
Global Policy Network

<http://www.gpn.org>

Economic Development and the Labor Market in El Salvador, 2004-2005

Presentado por:

funde

Fundación Nacional para el Desarrollo

Área Macroeconomía y Desarrollo

Calle Arturo Ambrogi. No. 411. Col. Escalón. San Salvador, C.A.

Tels.: (503) 2264 4938, al 43

Fax: (503) 2263 0454

Web: <http://www.funde.org>

Correo electrónico: edgar@funde.org

Published for GPN November 2, 2005.

1. Macroeconomic Context in El Salvador

For the past sixteen years, economic policy in El Salvador has been based on the policies established in the “Washington Consensus,” which outlined economic deregulation, commercial liberalization, and privatization. These are the key factors that have determined both economic and social trends in the country; naturally, secondary factors such as international economic trends and natural events (earthquakes, hurricanes, etc.) have also significantly affected the economy.

Currently, within the context of the “Washington Consensus” policies, the country shows signs of heading in a troubling direction. Since 1996 the economy has slowed, and in 2004 the country saw the lowest GDP growth since the beginning of the 1990s. Similarly, there has been a decline in average income; in 2004, the GDP per person dropped by 0.2% (Chart 1). Within the region, El Salvador stands alongside Haiti as the country with the lowest economic growth.

Chart 1
El Salvador: Macroeconomic Indicators

Indicators	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Population (Millions)	5.7	5.8	5.9	6.0	6.2	6.3	6.4	6.5	6.6	6.7
Annual GDP Growth	6.4	1.7	4.2	3.7	3.4	2.2	1.7	2.2	1.8	1.5
Annual per capita GDP Growth	4.2	-0.4	2.1	1.6	1.4	0.2	-0.2	0.3	0.0	-0.2
Tax Burden	12.0	10.6	10.3	10.2	10.2	10.2	10.5	11.1	11.6	11.5
Expenditures & Net Lending Concession/GDP	18.1	19.5	17.1	17.6	17.8	18.8	18.5	18.8	18.4	16.9
Fiscal Defecit/GDP	-0.1	-2.5	-1.8	-2.6	-2.8	-3.0	-4.4	-4.4	-3.7	-2.4
Internal Debt/GDP	10.8	9.4	8.5	7.2	7.5	9.5	12	11.6	11.4	11.9
External Debt										
Debt / GDP	20.8	22.0	24.2	22.0	22.5	20.4	21.6	26.9	29.1	28.5
Service /GDP	3.1	2.8	8.0	5.4	4.4	2.6	3.5	4.8	3.0	4.2
Current Revenues	26.2	11.1	-3.4	-87.9	3.4	6.5	2.0	5.5	12.5	20.0
Current Expenditures	17.0	23.1	-5.2	87.1	9.6	12.2	-4.6	2.4	10.6	16.0
Family Remittances/GDP	..	..	10.8	11.3	11	13.3	13.8	13.5	14.1	16.1
Net Trade Balance/GDP	17.7	13.9	11.9	12.7	13.0	15.3	15.7	15.4	17.6	18.8
Rate of Inflation	..	7.4	1.9	4.2	-1.0	4.3	1.4	2.8	2.5	5.4

Source: BCR

Without a doubt, 2004 was not a favorable year for El Salvador. For one, the public debt (internal and external) grew, eventually reaching some 40.5% of the GDP and approaching the limits set out by international financing organizations. This has greatly undermined confidence in the government’s ability to maintain sustainable debt levels. It’s important to note that there have been strong moves to increase the [recaudacion tributaria]; 2004 saw a [carga tributaria] of 11.5%, significantly lower than that of 2003; nevertheless, projections foresaw a renewed increase by the end of 2005.

Secondly, prices have increased significantly in comparison to 2003. The inflation rate rose to a high of 5.4% and stood at 4.4% in 2005. These increases were primarily induced by rising petroleum prices on an international level.

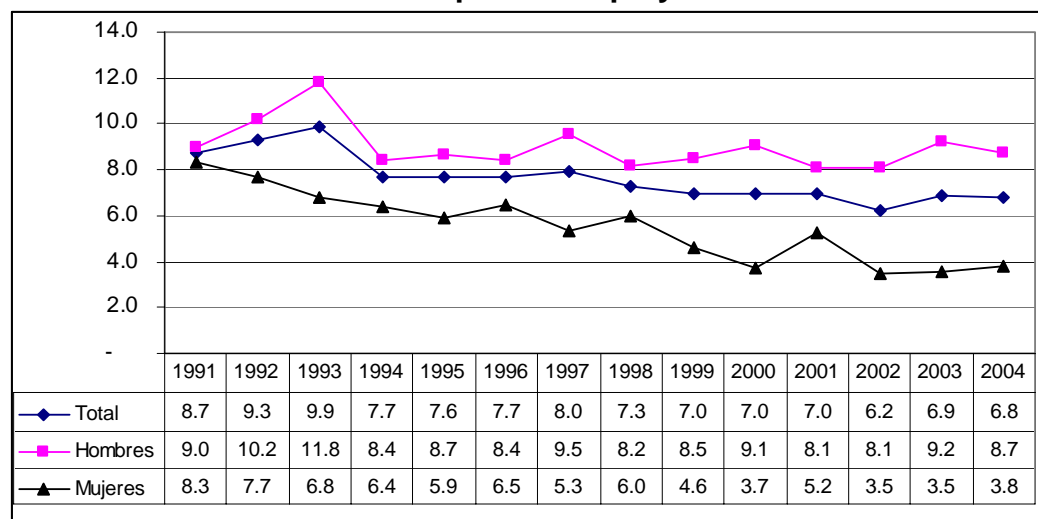
Thirdly, the commercial deficit has steadily increased in the past several years, ultimately reaching 18.8% of the GDP. This trend is aggravated by increased commercial liberalization (today dictated by the Free Trade Agreements), a policy that does not guarantee competitiveness for the production sector, and favors the external sector over internal production. In addition, the country has shown little diversity when it comes to exportable production and the destination of exports; the manufacturing industry accounts for 55.2% of exports, and 65.4% of all exports are headed for the United States. This situation puts El Salvador in a vulnerable position, as the fate of the export sector is linked to the performance of the United States manufacturing.

In addition, there has been an increase in family remittances from abroad, which now account for some 16.1% of the GDP. This capital keeps the economy afloat in many ways, helping it weather slow growth, and it allows many families to buy basic goods; however, this capital also promotes tertiary activities, often at the expense of primary economic areas.

2. Development of the Job Market

In recent years, the drop in employment has been much slower than it was at the beginning of the 1990's; nonetheless, the employment rate has shown an all too consistent drop from 1999 to 2004 (Graph 1). This trend is concurrent with the overall economic slowing seen throughout the country.

Graph 1
El Salvador: Open Unemployment Rate



Source: Encuesta de Hogares de Propósitos Múltiples

In 2004, the unemployment rate stood at 6.8%, 0.1% lower than in 2003. The sectors in which unemployment levels grew were construction and industrial manufacturing. The former was due to the slowing of jobs created after the 2001 earthquakes; in the case of industrial manufacturing, the slow in unemployment shrinkage is due to the sluggish performance of the machinery sector, primarily due to the entrance of China on the

United States market and overall increased competitiveness between Central American and Caribbean countries, particularly with regard to textile machinery. In 2004, unemployment levels in the farming and agricultural sector dropped, but this sector continues to have the highest unemployment levels in the country.

At the end of the 1990's, the ranks of the unemployed was comprised more and more by higher-level workers. In 1994, those unemployed who had no formal schooling accounted for 22.1% of the unemployed; in 2004, this figure dropped to 15.1%. Meanwhile, the unemployed who had 13 or more years of study stood at 6% in 1994 but had swelled to 10.2% a decade later (Chart 2). This situation clearly indicates that those jobs that the economy is creating do not require formal education or training.

Chart 2
El Salvador: Desempleados según años de estudios aprobados

Years of Education	1994		1998		2002		2004	
	No.	Part. %	No.	Part. %	No.	Part. %	No.	Part. %
Total	162,298	100	175,723	100	160,192	100.0	183,874.0	100.0
NONE	35,888	22.1	21,013	12.0	19,410	12.1	27,701	15.1
1 - 3	26,973	16.6	25,691	14.6	22,075	13.8	23,693	12.9
4 - 6	33,289	20.5	39,421	22.4	32,438	20.2	36,929	20.1
7 - 9	27,257	16.8	35,227	20.0	30,511	19.0	38,233	20.8
10 - 12	28,991	17.9	41,199	23.4	41,160	25.7	38,596	21.0
13 Y More	9,760	6.0	13,172	7.5	14,598	9.1	18,722	10.2
Other	140	0.1	..	..	..	..	..	..

Source: Encuesta de Hogares de Propósitos Múltiples

Another interesting trend within the labor market is that women display lower unemployment levels than men. The unemployment level for women is 3.8%, while it stands at 8.7% for men. As seen in Graph 1, the female unemployment rate has consistently dropped, while that of men has stayed at around 9%. The lower level of unemployment among women is due to the fact that those economic activities which have grown and created jobs since the 1990s are accessible to female workers; among these are the commercial/hotel/restaurant sector and the industrial manufacturing (especially textiles) sector. Despite this growth, these are sectors that are not known for their employment conditions, high wages or fair labor practices. In addition, the burden at home continues to be carried by women, even though they participate in the same work-day as their male counterparts.

The lower levels of unemployment in recent years nevertheless coincides with a deterioration of the quality of jobs created. Since the end of the 1990's, the labor sector has become markedly more unstable. As seen in Chart 3, since 2000 employment in the informal sector has grown, reaching almost half of the working population (49.8%) by 2005. Similarly, subemployment, which began to drop in the mid-90's, has recently begun to grow; while 2004 saw a slight decrease in subemployment, the rate continues to be higher than it was a decade ago.

With regard to social security, while Article 50 of the Constitution declares that “*Social Security is an obligatory public service,*” some 56% of urban workers do not have access to social security. This points to the troubling fact that the majority of workers are not being protected, and that little progress is being made to better labor conditions in this country.

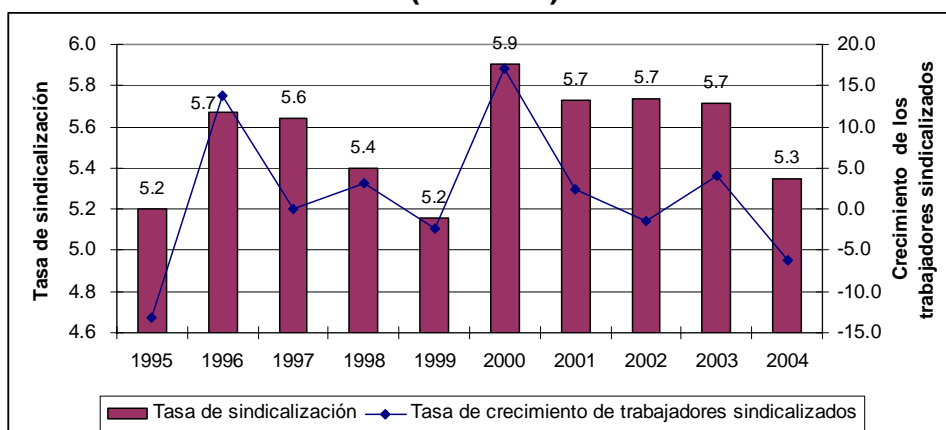
Chart 3
El Salvador: Indicators of Labor Instability
(Urban Areas, Percentage of Workers)

Year	In Informal Sector	Rate of Sub-employment	Workers without Social Security
1994	48.8	32.7	59.1
1995	47.1	31.9	61.6
1996	47.4	30.6	62.1
1997	49.5	29.9	61.3
1998	46.6	31.7	56.2
1999	46.5	29.1	51.5
2000	47.7	26.3	54.2
2001	49.4	27.8	53.6
2002	49.7	29.8	54.5
2003	47.9	37.1	54.3
2004	49.8	35.4	56.0

Source: Encuesta de Hogares de Propósitos Múltiples

In 2004 there were no significant steps taken with regards to unionization. Over the past ten years, unionization levels have held at around 5%. There is a perception among the general working population that the government and employers in this country are anti-union; new entrants to the labor market, then, view unions with a certain degree of skepticism.

Graph 2
El Salvador: Rate of Unionization (bars) and Rate of Growth in Unionized Workers (blue line)

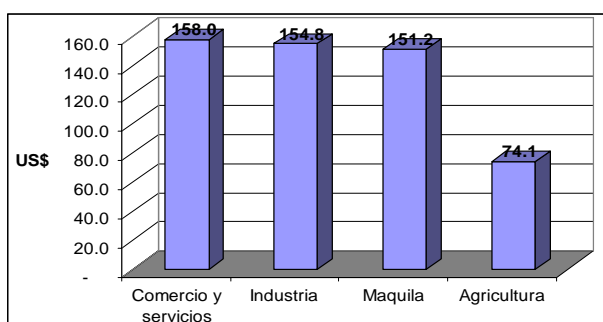


Source: Elaboración propia con base a información de la EHPM y el MTPS

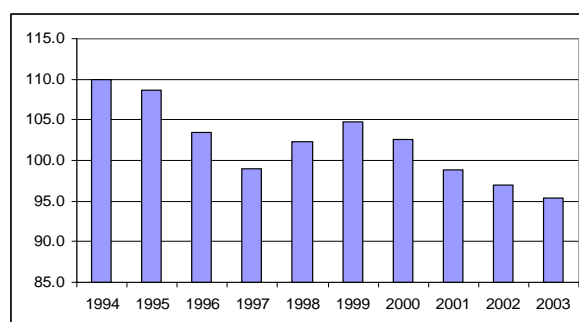
Moreover, the high levels of informality throughout the economy, and an increasing preference among employers for subcontracted labor have stripped some unions of their negotiating power; as companies subcontract many of their permanent positions, unions slowly deteriorate.

Wage policy in El Salvador continues to be rigid; wages have not been adjusted to account for inflation, which as of late has become a significant factor. As inflation increases, and wages remain the same, the buying power of the average household for basic good and services drops to troubling levels. In Graph 3, we can see the minimum wage levels since 2003; as of now, the government has no plans to increase minimum wages.

Graph 3
El Salvador: Minimum Wage in US\$
(2004/2005)



Source: MTPS



Source: ILO, Panorama laboral 2004

The sluggishness of wage policy, coupled with the rise in price levels, has led to a drop in real wages. As seen in Graph 4, since 1999 real wages have dropped consistently; this trend continued in 2005.

3. Human Development, Poverty, and Inequality¹

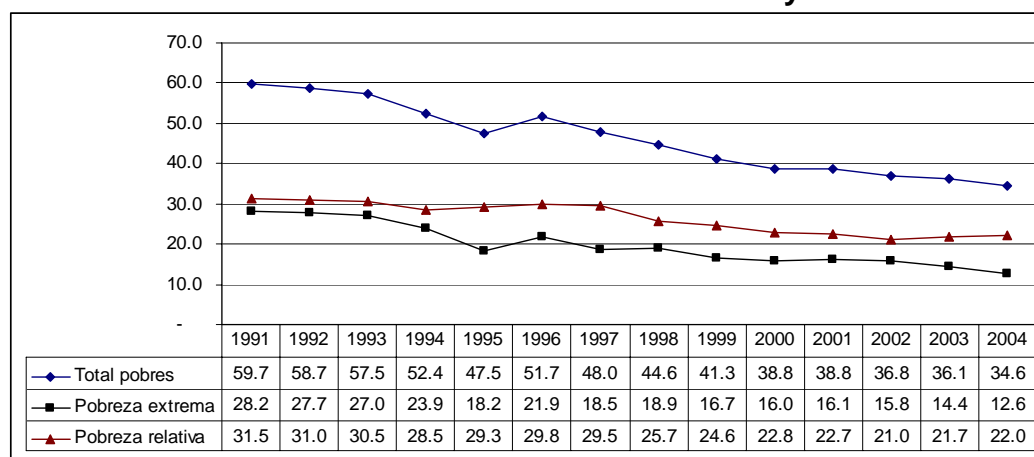
According to the 2005 Human Development Report by UNDP, El Salvador lands among the mid-level countries when it comes to human development, ranking 104th out of 177 countries; in first place is Norway, while Niger ranks at 177. Within Central America, El Salvador ranks as third, behind Costa Rica and Panama. While the Human Development Index (IDH) has grown when compared to previous surveys, the growth in 2005 would not have been enough to maintain the country's ranking (103); in other words, El Salvador may be lagging when compared to other nations.

¹ This section summarizes the findings of: Arrivillaga, Rosa y Lara López, Edgar (2004). La pobreza y el empleo en el contexto de la administración Flores. En Alternativas para el Desarrollo No. 89. FUNDE. El Salvador.

Poverty in El Salvador has continued to shrink; that said, the rate at which it has dropped has slowed: between 1990-1997, poverty dropped by some 11.7%, while the drop was only 10.0% between 1998-2004. These figures indicate that the government has had problems truly eliminating household poverty, which maintained a level of 35% from 2000 to 2004 (Graph 5).

One of the key obstacles the government has faced in trying to reduce poverty has been its inability to reverse economic deceleration. The low levels of economic growth since the mid-1990's have directly affected the battle against poverty. Economic policy priorities have a direct effect on the drive to eliminate poverty; as of late, the government has focused its policy on liberalization, commercialization, and economic infrastructure. While these may have an effect on overall economic performance, there is debate about their effectiveness in fighting poverty.

Graph 5
El Salvador: Households in Poverty



Source: Elaboración propia en base a información de EHPM.

With regards to geographic areas, the rural areas continue to show higher poverty levels. In 2003, some 43.7% of rural households stood in poverty; this figure was 29.2% for urban households. It's important to note that between 1999-2004, poverty reduction was more significant in rural areas. Rural poverty dropped by 11.2%, while urban poverty shrunk by 3.6%. These numbers should be viewed in context, though: during this period, the farming sector (which accounts for the majority of rural activity) underwent a significant crisis. The agricultural GDP shrunk considerably, and the sector lost its ability to create jobs. Despite this, increased levels in family remittances allowed for the overall reduction in poverty levels.

While indices have shown advances in the struggle against poverty (albeit at lower levels than in the 1990s), these levels do not concur with the support and participation of the

Salvadoran population² on the economic and social well-being of the country. This hints at the possibility that there are difficulties in truly measuring poverty levels, and that indices may not accurately represent reality. The UNDP office in El Salvador, in its Human Development Report, poses some questions about the methodology used to measure poverty, and raises the possibility that poverty is in fact being underestimated.

Unequal distribution of wealth is a significant problem in El Salvador. According to a report by CEPAL, the Gini³ coefficient in 1995 was 0.507; in 2001, that index had risen to 0.521, indicating that the country is moving towards more and more stratified wealth levels. According to a 2002 on the status of the Millennium Development Objectives, the poorest 20% held 2.7% of the country's wealth, while the richest 20% accounted for 56.9% of wealth⁴.

In the end, the economic and social situation shows several troubling characteristics: overall economic deceleration; high labor instability; little dynamism when it comes to poverty reduction; and high inequality. These factors indicate that the government has fallen short in its role as policy director and has failed to spur growth in virtually every sector. While the government has, as of 2005, sought to diversify its economic policies and place a greater emphasis on social factors, El Salvador continues to suffer as a result of economic liberalization and deregulation.

² Para un mayor conocimiento de las apreciaciones ver encuestas de opinión públicas de: UCA, UFG y UTEC.

³ The Gini coefficient measured the levels of equality/inequality in a country or region, providing a score between 0 and 1. A score of 0 indicates total equality, while 1 signifies complete inequality.

⁴ For a more in-depth exploration of inequality, see: El Salvador, primer informe de país sobre los avances de los Objetivos de Desarrollo del Milenio.