor. This is also needed to inform the design of an effective safety net system, which plays the role of redistribution; protects vulnerable households when shocks arise; and forms an effective risk management strategy.

**There is a wide range of poverty measures to determine the concept of “vulnerability to poverty.”** However, there is still no consensus on how to identify vulnerable individuals within a given population. The “operational” definition widely used in the LAC region defines vulnerable households as those with daily incomes between \$5 and \$13 a day (in 2011 PPP Dollars). This method does not allow for easy identification of the underlying sources of vulnerability.

**The World Bank Equity Policy Lab (EPL) and the Global Solutions Group on the Welfare Implications of Climate Change, Fragility, and Conflict Risks have developed a novel tool to estimate vulnerability to poverty systematically and to decompose the different sources of vulnerability.** The methodology (Gao, Vinha, and Skoufias, 2020) allows for quantification of vulnerability based on two components: (i) the average level of welfare, and (ii) the variability of welfare. The method also sheds light on vulnerability sources: (i) also called structural or chronic, and related to low physical and human assets, and (ii) risk induced (due to high volatility). The methodology also distinguishes between idiosyncratic and covariate shocks, as community-level shocks or household-level shocks, and supports the design of targeting methods based on the ex-ante probability of households becoming poor when adverse shocks occur. This tool has been piloted in other countries using consumption as the welfare level but has not been piloted in a country like El Salvador using income-based measures. We pilot this methodology in El Salvador using four cross-sections from 2016 to 2019 (EHPM data). The tool draws from three sets of parameters: (i) a set of covariates, measuring variables of interest at the household or community level; (ii) parameters measuring vulnerability and poverty, as well as the threshold for vulnerability and the poverty line; And a set of subgroups of interest (e.g., the rural and urban population). We control for household characteristics and municipality characteristics and use per capita income as our main variable of interest. We use the international moderate poverty line of US\$5.5 2011-PPP-dollars to define poverty, and a probability threshold of 50 percent to fall into poverty over the next two years to define vulnerability. For a detailed overview of the underlying methodology and assumptions as well as the detailed results, see the technical paper “Quantifying Vulnerability to Poverty in El Salvador.”

The main results show that:

- › Vulnerability is slightly higher than poverty, with 23.7 percent of the population being vulnerable to poverty.
- › The prevalence of vulnerability is slightly higher than poverty (US\$5.5) and significantly higher in rural than urban areas (41.2 percent versus 13.5 percent).
- › There is a significant overlap with poverty, but a large fraction of the non-poor are vulnerable, with only 45.4 percent of the vulnerable living below the US\$5.5 poverty line.
- › Most vulnerability is risk-induced, with a ratio of risk-induced to poverty-induced vulnerability of 1.7. This ratio is 1.4 in rural and 2.7 in urban areas.
- › In rural and urban areas, idiosyncratic vulnerability (household-level shocks) is more marked than covariate vulnerability (municipality-level shocks).
- › Vulnerability to poverty has decreased in recent years, and risk factors have become relatively more important, especially in rural areas.

**This analysis has several policy implications.** If the vulnerability is a result of low assets or low human capital (poverty-induced or structural/chronic poverty), a redistributive or poverty alleviation (conditional or unconditional) program may be more appropriate to reduce vulnerability. If the vulnerability is due to high variance (risk-induced), even if not poor, then an insurance program (i.e., cash transfers) could work best. El Salvador should focus on designing social insurance mechanisms that help households cope with negative shocks and recover strongly from them. Targeting should focus on the potentially adverse effects of individual-level shocks and not on chronic correlates of poverty at the municipality level, especially in urban areas. Specific tools are needed to address vulnerability, as traditional tools for poverty reduction are focused more on long-term structural poverty. These instruments, such as investments in human capital, should be combined with instruments addressing short-term needs when vulnerability is risk-induced, as in El Salvador.

*Source:* Background Vulnerability Diagnostic, forthcoming 2021.

### Annex 3.4. Probit Model: Drivers of Poverty

The following section analyzes the underlying drivers of poverty in El Salvador. We use repeated cross-sections from 2016–2019 and run a Probit model on a dummy variable equal to one if an individual is poor. Although we speak of causalities, we would like to stress that the results are correlations taken as proxies to causal relations. We cluster our standard errors at the department level. Our primary outcome variable of interest is a dummy equal to one if a person is poor or a dummy equal to 1. The poverty status is directly observed in the household survey and equals one if a person disposes of a per capita daily income less than the international poverty line of US\$5.5 2011-PPP. Additionally, we run the Probit model for the rural and urban populations to test for underlying drivers.

We use a variety of explanatory variables and the international poverty line as parameters in our model. The following control variables are introduced at the individual level: gender, marital status, age, homeownership, overall years of schooling, labor activity status, self-employment status, public/private

sector, informal employment status, and urban/rural status.<sup>49</sup> We also control for the number of household members, the number of children below 15 years old in the household, the number of children below 15 years old attending school, and the number of household members out of the labor force. Additionally, we control for municipality characteristics: the employment rate, the unemployment rate, the share of self-employed and entrepreneurs, the share of public sector employees, the share of children attending school, and the share of the population with secondary education. We also create an index to measure individual exposure to crime, insecurity, and natural hazards. The results are shown in Table A.4.

**Table A.4. Determinants of poverty (marginal effects)–overall population (2016–2019)**

Variables	Probability to be poor	Variables	Probability to be poor
<b>General characteristics</b>		<b>Labor market</b>	
Urban	-0.008	No. of inactive	0.013***
Age	-0.003***	Employed	-0.174***
Male	0.073***	Self-employed	0.077***
Home Ownership	-0.014***	Entrepreneurship	-0.087***
Emigrants	0.080***	Public sector	-0.170***
<b>Human Capital and Health</b>		Informal	0.150***
Years of schooling	-0.007***	Primary sector	0.071***
Literacy	-0.024**	Female premium	0.042***
Malnutrition (child)	0.047***	<b>Risks and hazards</b>	
Lack of access health system	-0.007	Exposure to crime	-0.020***
No. of children < 6 years	0.020***	Insecurity	0.009***
No. of children in school	0.013***	Environmental damages	-0.002
<b>Services</b>			
Electricity	-0.041***		
Water	-0.020***		
Sewerage	-0.076***		
Internet access	-0.079***		

Source: EPHM (2016–2019).

Note: Poverty is defined by the international poverty line of having less than 5.5 2011-PPP-US\$ per day per capita. We control for department and survey year fixed effects and cluster standard errors at the department level. The interpretation of the coefficients should be taken with caution as they could suffer from reversed causality or omitted variable bias. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

The probability of being poor diminishes with access to the labor market and human capital; it increases with working in the informal sector, inactivity, self-employment, household emigration experiences, and insecurity; in contrast to vulnerability, services play an important role in poverty dynamics. The following factors significantly increase the probability of being poor: the number of children between 0–5 years old, and the number of school-aged children in a household, child malnutrition, the number of inactive adults, being male, living in a household with international emigrants, being self-employed, working in the informal sector and the perceived insecurity in the neighborhood. Several factors have a significant negative influence on poverty: living in urban areas (compared to rural), age, human capital accumulation (as measured by the years of schooling), being employed, being an entrepreneur, working in the public sector, as well as the access to electricity, water, the sewerage system, and internet.

Increasing access to a high-quality labor market and services is crucial for eradicating poverty in El Salvador, as are investments in human capital, especially ECD, risk-mitigation strategies to address crime; and rechanneling remittances to more productive purposes. The most important driver of poverty is informality (a percentage point increase of 14.9 percentage points); poverty diminishes most with access to the labor market (11.5 percentage points), and so a high-quality labor market is crucial for eliminating poverty. Moreover, child malnutrition and the number of children below five years old in a household significantly increase the probability of being poor (by 4.8 and 2.0 percentage points, respectively), supporting investments in ECD as a means to contribute to poverty reduction, and should be prioritized, including over health, which is less significant. Increasing access to services can help reduce the number of poor as access to electricity, the internet, and the sewage and water system are significant drivers of poverty. Perceived insecurities increase poverty by 0.9 percentage points, and coming from an emigrant household increases it by 7.8 percentage points, these factors increase the probability of being poor, as such risk-mitigation strategies to address crime and channel remittances to more productive purposes could also diminish the poverty rate. Working in the primary sector increases the probability of being vulnerable compared to not working in the primary sector.

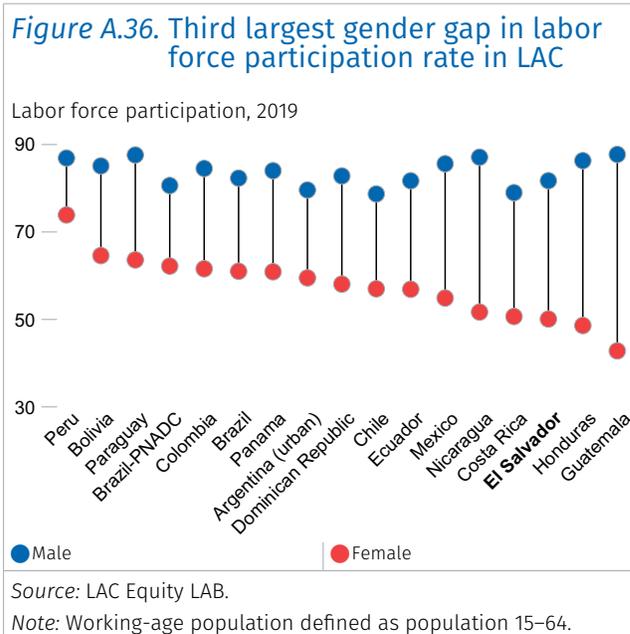
The effects are again more marked for the rural population; for poverty-reduction, investments in rural areas could be crucial. The effect of belonging to an emigrant household is larger for the rural than for the overall population, as is the effect of having access to services or the labor market, human capital accumulation, and ECD. Consequently, special attention should be paid to rural areas when designing policy measures addressing poverty.

### Annex 3.5. Model of Female Labor Force Participation

The benchmarking exercise finds El Salvador to be one of the countries in LAC with low female labor force participation. The use of human capital is particularly low among females; low labor force participation, and a higher incidence of unemployment has led to poor employment prospects. The gender gap in labor force participation is the third-largest in LAC (2019) (Figure A.36).

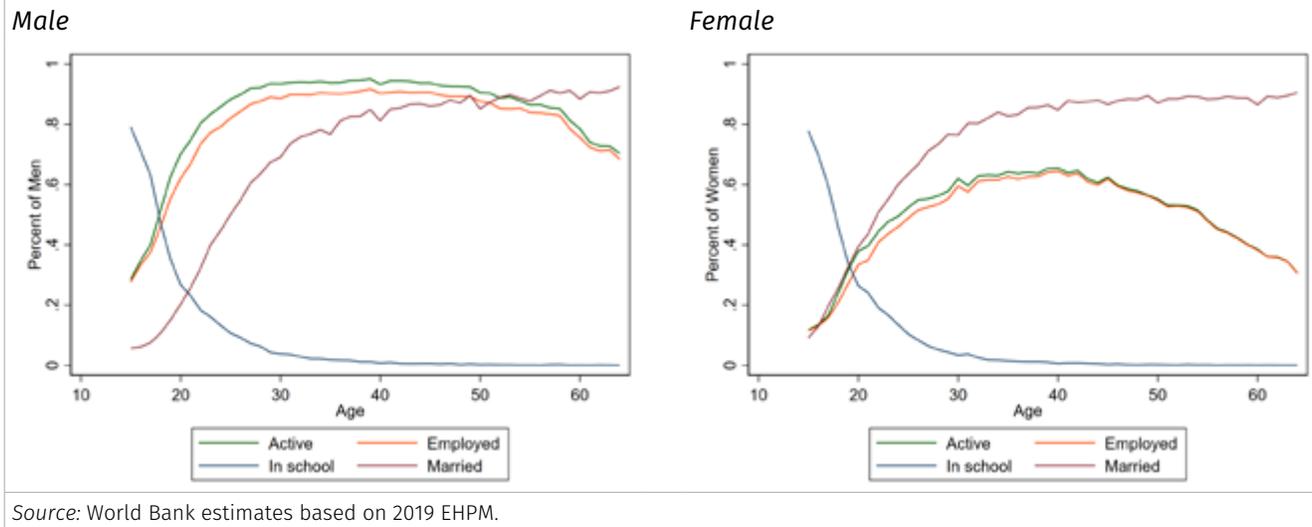
Limited evidence exists on the potential factors and determinants affecting female labor force participation in El Salvador. Childcare responsibilities, gender-biased social norms, restricted labor market regulation, and lack of working experience could all play a role.

Differences in the school-to-work transitions may explain subsequent differences in labor market outcomes, including entrance to the labor market. The gender gap in the labor market is notorious starting at age 15, when the gender gap in labor force participation is about 20 percentage points. Women get married at a very young age (19.9 years in 2008), compared to other developing countries



like Bulgaria, Turkey, Mexico, and Chile, where the average age of getting married is about 25 years. As a result, women enter the labor market later than men and with less work experience; their labor force participation peaks at age 40 and declines afterward (Figure A.37). The overall (unadjusted) gender wage gap is small; however, skilled men make 17 percent more than women. This is also reflected in the lower skill wage premium for women compared to men even after controlling for observable characteristics, with a widening gap in 2018–2019.

Figure A.37. School, marriage, and work across the lifecycle



Source: World Bank estimates based on 2019 EHPM.

**Childcare responsibilities also hinder mothers of school-age children from participating in economic activity.** Women whose youngest child is one year old or younger are 21 percentage points and 16 percentage points less likely to participate in the labor market and have a job, respectively, than women without children. This gap is smaller for women with older children and vanishes when the youngest child reaches school age (Figure A.38). In contrast, the employment outcomes of men are basically the same regardless of their children’s age. Having children is also correlated with the women’s job characteristics: female workers whose youngest child is four years or younger are more likely to work part-time or in the informal sector than their counterparts without children. In a similar vein, young women constitute most NEET youth (79 percent of NEET were women in 2019), where the majority are devoted to housework and caretaking activities. Access to early years childcare is low: pre-kindergarten (PreK) and kindergarten (KG) enrollment rates are below 8 and 69 percent, respectively, with important differences in access by family income and area of residence. (MINEDUCYT and EHPM, 2017). The government recently approved the National Policy of Early Childhood Development, “*Creceer Juntos*,” which, includes the aim to increase quality and access to ECD services. The government approved the law “*Sala de Cunas*” in 2018, which applies to companies with 100+ employees, operational regulations for this are expected to be approved in January 2022.

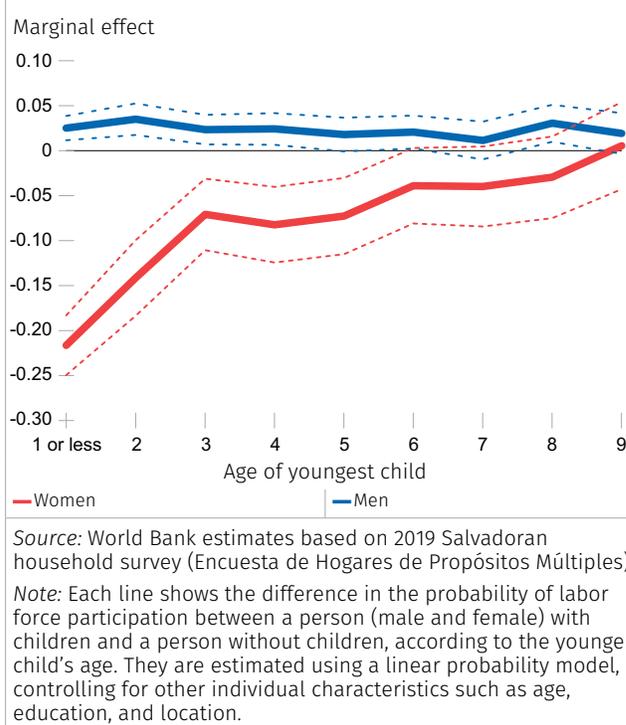
**Gender-biased social norms may limit women’s access to better jobs.** Pervasive gender-biased social norms and patriarchal views regarding their role as traditional caregivers imply that many leave the labor force or work informally when they have children below school age. Teenage pregnancy is quite common, see Annex 7.2.

Labor market regulations also play an important role. El Salvador provides 82 days of maternity leave allowance, similar to other LAC countries. However, the absence of compulsory paternity leave does not encourage the distribution of child-bearing responsibilities between men and women. Introducing more flexibility in the labor market to facilitate the ease of hiring and firing, supporting more flexible forms of employment, and boosting active labor market policies (ALMP) and policies to help the school-to-work transition will likely boost female labor force participation.

**Crime and violence also explain female inactivity.** Research has shown that the prevalence of violence implies reduced female participation in the labor market, specifically in the formal sector (Dinarte Diaz, Khanna, and Schmidt-Padilla, 2021). This is detrimental to women, as lower labor force participation implies a reduced human capital via a reduced work experience.

Source: World Bank estimates based on 2019 EHPM, Jobs Diagnostic (2020), and Central America Gender Assessment (2019)

Figure A.38. Number of children affects female labor force participation



### Annex 3.6. Model of Institutional Trust and Social Perceptions of Income Inequality

A background study was conducted to examine the potential relationship between trust, institutions, and economic development at a subnational level. The analysis relies on multiple waves of public opinion surveys (LAPOP, which identifies respondents location of residence, and the Latinobarometro) over time (2004–2018), it also takes a time-varying proxy of economic activity across Salvadorean regions (i.e., satellite data on light density at night) and several proxies of state capacity (from Central Government unconditional transfers (FODES) to baseline indicators of access to public goods such as electricity, water, etc., from several waves of EHPM).

Analysis of the attitudes toward Salvadoran institutions reveals a clear pattern: all measures towards municipal governments, apart from trust, Municipal government have fallen steadily since the 2008 global financial crisis with a clear acceleration from 2014 onwards. Following the global financial crisis, satisfaction with democracy plummeted from 60 percent to less than 20 percent in 2018. Despite having one of the lowest levels of income inequality in LAC, many Salvadorans believe the income distribution is unfair. The study found levels of generalized trust, satisfaction with the democracy, perceptions of fairness around income distribution, and government approval are among the lowest in LAC (Latinobarometro, 2018).

**The findings show that individuals' trust towards the President and local government is positively correlated with a higher level of development at the municipality level.** People in rural areas tend to have a greater level of trust in state institutions, and men and older individuals tend to trust less in local government. The size of central government transfers positively correlates with trust in local government, although this does not automatically correlate with trust in the President. There is a positive relationship between economic development and trust in the national legislature and judicial system, but the effect is much more nuanced compared with the pairing of President and local government. The national legislature and the judicial system are the least trusted institutions of those surveyed. The positive association between income and trust in the President is mostly explained by individuals living in rural areas or areas with weak state capacity, while the association between income and trust in local government is essentially driven by individuals in urban areas.

**There is also a correlation between perception of income inequality and improved economic conditions.** Individuals whose economic conditions have recently improved tend to report that the income distribution in the country is fair, however, this effect is not the case in areas with weak state capacity and is exclusively explained by individuals living in locations with strong state capacity.

**Homicide rates are negatively associated with trust in all institutions, except the Catholic Church.** The judicial systems are most affected in terms of trust: there is a 4.5 percentage point drop in confidence that the judicial system would punish a guilty person between someone living in a municipality in the 10th percentile and someone in the 90th percentile distribution of crime rates.

*Source:* Depetris-Chauvin (2021). Institutional Trust, Perceptions of Distributive Unfairness, and Income Across Salvadorean Municipalities (background paper).

## Annex 4. Prioritization Methodology

### Annex 4.1. Prioritization Approach

This SCD Update uses the 2015 prioritization methods and enhances them by conducting it in two steps. In the first step, the Update uses “the impact on twin goals” as a screening filter. This filter was also used in the 2015 SCD, but this step introduces an enhanced asset-based framework (vulnerability framework) that explicitly incorporates risks and resilience to households, firms, and the state to identify areas with the greatest impact on the twin goals.<sup>50</sup> The vulnerability lens better captures the current context and recent developments for several reasons. First, it shifts the focus from poverty reduction to poverty and vulnerability reduction, and then, it shifts the focus from understanding low growth as a significant constraint for poverty reduction (key area of focus in 2015 SCD) to understanding why the significant poverty reduction achieved from 2012 to 2019, even with low growth, appears unsustainable. Finally, it shifts from a macro approach to a micro (household, firms, the state) approach to understand the role of risks and resilience of economic agents to shocks (such as COVID-19), which opens the possibility of new entry points.

The second step uses the two filters from the 2015 SCD (time-horizon/complementarities and feasibility) and adds crime and migration to narrow priorities. The latter filter is added as these points continue to be key structural factors that affect households, firms, and the state. The two-step process helps narrow down priorities in a more systematic and transparent fashion.

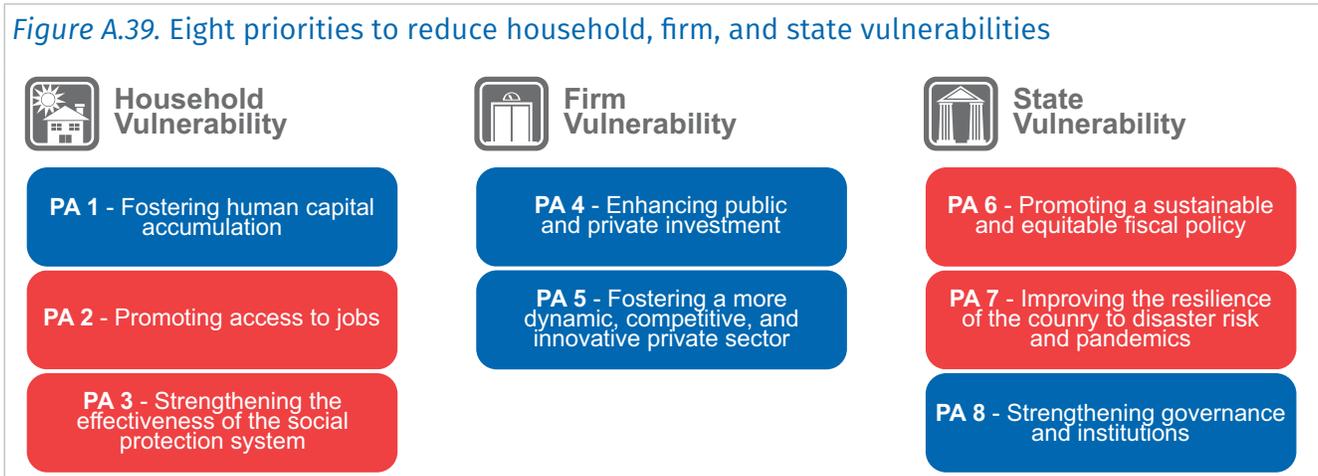
The underlying view on migration is that it can have considerable benefits for individuals (migrants) and sending countries but can also be costly; the migration filter aims to find policy actions that can improve the conditions of migrants and enhance the net benefits of migration. The economic literature on the topic of the “brain drain versus brain gain” shows that the effects of emigration on sending countries can be adverse or positive depending on the country context (Lieng and Wan, 2005). Benefits for migrants include higher incomes and enhanced access to public services like education and health. The country could benefit through increased remittances, investments, trade, skill, and technological transfers, all factors that can spur growth and contribute to poverty reduction (Aguilera et al., 2021; Clemens et al., 2016). In the case of El Salvador, remittances do not contribute significantly to poverty reduction as only a small share of the poor receives them, most remittances are used for consumption and not investments, and they have also been found to have a disincentive effect on labor force participation, particularly among females. Past research from El Salvador shows that that policy interactions are needed to make more productive use of remittances (see Ambler et al., 2015). Additionally, Gibson et al. (2013) show that positive effects of emigration on poverty in sending households might be short-lived. Migration can also be costly for those that decide to migrate and for the countries they leave. Migration can result in brain drain and labor supply shortages in key occupations, depending on the magnitude and type of flows experienced. The evidence for El Salvador shows that migrants represent important human capital, as recent cohorts are more likely to come from the middle and upper half of the wage distribution, though not highly skilled by international standards.

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50 Vulnerability is defined as the likelihood of a system (households, firms, and government) being negatively affected by some sort of perturbation or sudden ‘shock’ going beyond the normal range of variability (Gallopín 2006). In this framework, households have assets—such as human, physical, and social capital—which are deployed to generate income over the lifecycle. Income is turned into well-being, mainly through consumption. At each stage in the income generation process, risks and shocks can affect the ability of these households to generate income. For instance, assets are risky since they may be destroyed due to environmental factors or crime, the erosion of human capital due to health or unemployment (COVID-19), and other factors.

To identify ways to begin to break the vicious circles, the enhanced asset-based framework or vulnerability framework is applied to households, firms, and the state. The standard asset-based framework helps understand the factors affecting the ability of households to generate income by two main channels: assets and productivity (Attanasio and Szekely, 1999; Carter and Barrett, 2006; Lopez-Calva and Rodriguez-Castelan, 2014). The vulnerability framework is an “enhanced” asset-based framework, expanded to i) emphasize the role of risks and resilience, and ii) include households as well as firms and the state. The concept of vulnerability is defined relative to a benchmark: for households, the benchmark is vulnerability to poverty (defined as ex-ante or “future” poverty). For firms, the benchmark is financial vulnerability stemming from corporate balance sheets; however, this lens can be extended to other aspects of the operating environment of the firms. For the state, the benchmark is vulnerability to fiscal shocks such as refinancing risks, revenue downfalls, and natural disasters. The risks considered are adapted from the frameworks developed by Dercon (2001 and 2007) and Hallegate (2014) and include economic shocks (COVID-19) and risks related to climate change and disasters and conflict.

Figure A.39 summarizes the results of the first stage prioritization process.



The second step narrows down the list of priorities to four (“Tier 1” priorities), based on three additional filters. The first filter in this second step combines the time horizon of impacts and whether improvement in a given area may be a precondition or if it will complement progress in other areas. Priority is given to reforms with short-term impacts that are required for other reforms to happen (or have significant spillovers). The second filter considers the SCD Update team’s informed assessment of the feasibility of taking action in a given area. Finally, the Update added a filter on the likely impact of a priority on crime and migration. Priority should be given to reforms with short-term impacts, large spillovers, that are politically and socially feasible, that can reduce crime, and that enhance the benefits of migration.

Table A.5 below summarizes the results of the second stage prioritization.

The four Tier 1 priorities are not a *sine qua non* condition for addressing the other five priorities, nor mandatory starting points for reforms. Any progress in the priority areas will contribute to achieving the twin goals.

Table A.5. Summary of second stage prioritization

Priorities	Filters			Tier 1
	Time Horizon of Impacts and Complementarities (shorter-term impacts and spillovers)	Feasibility	Potential Impacts of PA on Crime and Migration	
(PA #1) Fostering human capital accumulation	Short-Term/Medium Term	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
(PA #2) Promote access to jobs	Short Term	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
(PA #3) Strengthening the effectiveness of the social protection system	Short Term	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
(PA #4) Enhancing private and public investment	Short-Term/Medium Term	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
(PA #5) Fostering a more dynamic, competitive, and innovative private sector	Short-Term/Medium Term	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
(PA #6) Ensuring sustainable and equitable fiscal policy	Short Term	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
(PA #7) Improving the resilience of the country to natural and health disaster risks	Short Term	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
(PA #8) Strengthening governance and institutions	Short-Term/Medium Term	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>

## Annex 4.2. SCD Update Stakeholder Consultations

The prioritization process also relies on internal and external consultations, in addition to data-driven methods already used; this SCD Update involved an extensive process of consultations with stakeholders in El Salvador and different areas within the World Bank Group. An initial set of stakeholder consultations started in 2019 and included central and local governments, private sector, vulnerable groups (e.g., indigenous population and youth), donors, political candidates, returned migrants, sectoral experts, and academics. Having identified a series of intervention options, the team sought to bring additional information to the prioritization process by asking technical experts from different World Bank Global Practices and outside the organization to validate priorities and rank policy areas across several key dimensions.

### Internal Consultations and Prioritization Workshop

The core SCD team engaged with the WBG country team and organized a “BBL series,” consisting of 10 sessions, where colleagues presented their analytical work on selected themes, which provided a platform for a dialogue on the development challenges and opportunities in El Salvador. Table A.6 shows the calendar for the “BBL series” presentations and respective presenters/core focal points.

In addition to the BBL series, a prioritization workshop for the El Salvador SCD Update was held on June 24th, 2021, the objective of which was to present the main storyline and prioritization approach that each core SCD team used to identify the emerging priorities and gather additional sectoral feedback.

**Table A.6. BBL Series on Challenges and Opportunities for Inclusive Growth and Poverty Reduction***BBL Series on Challenges and Opportunities for Inclusive Growth and Poverty Reduction in El Salvador, December 2020–March 2021*

Date	Topic	GP	Presenters
11-Dec	Macroeconomy and LT growth	MTI	Rafael Barroso
	Poverty and Equity	POV	Monica Robayo
15-Dec	Private Sector Development	FCI	Thomas Haven
	Financial Sector Development	FCI	Rafael Pardo
	Infrastructure Finance	INF	Cledan Perrott
17-Dec	Jobs and Social Protection, Pensions	SPJ	Clemente A & Aylin, Asta Zviene (pensions)
12-Jan	Environment and Climate Change	ENV	Paul Martin & Phillippe Dardel
	Resilience	SURR	Zoila Portocarrero
	Urban and Land Management	SURR	Ana Aguilera
14-Jan	Governance and Institutions	GOV	Francesca Recanatini, Josef S. Trommer, Alejandro Solanot
	Energy	EEX	Mariano Gonzales
19-Jan	Health	HNP	Roberto Iunes
	Education	EDU	Enrique Alesino
21-Jan	Digital Development	TDD	Rocio Sanchez
	Citizen Security and Social Development	SD	Christopher Johnson, Maria Elena Garcia Mora, and Ricardo Marteen
26-Jan	Water	WSS	Marie-Laure Lajaunie
	Agriculture	AGR	Augusto Garcia & Ramon Ernesto
28-Jan	Transport	TDD	Rohan Shah
4-Mar	Trade Facilitation	IFC	Mayra Del Carmen Alfaro
	Private Sector Development	IFC	Miguel Pereira and Lorena Rodriguez

## Political Landscape Panel

The SCD team organized a panel discussion, “Current Political Landscape of El Salvador” to inform the governance angle of the Systematic Country Diagnostic, including the political feasibility of some policy priorities.

The panelists discussed the following questions:

- 1 Who are the most relevant political actors and interest groups in El Salvador today?
- 2 Which one of these actors/groups is most powerful when it comes to policy reforms? Do they control specific sectors or areas of the country?
- 3 How have these actors and groups gained their powers? Through what mechanisms and channels are they able to maintain their powers?

The panel included the following speakers: Nelson Fuentes, former Minister of Finance El Salvador; Alberto Arene, Salvador Political Economist; Paula Avila Guillen, Lawyer and Executive Director at the Women’s Equality Center (WEC); and Ramon Villalta, Executive Director, Iniciativa Social para la Democracia.

### **External Consultations: The SCD Update Surveys: Web-based and Mobile surveys**

For the second prioritization layer, The World Bank (WB) team implemented two surveys to inform the prioritization of the SCD Update, and to validate and rank the set of priorities. In addition, they collected information on the perceived political feasibility of the proposed reforms.

- a A web-based survey was given to selected WBG staff; available here:  
<https://www.bancomundial.org/es/country/elsalvador/brief/ElSalvadorscdconsultation>
- b A nationally representative phone survey covering approximately 1,200 individuals in El Salvador, in September and October 2021, used Computer Assisted Telephone Interviews (CATI).
  - › **Sample:** RDD (Random Digit Dialing) probabilistic sample of mobile phones and landlines with full coverage according to the telephone numbering plan
  - › **Coverage:** National, Population aged 18 years and over with a mobile phone and/or a landline phone at home; Households with a landline telephone and/or households in which at least one member has a cell phone.
  - › **Sample design:** Dual sampling frame (mobile and landline phones). Selection of mobile and fixed telephones in a stage with equal probabilities in each stratum.

The table below summarizes the results of both surveys.

Table A.7. Results of a national representative survey of Salvadoreans

	<i>Policy Priorities</i>	<i>Relative importance of constraint to eradicate poverty and promote inclusive growth<sup>1</sup> (1 = not important at all, and 5 = extremely important)</i>	<i>Impacts on inclusive growth and the twin goals<sup>2</sup></i>	<i>Feasibility and political support<sup>3</sup></i>
Fostering human capital accumulation and use, access to jobs, and strengthening the effectiveness of the social protection system	Fostering human capital accumulation among children and youth, focusing on ECD and policies to reduce dropouts	4.93	0.99	0.96
	Promote access to jobs by reducing barriers to employability, reforms to encourage and enable work and support more inclusive labor regulations	4.84	0.98	0.89
	Strengthening the effectiveness of the social protection system	4.61	0.96	0.93
Fostering a more dynamic and competitive private sector by enhancing labor productivity, foreign direct investment, and trade integration are essential to reduce firm vulnerability	Fostering a more dynamic and competitive private sector by enhancing private and foreign direct investment	4.69	0.93	0.92
	Fostering a more dynamic and competitive private sector by enhancing trade integration and improving the business environment	4.41	0.96	0.92
	Fostering a more dynamic and competitive private sector by enhancing labor productivity through innovation skills and entrepreneurial capabilities	4.59	0.94	0.93

**Table A.7. Results of a national representative survey of Salvadoreans (continued)**

	<i>Policy Priorities</i>	<i>Relative importance of constraint to eradicate poverty and promote inclusive growth<sup>1</sup> (1 = not important at all, and 5 = extremely important)</i>	<i>Impacts on inclusive growth and the twin goals<sup>2</sup></i>	<i>Feasibility and political support<sup>3</sup></i>
Ensuring Sustainable and Equitable Fiscal Policy, Natural Disaster Risk Management, and Strengthening Governance and Institutions	Promote a Sustainable and Equitable Fiscal Policy	4.48	0.92	0.88
	Promote efficient management of natural disaster risks through a natural disaster management system focused on prevention and investments in critical infrastructure for reducing the risk of natural disasters	4.65	0.93	0.92
	Strengthening institutions to build a more transparent and efficient state, by improving accountability of the public administration while maintaining incentives for improving service delivery and taking a firm stance on corruption	4.60	0.94	0.90

Source: Author's estimates based on nationally representative phone survey.

Notes: 1. The score is a weighted average of the respondent's score, where 1= not important at all and 5= extremely important. 2 The score is the share of respondents that consider the impact of tackling this constraint on the twin goals is significant. 3. The score is the share of respondents that consider that policy reforms in this area are feasible and have sufficient political support.

Table A.8. Results of a web-based survey among selected WBG staff

	<i>Policy Priorities</i>	<i>Relative importance of constraint to eradicate poverty and promote inclusive growth<sup>1</sup> (1 = not important at all, and 5 = extremely important)</i>	<i>Impacts on inclusive growth and the twin goals<sup>2</sup></i>	<i>Feasibility and political support<sup>3</sup></i>
Fostering human capital accumulation and use, access to jobs, and strengthening the effectiveness of the social protection system	(PA #1) Fostering human capital accumulation among children and youth, focusing on ECD and policies to reduce dropouts	4.80	0.75	0.70
	(PA #2) Promote access to jobs by reducing barriers to employability, reforms to encourage and enable work and support more inclusive labor regulations	4.36	0.92	0.70
	(PA #3) Strengthening the effectiveness of the social protection system	4.36	0.92	0.86
Fostering a more dynamic and competitive private sector by enhancing labor productivity, foreign direct investment, and trade integration are essential to reduce firm vulnerability	(PA #4) Fostering a more dynamic and competitive private sector by enhancing private and foreign direct investment	4.04	0.79	0.77
	(PA #5) Fostering a more dynamic and competitive private sector by enhancing trade integration and improving business environment	3.96	0.79	0.59
	(PA #6) Fostering a more dynamic and competitive private sector by enhancing labor productivity through innovation skills and entrepreneurial capabilities	3.88	0.75	0.70

**Table A.8. Results of a web-based survey among selected WBG staff (continued)**

	<i>Policy Priorities</i>	<i>Relative importance of constraint to eradicate poverty and promote inclusive growth<sup>1</sup> (1 = not important at all, and 5 = extremely important)</i>	<i>Impacts on inclusive growth and the twin goals<sup>2</sup></i>	<i>Feasibility and political support<sup>3</sup></i>
Ensuring Sustainable and Equitable Fiscal Policy, Natural Disaster Risk Management, and Strengthening Governance and Institutions	(PA #7) Promote a Sustainable and Equitable Fiscal Policy	4.08	0.75	0.23
	(PA #8) Promote an efficient management of natural disaster risks through a natural disaster management system focused on prevention and investments in critical infrastructure for reducing the risk of natural disasters	3.92	0.87	0.62
	(PA #9) Strengthening institutions to build a more transparent and efficient state, by improving accountability of the public administration while maintaining incentives for improving service delivery and taking a firm stance on corruption	4.08	0.80	0.22

Notes: 1. The score is a weighted average of the respondent's score, where 1= not important at all and 5= extremely important. 2 The score is the share of respondents that consider the impact of tackling this constraint on the twin goals is significant. 3. The score is the share of respondents that consider that policy reforms in this area are feasible and have sufficient political support.

### Annex 4.3. Comparison of the Emerging Priorities in the SCD Update with the 2015 SCD

The policy priorities from the SCD remain relevant; however, the current context and the COVID-19 crisis heightens the need to focus on jobs and social protection, and to add three policy priority areas that previously played a role but merit increased attention in this Update.

Five of the priority areas identified in this SCD Update were also a priority in the 2015 SCD. These are Priority Area 1 (Fostering human capital accumulation); Priority Area 5 (Fostering a more dynamic, competitive, and innovative private sector); Priority Area 6 (Ensuring Sustainable and Equitable Fiscal Policy); Priority Area 7 (Improving the resilience of the country to disaster risk and pandemics); and Priority Area 8 (Strengthening institutions). For most of these priorities, there has been insufficient progress since the previous period (circa 2000–12). For some, the situation has even deteriorated. The pandemic has introduced additional challenges to all of these constraints, and so investments in these areas remain crucial for the country's development trajectory. Strengthening violence prevention, a priority covered in the SCD, is covered under several priorities in the Update. Some actions to reduce crime and violence mentioned in the SCD (enhanced accountability, strengthening the judicial system) are covered under the governance priority. Others (entry

points for creating income to steer youth away from gangs) are also covered under other PA (human capital, jobs, social protection). The only action under this priority area in the SCD and not covered in the Update is law enforcement, as there is insufficient evidence on the impacts of law enforcement.

**The SCD Update identifies three additional priorities not prioritized in the 2015 SCD:** Priority Area 3 (Strengthening the effectiveness of the social protection system), Priority Area 2 (Promoting access to jobs by reducing barriers), and Priority Area 4 (Enhancing private and public investment). These additional priorities are included as the Update has a stronger focus on mitigation policies, this focus reflects the inability of the social protection system to protect the poor and vulnerable after the COVID-19 crisis and its myriad social impacts. It also identifies a significant deterioration of labor market outcomes among the bottom income quintile even before the COVID crisis and more after it. The Update concludes that there is a need for a stronger focus on jobs and improving access to high-quality jobs. The Update also has a much stronger focus on the private sector as the main engine of jobs and growth, given the current fiscal constraints.

**One priority area that was present in the 2015 SCD is not in the SCD Update: financial inclusion.** While El Salvador is still among the worst performers on this dimension, improvements since the 2015 SCD period have been large. There is also limited evidence of financial inclusion's effects on the twin goals in the country, despite abundant evidence for other countries. Cross-country evidence shows that low education levels are one of the main reasons that poor people opt out of the financial system, and why investments into financial inclusion might be of secondary importance compared to educational investments. Therefore this SCD Update recommends focusing first on educational outcomes, then tackling financial inclusion.

## Annex 5. Knowledge and Data Gaps

**Table A.9. Stocktaking of recent evidence since previous SCD**

***Recent analytical evidence since previous SCD***

- › Central America Gender Assessment (2019)
- › Jobs Diagnostic (2020)
- › Employment multipliers (2021)
- › Unleashing Central America's Growth Potential (2020)
- › Talent Allocation and Post-Reform Growth in Central America (2020)
- › El Salvador Policies for Business Recovery, Jobs, and Economic Transformation (2021)
- › Deep Trade Agreements and Global Value Chains in Latin America and the Caribbean (forthcoming)
- › LAC Digital Flagship
- › 2020 COVID High-Frequency Firm and Household Surveys Rapid Assessments
- › Jobs amenability to working from home (Hatayama, Viollaz, and Winkler, 2020)
- › The Unintended Consequences of Deportations: Evidence from Firm Behavior in El Salvador, Bandiera et al. (2021)
- › Acting Now to Protect the Human Capital of Our Children: The Costs of and Response to COVID-19 Pandemic's Impact on the Education Sector in Latin America and the Caribbean (2021)
- › Human Capital Index 2020 Update
- › Gang Rule: Understanding and countering criminal governance, Blattman (2021)
- › Gangs, Labor Mobility and Development, Melkinov (2020)

***New analytical evidence committed for this report***

- › Vulnerability Diagnostic
- › Updated Poverty Maps
- › Distributional impact of fiscal policy (CEQ) Paper
- › SIMLAB (Structural macro-micro simulation of the labor market)
- › Institutional and Political Economy Paper
- › Political Economy and Development outcomes Paper

**Table A.10. Summary of knowledge and data gaps**

<i>Knowledge and Data Gaps identified in 2015 SCD</i>	<i>Description</i>	<i>Addressed?</i>	<i>Evidence</i>
Poverty and Disasters	What is the impact of frequent disasters on the poor and vulnerable?	Yes, partially	Vulnerability Diagnostic and Poverty Maps
Corruption	Given the widespread perception of corruption and low bribe payments, which other types of corruption are undermining growth	No	
Crime and Shared Prosperity	To what extent is the high crime the result of limited opportunities, and how does it affect shared prosperity?	Yes, partially	Vulnerability Diagnostic
Domestic Competition and Shared Prosperity	How does limited domestic competition affect shared prosperity?	No	
Drivers of low female labor force participation	Why is the rate of female labor force participation low?	Yes, partially addressed	Jobs Diagnostic and CA Gender Assessment
Drivers behind school dropouts	Why do so many students drop out of school?	No	

**Table A.11. New knowledge and data gaps**

	<i>Description</i>	<i>Addressed?</i>	<i>Evidence</i>
<b><i>New Knowledge Gaps</i></b>			
Drivers and determinants of Vulnerability to Poverty	Full diagnostic of vulnerability to poverty	Yes	Background paper for this report by Monica Robayo and Britta Rude
Impact of Fiscal Policy on Poverty and Inequality	A comprehensive distributional impact of fiscal policy (CEQ) can inform reform options on tax and expenditure sides	Yes	Background paper for this report "The distributional impact of the fiscal system in El Salvador" by Monica Robayo-Abril and Jose Olivo (forthcoming)
Impact of human capital policies on labor markets, growth, and poverty	SIMLAB is a structural model of the labor market, capable of simulating a rich array of labor market and other relevant macroeconomic variables. Its key objective is to capture ex-ante effects of selected policy reforms, including human capital policies, public-sector employment policies, formalization, and labor market policies. SIMLAB can capture micro-distributional and macroeconomic effects of selected policy reforms.	Yes	SIMLAB background paper for this report by Monica Robayo (forthcoming)
Institutional and Political Economy Analysis	Analysis of the current landscape of institutional and political economy aspects of El Salvador.	Yes	Background paper for this report by Manuel Melendez Sanchez (forthcoming)

**Table A.11. New knowledge and data gaps (continued)**

	<i>Description</i>	<i>Addressed?</i>	<i>Evidence</i>
Political Economy and Development outcomes	Identify the potential effect of regional economic disparities, and its interaction with the degree of state capacity at the subnational level, on people's attitudes toward state institutions (distinguishing between national level and local state institutions), support for democracy, and perceptions of inequality.	Yes	Background paper for this report by Emilio Depetris (forthcoming)
Poverty and Distributional Impact of trade facilitation and Infrastructure Investments	Poverty and distributional impacts of trade facilitation measures and identification of affected groups	No	
Drivers of emigration (push and pull factors)	Understanding the reasons (push and pull factors) behind the decision to migrate is key to maximizing welfare gains of migration	No	
Migration links with Human Capital and labor markets	Impact of migration on the distribution of human capital, wages, returns to skills, labor productivity and labor market outcomes	No	
Public expenditure efficiency and poverty Impacts of Government Effectiveness	Determinants of public expenditure efficiency, including an assessment of fiscal needs of municipalities based on their service provision responsibilities and decentralization strategies to improve public services	No	
Productivity drivers at macro and firm-level	There is no empirical investigation on the drivers of declining productivity in El Salvador either at the aggregated level (total factor productivity) or at the firm level.	No	
Macro and distributional Impacts of climate change and climate policy.	There is no study or tool to evaluate the impact of climate change and macroeconomic policies to mitigate climate change on output, employment, and fiscal accounts. Distributional impacts are also unknown.	No	
Actuarial analysis of pension system in SLV	There is no comprehensive and updated actuarial analysis of the pension system in El Salvador, which is a gap for fiscal and poverty analysis.	No	
New technologies and financial markets	Evaluate the potential of new technologies such as digital payments, fintech, and distributed ledger to improve financial access and the efficiency of payments	No	
AML/CFT	Integrity assessment of the Anti-Money Laundering and Combating the Financing of Terrorism framework	No	
<b>Data Gaps</b>			
Outdated Population Census	The last Population Census took place in 2007 and, thus, is outdated. An obsolete frame can contain inaccuracies and is likely to be incomplete, especially in household surveys		

**Table A.11. New knowledge and data gaps (continued)**

	<i>Description</i>	<i>Addressed?</i>	<i>Evidence</i>
Outdated poverty maps	Poverty maps are outdated (based on the 2007 Census). This can be an issue in a country with high migration, as the rankings of municipalities based on poverty incidence can significantly change	Yes	Updated poverty maps, a joint collaboration with DIGESTYC
Statistics for ethnic minorities, LGBTI, persons with disabilities, and migrants	<p>The EHPM cannot be used to investigate smaller sub-groups of the population. Given that stratification does not account for all possible characteristics, it is to be expected that official household surveys are not representative of groups such as ethnic groups, emigrants, or persons with disabilities. They cannot be used for indicative trends as the EHPM does not include variables to identify ethnic minorities, people with disabilities, or LGBTI. The EHPM does include a question on migrant member(s) in the household and a section on remittances access and use.</p> <p>Information can be obtained from the specialized survey, namely (i) the 2015 Disabilities Survey and (ii) the 2012 National Survey on LGBTI.</p>	No	

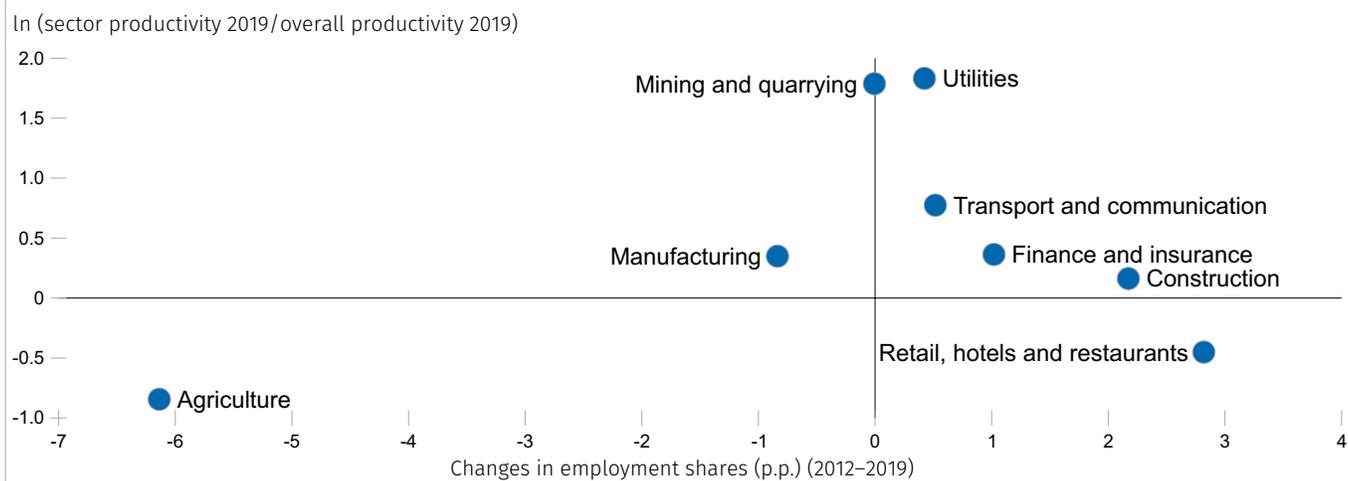
## Annex 6. A Zoom into Skills and the Labor Market

Faster real wage growth among those with low- and middle-skill levels (have completed secondary and below) suggests that the demand for skilled labor at this level grew faster than the supply, leading to a tighter labor market for these workers. A market-clearing model of labor demand and supply suggests that if the demand for low- and medium-skilled labor were to increase at a higher pace as their supply, their relative real wages would also be expected to increase or remain stable. This is the scenario as the wages of low and medium-skilled grow relative to the highly-high skilled. Conversely, slower wage growth among the highly skilled skill suggests slower growth in relative demand for college workers.

### Labor Demand

The Salvadoran economy had limited structural transformation, with high growth (and demand) in low productivity sectors, that are intensive in low- and middle-skilled labor. Changes in the allocation of labor that are associated with processes of structural transformation do not exist in El Salvador (Jobs Diagnostic, 2020). Overall employment trends show that, while high productivity sectors remain small, the employment share of low and medium-skilled sectors increased (i.e., construction and retail, hotels, and restaurants) (Figure A.40).

Figure A.40. Limited structural transformation in the period 2012–2019



Source: World Bank estimates based on Salvadoran household surveys (Encuesta de Hogares de Propósitos Múltiples and sectoral GDP from Central Bank

Note: Sectoral productivity measures based on GDP per person employed.

High-productivity sectors concentrate a higher share of large firms, whereas low productivity sectors are occupied mainly by micro and small-size firms. Larger firms account for 60–70 percent of overall sectoral jobs in manufacturing and finance (high-productivity sectors). Contrarily, they account for only 10 percent of overall employment in the agriculture, retail and wholesale, and restaurants and hotels sectors (high-productivity sectors) (Jobs Diagnostic, 2020).

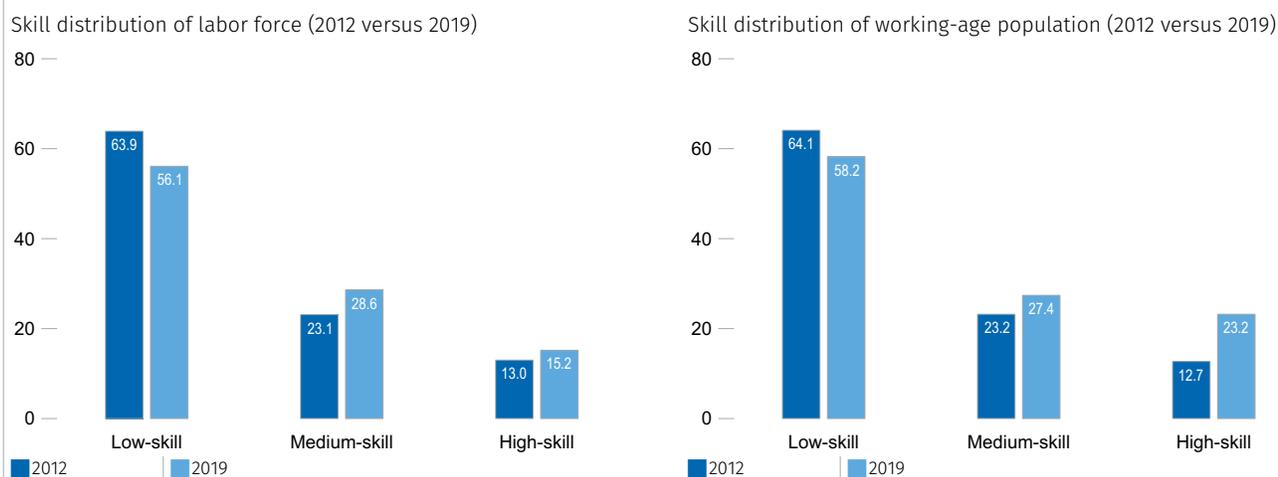
Employment is concentrated in small and large firms, as compared to regional comparators. Mid-size enterprises generate limited employment, but they are the most productive. Micro-firms account for most of

the jobs in the informal sector, while large firms absorb most workers in the formal sector. High productivity sectors concentrate a higher share of large firms, while low productivity sectors concentrate micro and small firms (Jobs Diagnostic, 2020).

## Labor Supply

The workforce composition is changing toward more educated and older workers; since 2012, the share of the labor force with medium and high skills has been rising. There was a significant rise of adults in the labor force (+15) with middle-skills (complete or incomplete secondary), from 23.1 to 28.6 percent. The share of the labor force with high-skill levels (incomplete or complete tertiary) has also increased, though at a slower rate (from 13 to 15.2 percent). At the same time, there has been a drop in adults without education and primary school, leading to an increase in the average years of schooling for adults in the workforce (Figure A.41).<sup>51</sup> These positive trends in the human capital distribution are likely associated with the two facts: the share of working-age adults with medium and high skills has been rising, and ii) larger drops in labor force participation among the low skilled (2.6 percentage points reduction). The labor force participation rate of the medium- and high-skilled, on the other hand, has remained stable. The population is also slightly getting older. Since more educated and experienced workers are on average more productive, these trends could have likely contributed to the rising average productivity and wages, in addition to the faster real wage growth among the low and middle-skilled.

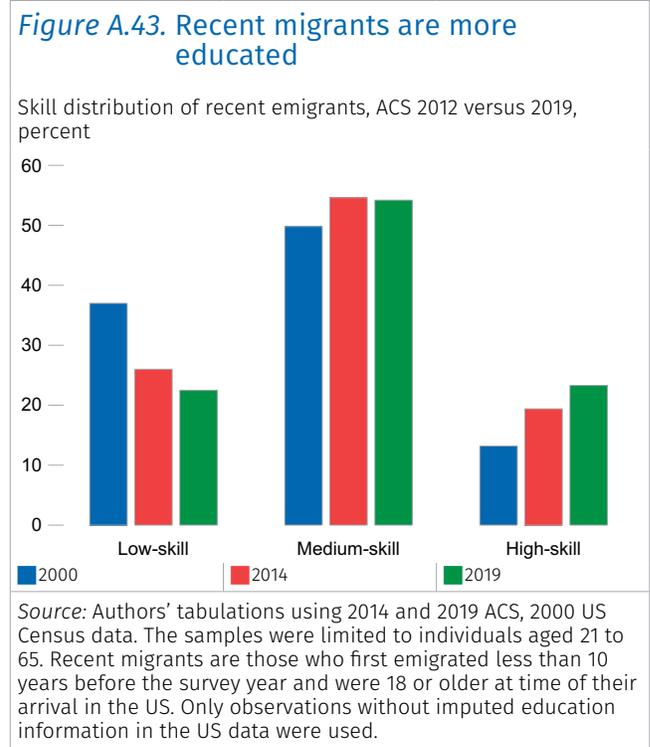
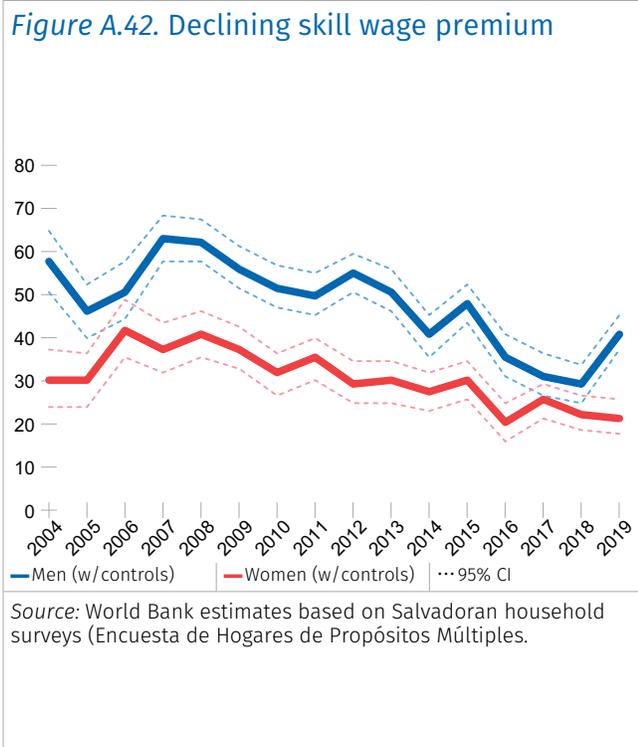
Figure A.41. Composition of working-age population and labor force is changing



Source: World Bank estimates based on Salvadoran household surveys (Encuesta de Hogares de Propósitos Múltiples).

The slow expansion of tertiary education is also consistent with decreasing average returns to university education. The average wage premium associated with tertiary has decreased, suggesting that while the relative supply of college graduates increased, the relative demand for their skills did not keep up. Looking at the other side of the coin, unskilled labor is becoming scarcer, and their relative returns are rising. The skill premium declined since 2007 for both men and women even after controlling for other factors such as age, gender, education, region, type of employment, type of firm, and sector (Figure A.42). While college-educated men and women were expected to earn wages approximately 62 percent and 33 percent higher than their peers who had not completed primary education in 2012, by 2019, those figures were 46 percent and 24 percent, respectively. Given the growth in tertiary graduate supply, a market-clearing model requires

(even more) slower growth in the relative demand for college workers to reconcile increasing tertiary supply with decreasing tertiary wage premiums.



The decline in the skill wage premium may also help explain recent migration patterns, which shows that recent migration cohorts tend to be more educated. The evidence on migration shows that migrants are disproportionately young adults who, though not highly skilled by international standards, represent important human capital in El Salvador (Arayavechkit, Scott & Sousa, forthcoming). Reflecting the low levels of educational attainment in the population, the stock of migrants in the US is largely made up of low and medium-skilled workers with complete or incomplete secondary education, and recent cohorts tend to have higher levels of schooling. Those with primary or less accounted for a small and decreasing fraction of migrants. Recent evidence suggests that, based on their observable characteristics, migrants from El Salvador in the US are more likely to come from the middle and upper half of the wage distribution of their country of origin, suggesting positive selection (Figure A.43). This is consistent with the fact that most remittances do not go to the poor.

More evidence is needed to understand fully the impact of migration on the distribution of human capital, wages, returns to skills, labor productivity and labor market outcomes (Table A.11). Even though the impacts of migration on the human capital distribution are unknown, it is likely that without these migration flows, lower increases in the educational attainment would have been observed.

*Annex 7. Inclusion Challenges and Access to Services*

## Annex 7.1. Main Challenges Facing Minority Groups

**Indigenous Peoples (IP) and Afro-descendants face historical discrimination and limited recognition.** IP and afro-descendants represent a small proportion of the population (approximately 0.1 percent of the total population, respectively, or around 0.01 million individuals each group). The 2007 census is the only primary official statistical source available to identify and characterize ethnic minority groups. Although these groups are small, available information shows patterns of vulnerability with consistently lower access to essential services; they experience lower access to electricity, water, sewerage, cell phones, computers, and internet.<sup>52</sup> Half of urban Afro-descendants live in slums, Lack of representation (and variables to identify them), means that it is not possible to estimate monetary poverty among these groups through primary household surveys. Since the official recognition of Indigenous Peoples in the constitution in 2014, policy measures for inclusion have been limited. The El Salvador Indigenous Peoples' Plan (Plan PIES), signed by the government in 2017, states priority actions for inclusion and a strategic framework for engagement with these populations; however, these have had limited implementation.

**Recent evidence shows numerous challenges faced by persons with disabilities.** The 2015 specialized survey on disability showed that the rate of disability peaks at 9.2 percent for the poorer quintile and 6.6 percent in the richest one.<sup>53</sup> It also shows that beyond the policy sphere, stigmatization is rampant, and more than 50 percent of persons with disabilities reported feeling discriminated against by their neighbors. An estimation of multidimensional poverty shows that persons with disabilities have one of the highest household deprivation rates in the region: 44 percent.<sup>54,55</sup> A person with disabilities in El Salvador earns US\$0.58 for every US\$1 of their peers without disabilities, they tend to work in the informal sector; live in informal settlements, and have lower levels of education and low workforce participation.<sup>56</sup> Forty-two percent of households in informal settlements include persons with disabilities, access to assistive devices is significantly limited.

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52 As estimated with census 2007 data, access to basic services for indigenous peoples (IP) compared to non-indigenous are: electricity (62 percent among IP vs 88 percent among non-IP), sewerage (34 vs 43), water (61 vs 76), cell phones (48 vs 67), computer (8 vs 11) and internet (3 vs 4); for afrodescendants (AD) compared to non-afro: electricity (87 percent among AD vs 89 percent among non-AD), sewerage (35 vs 43), water (68 vs 76) and computer (7 vs 11); and for people with disabilities (PWD) compared to persons without disabilities (PWOD): electricity (87 percent among PWD vs 89 among PWOD), sewerage (42 vs 47), water (76 vs 78), computer (8 vs 12) and internet (3 vs 4).

53 The National Disability Survey was not designed to measure poverty. However, a proxy of quantiles is available by using matching data provided by the National Statistics Agency (Dirección General de Estadística y Censos-DIGESTYC). This quintile variable is indicative but is methodologically different to the one used by the Multipurpose Survey in their estimations of official national poverty rates. Source: National Council for Comprehensive Attention to Persons with Disabilities, General Directorate of Statistics and Censuses, and UNICEF (2015). *Análisis de caracterización de las personas con discapacidad a partir de la Encuesta Nacional 2015*. Retrieved Oct 28, 2021 from [https://www.unicef.org/elsalvador/media/1346/file/Encuesta%202015,%20personas%20con%20discapacidad\\_2.pdf](https://www.unicef.org/elsalvador/media/1346/file/Encuesta%202015,%20personas%20con%20discapacidad_2.pdf)

54 Information on monetary poverty of persons with disabilities is not available in El Salvador, as the Multipurpose Household Survey does not include a variable to identify persons with disabilities.

55 This multidimensional poverty indicator (MPI) is calculated based on information on educational attainment of household members, demographics (dependency and head of household characteristics) and housing conditions including access to basic services (water, sanitation, electricity). In general in LAC, using an aggregate of available information, 23 percent of households with persons with disabilities are MPI poor compared to 16% of their peers without disabilities (circa 2010).

56 Only half of children aged 6–12 with disabilities attends primary school; that is 31 percentage points lower than those without disabilities and the lowest participation in the education system among children in this age group with disabilities in the region (where information is available): for example in Brazil 12 percent of children with disabilities 6-12 years do not attend school, Costa Rica 4.4 percent, Dominican Republic 18.1 percent, Ecuador 16 percent, Mexico 18.1 percent, Panama 7 percent, and Uruguay 6.5 percent. Poorer human capital accumulations can partially explain lower participation in the labor market: inactivity of persons with disability ages 18–59 is 59.6 percent compared to 38.9 among persons without disability in the same age group.

In August 2020, El Salvador passed a new **Special Law on the Inclusion of Persons with Disabilities** that creates the legal base for anti-discrimination provisions to persons with disabilities. The law took effect on January 1, 2021. Among its more concrete applications, it establishes income tax deduction for reasonable accommodations for employers; and a premium to firms complying with a disability quota when competing for a Government contract. The law also establishes the foundations for inclusive education and health services, and the right of persons with disabilities to participate in society and have access to economic opportunities. The regulations for its implementation are yet to be finalized.

**LGBTI people face numerous social obstacles and discrimination.** Sexual Orientation and Gender Identity (SOGI) issues remain challenging in a highly conservative society: in 2017, only 19 percent of people in El Salvador approved of same-sex marriage, one of the lowest in the Americas.<sup>57</sup> In El Salvador, the HIV epidemic is concentrated among key populations; men who have sex with men have an estimated HIV prevalence of 10.3 percent, dramatically higher than the HIV prevalence among the general population, which stands at 0.5 percent. LGBTI people experience multiple forms of violence; individuals are targets of homophobic and transphobic violence by police, gangs, and families. Although data is scarce, it is estimated that 600 members of the LGBTI community have been murdered in the past 24 years, according to the Salvadoran Secretariat of Social Inclusion.

## Annex 7.2. Access to Services

**The overall decrease in poverty and inequality in El Salvador comes along with considerable improvements in the health profile of the population, even when compared to the 2015 SCD period.** Life expectancy at birth is lower than the LAC average, but has increased in recent years and at an accelerated rate between 2012 and 2019 compared to 2000 to 2012 (WDI, 2021). Still, there has been a slight increase in the crude death rate from 6.8 per 1,000 people in 2012 to 7.1 per 1,000 people in 2019 (WDI, 2021). The share of the population dying from non-communicable diseases stayed constant at around 65 percent between 2015 and 2019 (WDI, 2021). The benchmarking tool shows that this measure is among the highest compared to: the world, other middle-income countries, and LAC countries. The fertility rate and maternal mortality rate have both decreased since 2012, as has infant mortality. Public health spending in El Salvador is progressive and reduces inequality, although it stands out as one of the lowest in the region, and has not increased since 2000.

**Self-reported illnesses have increased across income-quintiles, but the reasons could be manifold.** While 13.0 percent of people in the lowest income quintile reported having been sick during the last month of 2012, this share increased to 16.6 in 2019 (EHPM). There is also an increase in the upper quintile from 11.1 percent in 2012 to 14.2 percent in 2019. This does not necessarily speak for a decrease in the population's general health but could also be due to increased reporting or awareness.

**Access to health insurance remains low and unequal, reflecting the high prevalence of informality in the labor market; satisfaction with public health services has also declined.** Just 25.3 percent of the population had access to health insurance in 2019 (EHPM, 2019). Progress has been slow in recent years (2012–2019) as health insurance rose by just 3.2 percentage points from 2012 (EHPM, 2012–2019). Access to health insurance is

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57 Source: Orellana, C., & Orellana, L. (2020).

highly unequal across the income distribution: coverage in the lowest income quintile is less than 5 percent, while almost 45.5 percent of the population in the top income quintile has access to health insurance. The access gap in health insurance never went below 40 percentage points, and therefore inequality remained high in recent years. Finally, only 46 percent of citizens in 2018 were satisfied with public health services, a decline of 7 percent from 2012 (LAPOP 2018)

**There are significant disparities between the per capita spending on health by different public health providers, with the informal sector receiving the lowest per capita amount.** Public service providers of health services are playing an increasing role. In 2012, the ratio of private to public health spending was 0.59, but this had diminished to 0.50 in 2018 (MINSAL, 2019). Additionally, significant disparities persist when looking at per capita health spending across different public health providers. In 2018, the per capita health spending of the Bienestar Magisterial was US\$616 per capita compared to US\$136 per capita spent by MINSAL. As MINSAL provides public health services to the entire Salvadoran population, people not forming part of the Social Security System might avail of these services more often. This could also highlight significant health system inequalities across different population groups.

**The fertility rate and maternal mortality rate have decreased since 2012, as has infant mortality; teenage pregnancy remains common.** There has been a drop in the immunization rate of children below two years old compared to 2000–2012. The fertility rate measured as births per woman decreased slightly between 2012 and 2019.<sup>58</sup> The maternal mortality rate has decreased and is below the LAC average.<sup>59</sup> Nearly 100 percent of births were attended by skilled health staff in 2019 (WDI, 2021). Teenage pregnancy is common: according to the Ministry of Health, one out of every three pregnancies was to an adolescent mother in the 2013–2015 period (UNFA, 2016). The infant mortality rate has decreased from 15 per 1,000 births in 2012 to 11.4 per 1,000 births in 2019 (WDI, 2021). The decrease in infant mortality has slowed compared to 2000–2012. There has been a drop in the immunization rate of HepB3 of one-year-old children and DPT and measles among children aged 12–23 months. The decreasing rate has accelerated when compared to 2000–2019.

**Public health spending in El Salvador is progressive and reduces inequality, although it stands out as one of the lowest in the region with no increases compared to 2000.** Based on the fiscal incidence exercise, public health expenditure and provision of health services are progressive (positive Kawkani Index) and contribute to lower inequality (reduces GINI index by 0.017 Gini points) (Oliva and Robayo-Abril (forthcoming)). However, the benchmarking tool shows that domestic general government health expenditure as a percent of GDP in El Salvador falls among the lowest in the world and LAC countries (Benchmarking tool based on WDI indicators). While spending increased slightly between 2000 and 2012, it stagnated between 2012 and 2018 (WDI, 2021), as reflected in declining citizens' satisfaction for services since 2012 (especially in health services), rural areas have been especially penalized (LAPOP, 2018).

**El Salvador stands out as the country with the highest mortality due to injuries in LAC, mostly due to crime and violence.** Crime and violence have significant impacts on health issues; the benchmarking tool shows that mortality levels due to injuries are not among the highest globally, but they are among the highest compared to other lower-middle-income countries and LAC (Source: WDI indicators and benchmarking).

58 The fertility rate decreased from 2.2 in 2012 to 2.0 in 2019, equal to the LAC average of 2.0 (WDI, 2021).

59 The maternal mortality rate has decreased from 52 per 100,000 live births to 46 per 100,000 live births between 2012 and 2017. Source: (WDI, 2021), below the 2017 LAC average of 74.

This is also linked to catastrophic health expenditure, which has decreased during the past years but remained among the highest in the region (WHO GHED, 2020).<sup>60</sup>

**The prevalence of climate change and natural disasters could have adverse effects on human health in the country.** The literature has well established the impact of climate change and natural hazards on human health (Fairweather, Hertig, and Traidl-Hoffmann 2020). These effects are more significant for developing countries.<sup>61</sup> The water crisis has had adverse effects on health in El Salvador, also affecting mental health in the country.<sup>62</sup> A recent study shows that the country's high exposure to disasters has led to youth trauma.<sup>63</sup>

**The COVID-19 pandemic is an additional challenge to the health system, generating more irregular access to health services, with patients experiencing delayed consultations.**<sup>64</sup> There are negative impacts on mental health, leading to a higher prevalence of anxiety and depression disorders.<sup>65</sup> Recent progress achieved in maternal and child health, non-communicable diseases, and human resources priorities have likely been lost.<sup>66</sup> Following reports by *Medicos sin Fronteras*, communities with high levels of violence have less access to the health system and are more affected by the negative impacts of the pandemic.<sup>67</sup> In general, the infection risk varies largely by municipality.<sup>68</sup> Not only does the impact of a pandemic represent a significant obstacle to the sustained reduction of poverty, but a country's pandemic preparedness (Annex 7.3) can also have critical future impacts on poverty.

**Although the COVID-19 crisis has laid out weaknesses in the health system of many developing countries, in El Salvador, it makes more sense to focus on investments in education.** Access to health and public services has improved, and while important challenges persist, the country performs relatively well in the benchmarking exercise. In contrast, this exercise confirms areas in education lagging more than in health. An analysis of potential drivers of poverty shows that having access to the health system is not significantly related to poverty (Annex 3.4). Years of schooling and literacy, on the other hand, are significantly related to being poor. The Human Capital Index (HCI) also shows that education and not health is the main driver of productivity losses.

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60 Looking at our benchmarking tool, the percentage of the population incurring catastrophic health spending is below the regional average.

61 Source: Meierrieks, Daniel. "Weather shocks, climate change and human health." *World Development* 138 (2021): 105228.

62 Source: Lai, Carlo, et al. "Water Scarcity May Lead to Poor Mental Health: A Community-Focused Study in Rural El Salvador." *Ecopsychology* (2020).

63 Source: Johnco, Carly, et al. "Child trauma exposure and subsequent emotional functioning in El Salvador." *Traumatology* 26.1 (2020): 19.

64 Source: Médecins Sans Frontières (2020). People are dying at home amid the collapsing health system in El Salvador. Link: <https://www.msf.org/health-system-close-collapse-amid-covid-19-el-salvador>.

65 Source: Orellana, Carlos Iván, and Ligia María Orellana. "Predictores de síntomas emocionales durante la cuarentena domiciliar por pandemia de COVID-19 en El Salvador." *Actualidades en Psicología* 34.128 (2020): 103-120.

66 Source: UNICEF (2020). "Challenges posed by the COVID-19 pandemic in the health of women, children, and adolescents in Latin America and the Caribbean." Link: <https://www.unicef.org/lac/media/16376/file/undp-rblac-CD19-PDS-Number19-UNICEF-Salud-EN.pdf>.

67 Source: *Medicos sin Fronteras*. 2020. "El Salvador: doble impacto del COVID-19 en la población afectada por la violencia y en deportados." Link: <https://www.msf.org.ar/actualidad/el-salvador-doble-impacto-covid-19-poblacion-afectada-violencia-deportados>.

68 Source: Government of El Salvador, January 2021.

## Recent Developments in Access to Other Public Services (Water, Sanitation, Electricity, Internet, and Housing)

The gap between income quintiles and the rural versus urban population in access to water at home has decreased since 2012, but it is still high; it has further increased compared to the previous period. Access to water sources at home has increased by 7.8 percentage points to 67.3 percent in the lowest quintile, remaining constant high for the upper quintile (around 89 percent). Water system coverage increased for the rural population by 10.6 percentage points to 66.7 percent in between 2012 and 2019. However, the urban/rural discrepancy is still significant (21.8 percentage points) (EHPM, 2012–2019). Overall, 97.4 percent of the population had access to at least basic drinking water services in 2017, up from 92.4 in 2012 and 77.8 in 2000 (WDI, 2021).

There are significant gaps among income quintiles and the rural versus urban population in the access to sanitation, there have been no significant improvements since 2012; access to basic sanitation increased between 2000 and 2012, but it has stagnated since then. In 2019, only 12 percent of the lowest quintile had access to the sewerage system compared to 57.9 percent of the upper quintile, among which the share has also fallen over time (EHPM, 2019). The gap between the urban and rural populations is significant. Additionally, there are gaps in access to sanitation among racial groups, with only 1 out of 3 indigenous people having access to the sewerage system, compared to more than 40 percent among the non-indigenous population.<sup>69</sup> Access to basic sanitation facilities has increased by 3.1 percentage points to 86.3 percent between 2000 and 2012 but has stagnated since (WDI, 2021).

Electricity coverage is high in El Salvador among all income quintiles, but there is room for improvement in energy efficiency and renewable energies. There is nearly full electricity coverage among the population in El Salvador's rural areas have almost caught up with urban ones since 2012 (EHPM, 2012–2019).

Indirect subsidies for water and electricity have been progressive and equalizing, but their overall effect on inequality has been low. In terms of percentage of GDP, from 2011 to 2019, indirect subsidies went from 2.1 percent to 1 percent (Oliva and Robayo-Abril (forthcoming)). Between 2011 and 2019, the distribution of water subsidies improved, changing from presenting a negative (regressive) marginal contribution to a positive (progressive) contribution. On the other hand, the progressive effect of electricity was reduced: the marginal contribution of the latter was lower in 2019 than that of 2011. In general, indirect subsidies benefit the poor, although to a lesser extent since 2011 (Oliva and Robayo-Abril (forthcoming)). This is mainly driven by low targeting and exclusion as well as inclusion errors.

Despite recent growth in overall internet connectivity, persistent gaps remain between income quintiles, and the digital urban-rural divide is astoundingly large. These issues are a reflection of uncompetitive markets, poor infrastructure and regulation. Although internet access has increased since 2012, access is 21 percentage points lower for the poor, and the gap has persisted between 2012 and 2019 (EHPM, 2012–2019). There are significant differences in internet access and the frequency of internet usage between rural and urban areas, but no gender gaps (Annex 1, Figures A1.10 and A1.11). The proportion of rural households with internet access at home is only 5 percent, compared to 26 percent at the national level and 29 percent in urban areas, significantly higher than other LAC countries, suggesting the need for a considerable

69 Source: Population Census, 2007. No more recent data is available to the household surveys as they do not include an ethnic minority oversample; therefore, they cannot be used to make inferences for these groups (see Annex 8 on data gaps).

rural infrastructure development effort (Inter-American Development Bank, 2020). Low rates of computer ownership aggravate this problem, a recent report concluded that WIFI connectivity could be one of the factors creating resilience against shocks and helping to impede income losses.<sup>70</sup> According to data from the International Telecommunication Union, 30 percent of the population in El Salvador is still without 4G coverage (latest data, 2018). The prices of mobile and fixed broadband packages are remarkably high for most people. This is reflected in the fact that most subscriptions are prepaid, i.e., the population does not have access to the internet on a continuous basis. The cost of mobile broadband (3 percent of GNI per capita) is in line with structural peers (3.4 percent) but higher than aspirational peers (1.4 percent). The cost of fixed broadband (8.4 percent of GNI per capita) is higher than in structural peers (7.1 percent) even with Honduras (14.1 percent) and Jordan (-12.1 percent) as outliers and higher than in aspirational peers (2.1 percent). El Salvador is the only country in LAC without a submarine cable to provide greater quality, lower costs, security and resilience to broadband networks. Likewise, the weakness of the telecommunication regulator is ranked #104 out of 192 countries in the ICT Regulatory Tracker. The approval of new laws, e.g., data protection law, outlined in Digital Agenda 2030 and the National Connectivity Network Program would strengthen the regulatory framework and allow for digital catch-up.

**More than half of the population in El Salvador are property owners.** Still, there are gaps among income quintiles and the rural versus urban population, especially with respect to the quality of housing. In 2019, 66 percent of the wealthiest quintile owned their property, however this share is 59.2 percent in the lowest quintile, a gap of only about six percentage points (EHPM, 2019) although housing among the poorest is of lower quality. More people in rural than urban areas owned their houses in 2019 (66.5 percent compared to 59.2 percent) (EHPM, 2019).

### **Recent Developments in Financial Inclusion and Digital Access**

Financial inclusion in El Salvador is low, but improvements over time are significant. Benchmarking analysis has flagged financial inclusion as a problem area, but the SCD Update finds that it is more important to focus on education and therefore does not prioritize financial inclusion, which despite some persistent gaps across groups,<sup>71</sup> has improved significantly over the past decade. Nearly one-third of El Salvador's adult population holds an account with a financial institution or uses mobile money, but this figure is lower for women (24.4 percent), the poorest 40 percent (19.3 percent), and the rural population (27.2 percent). This is a significant increase since 2011 when only 13.8 percent of adults had an account (Findex). Financial inclusion is low compared to the rest of LAC, where 55.1 percent of adults have accounts, including 52 percent of women, 42.8 percent of the poorest 40 percent, and 53.1 percent of the rural population. Very few people use digital financial instruments, but mobile money's potential for growth is significant. A key part of the reason for low financial inclusion and digital payments is the underdeveloped nature of the financial sector's infrastructure and legal framework. Evidence from other countries also shows that low education levels are one of the main reasons poor people opt out of the financial system (Sabic-El-Rayess, 2019). However, improvements in education may not be enough to enhance financial inclusion or to reduce the gender gaps, as other factors limiting access may be at play.

70 Source: World Bank (forthcoming). Digital Economy Diagnostic for LAC: The Case of El Salvador. Washington, D.C.

71 Only one-fourth of the female population above 15 years old held an account in 2017. This is 13.2 percentage points lower than the share of men with an account.

### Annex 7.3. Pandemic Preparedness

After every significant epidemic, from Avian Flu to Ebola to Zika and now COVID-19, the need to invest in preparedness and to prevent outbreaks from becoming full-fledged epidemics has been stressed; however, investments in preparedness and resilient health systems have often been neglected, partly because they relate to a risk which in the best possible circumstances will not materialize.

Since the introduction of the International Health Regulations (IHR), there have been several efforts to assess the country's fulfillment of its IHR core capacities. Countries in LAC have been reporting exclusively through the Annual Self-Assessment Reporting (SPAR). The resulting subjective assessment tends to overestimate the state of country preparedness since data are not independently or externally verified.

In 2019, the Global Health Security Index (GHSI) emerged as an additional assessment tool for countries' capacity to respond to global health security concerns; El Salvador ranks slightly above the average scores for Central America and LAC. The GHSI is a comprehensive assessment and benchmarking tool for health security and related capacities across 195 countries. It measures a country's capacity to rapidly respond to and mitigate the spread of an epidemic, given its health system's ability to care for the sick and protect health workers. The index relies on publicly available data sources from individual countries and international organizations, such as WHO, the World Organization for Animal Health (OIE), the World Bank, country legislation and regulations, and academic resources. The GHSI gave El Salvador a rank of 65/195 and an overall score of 44.2 (out of 100), which is slightly above the average scores for Central America (39.4), Latin America (38.1), and the global average (40.2).

**El Salvador is well equipped to detect epidemics early on, but this does not translate into swift response.** The country can improve upon its pandemic preparedness in many ways. It is among the 8th decile when its prevention of the emergence of release of pathogens is compared to LAC or the rest of the world.<sup>72</sup> Although its preparedness to detect and report early on is strong: it is among the 2nd best performing decile in the LAC region, this does not translate into a rapid response and mitigation strategy, it only ranks in the 6th decile in regional comparisons. Its health system is also not robust enough to treat the sick and protect its health workers, and it is in the 7th decile compared to LAC. On the overall pandemic preparedness score, it ranks in the 6th decile compared to the rest of the world.

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72 World Bank Benchmarking Exercise.

**Table A.12. Annual self-assessment reporting (SPAR) scores, Central American countries 2019 (select indicators)**

SPAR Capacity	2019 SPAR Scores (percent)					
	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Panama
C1 Legislation and Financing	93	100	67	73	100	73
C2 IHR Coordination and National IHR Focal Point Functions	90	100	40	50	30	80
C3 Zoonotic Events and the Human–animal Interface	80	100	40	80	60	80
C5 Laboratory	93	100	80	67	87	87
C6 Surveillance	70	100	70	70	80	90
C7 Human Resources	80	100	60	60	80	80
C8 National Health Emergency Framework	67	100	73	67	93	80
C9 Health Service Provision	73	100	33	40	73	73
C10 Risk communication	80	40	40	60	80	60
C11 Points of Entry	60	100	60	50	90	60

Table A.13. Global Health Security Index (GHSI) - A Tool for evaluating pandemic preparedness

Country	GHSI Global Rank	GHSI Rank for LAC	GHSI Overall Score	1. Prevention of the emergence or release of pathogens	2. Early detection & reporting for epidemics of potential international concern	3. Rapid response to and mitigation of the spread of an epidemic	4. Sufficient & robust health system to treat the sick & protect health workers	5. Commitments to improving national capacity, financing, and adherence to norms	6. Overall risk environment and country vulnerability to biological threats
Honduras	156/195	29/33	27.6	21.6	27.7	26.5	12.0	41.8	39.5
Guatemala	125/195	21/33	32.7	21.2	50.0	25.0	11.4	42.2	49.1
Nicaragua	73/195	11/33	43.1	41.7	39.9	39.2	45.9	51.8	41.0
Panama	68/195	10/33	43.7	40.5	44.6	46.4	35.1	35.3	63.8
<b>El Salvador</b>	<b>65/195</b>	<b>9/33</b>	<b>44.2</b>	<b>22.1</b>	<b>73.9</b>	<b>42.1</b>	<b>25.2</b>	<b>50.5</b>	<b>48.0</b>
Costa Rica	62/195	7/33	45.1	44.2	56.0	36.6	24.8	43.1	71.7
CA Average	n/a	n/a	39.4	31.9	48.7	36.0	25.7	44.1	52.2
LAC Average	n/a	n/a	38.1	32.1	37.3	36.2	22.6	49.0	56.9
Global Average	n/a	n/a	40.2	34.8	41.9	38.4	26.4	48.5	55.0

Systematic Country Diagnostic Update

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