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MEMORANDUM OF THE PRESIDENT

OF THE

INTERNATIONAL BANK FOR

RECONSTRUCTION AND DEVELOPMENT

TO THE

EXECUTIVE DIRECTORS

ON A

COUNTRY ASSISTANCE STRATEGY

OF THE WORLD BANK GROUP

FOR

THE REPUBLIC OF EL SALVADOR

February 19, 1997

Central America Department
Latin America and the Caribbean Region

The last Country Assistance Strategy for El Salvador was discussed by the Executive Directors in September, 1993. It was included as Part I of the President's Report and Recommendation for the Second Structural Adjustment Loan to El Salvador (August 23, 1993; Report No. P-6108-ES)

CURRENCY EQUIVALENTS

Currency Unit	=	Colón (¢)
$1.0	=	¢8.75

FISCAL YEAR

January 1 to December 31

WEIGHTS AND MEASURES

Metric System

MAIN ABBREVIATIONS AND ACRONYMS

ACE	Community Education Association (*Asociación Comunitaria de Educación*)
ANDA	National Water Company (*Administración Nacional de Acueductos y Alcantarillados*)
ANTEL	National Telecoms Administration (*Administración Nacional de Telecomunicaciones*)
CACM	Central American Common Market
CBA	Basic Consumption Basket (*Canasta Básica de Abastecimiento*)
CBI	Caribbean Basin Initiative
CEL	National Power Company (*Comisión Ejecutiva Hidroeléctrica del Río Lempa*)
ECLAC	United Nations Economic Commission for Latin America and the Caribbean
EDUCO	Community Education program (*Educación con Participación de la Comunidad*)
FIAS	Foreign Investment Advisory Services
FMLN	National Liberation Front (*Frente Farabundo Martí para la Liberación Nacional*)
GINO	Gender Innovation Program
GSP	General System of Preferences
GTZ	German Agency for Technical Cooperation
IDB	Inter-American Development Bank
ISDEMU	Women's Development Institute (*Instituto Salvadoreño para el Desarrollo de la Mujer*)
ISSS	Social Security Institute (*Instituto de Seguridad Social*)
KfW	German Credit Institute for Reconstruction (*Kreditanstalt für Wiederaufbau*)
MOE	Ministry of Education
NAFTA	North American Free Trade Agreement
NGO	Non-Governmental Organization
NRC	National Research Council
SEMA	Environment Secretariat (*Secretaría Ejecutiva para el Medio Ambiente*)
SIFLD	Social Investment Fund for Local Development
SNF	Secretariat of the Family (*Secretaría de la Familia*)
TA	Technical Assistance
UNDP	United Nations Development Programme
USAID	Unites States Agency for International Development
VAT	Value Added Tax

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EL SALVADOR

COUNTRY ASSISTANCE STRATEGY

Table of Contents

Overview

I. HISTORICAL PERSPECTIVE AND RECENT DEVELOPMENTS....................1
The Onset of Peace....................1
Poverty and Social Conditions....................1
Economic Developments—Progress and Challenges....................2

II. EXTERNAL ENVIRONMENT AND DEVELOPMENT PROSPECTS....................4
External Environment....................4
Economic and Social Outlook....................5

III. GOVERNMENT DEVELOPMENT STRATEGY....................5
Social Development—Attacking the Root Causes of the Conflict....................6
Improving Environmental Management—Making Economic Growth Sustainable....................10
Enhancing Competitiveness—The Road to Globalization....................11
Modernizing the Public Sector—Improving Service Delivery in a Competitive Economy....................13

IV. BANK GROUP COUNTRY ASSISTANCE STRATEGY....................15
Progress Since the Last CAS....................15
The Proposed Country Assistance Strategy....................16
Lending Program....................16
Non-Lending Services....................17
Coordination with IDB....................17
Relations with the IMF....................18
Portfolio Management....................18
Exposure and Creditworthiness....................19
CAS Preparation—Client Consultation and Stakeholder Dialogue....................19
CAS Risks....................20

V. AGENDA FOR BOARD CONSIDERATION....................21

TEXT TABLES
Table 1: Poverty Rates, 1991-95 (% of households)....................2

TEXT BOXES
Box 1: Letting Communities Manage Schools in El Salvador—the EDUCO Program....................8
Box 2: Violence Against Women....................9

ANNEXES

Annex A:
1: Selected Indicators of Bank Portfolio Performance and Management
2: Bank Group Fact Sheet
3: Summary of Economic and Sector Work
4: El Salvador at a Glance
5: Key Economic Indicators
6: Key Exposure Indicators
7: Status of Bank Group Operations in El Salvador

Annex B: Poverty: Assessment and Progress

Annex C: Bank Dialogue with NGOs/Stakeholders

Annex D: El Salvador's Financial System

Annex E: EDI: El Salvador CAS Training Activities, FY97-00

Annex F: Mobilizing the Bank Group

Annex G: El Salvador: Country Strategy and Progress Benchmarks

MAP

EL SALVADOR

COUNTRY ASSISTANCE STRATEGY

Overview

This is the first Country Assistance Strategy (CAS) for El Salvador prepared under the new procedures being piloted Bank-wide. It includes several innovations and new emphases:

- *CAS preparation involved an intensive consultative and participatory process with Government.*
- *As part of CAS preparation, and in agreement with the Government, the Bank initiated a process of dialogue with NGOs and other stakeholders. We expect this dialogue to become a continuing process during CAS implementation.*
- *The CAS has a three-year horizon in order to dovetail with the country's electoral cycle. Although the strategic thrust of the CAS goes beyond the term of the current Administration, its emphasis is on the next three years.*
- *The CAS highlights the contribution of different parts of the Bank Group (e.g., Finance and Private Sector Development, FPD; IFC; Economic Development Institute, EDI; Learning and Leadership Center, LLC; External Affairs; EXT; MIGA; Foreign Investment Advisory Services, FIAS), in an effort to provide seamless service to the client and support country priorities.*
- *The development agenda and Bank Group assistance strategy are presented in a more thematic framework, focused on the four core themes which emerge from the Government's vision of competitiveness for all—social development, enhancing competitiveness, public sector modernization, and environmental sustainability—all linked by the overriding objective of the Government and the Bank to make peace sustainable.*

Progress since the last CAS has been considerable. The current assistance strategy does not propose a major change but rather adjustments in line with the Government's evolving vision and priorities. While the key aim of the previous strategy was peace consolidation, the current aim is peace sustainability. This will require not cnly high economic growth, but also a strong effort to reduce poverty and improve the living standards of the majority of Salvadorans. To achieve this, the Government has articulated a bold and challenging vision, centered around the concept of competitiveness for all. The country assistance strategy proposed here is designed to support the Government's vision.

The Bank's strategy must also adapt in order to effectively support the Government's vision. First, the Bank's major contribution and value added will increasingly rest on its capacity to provide advisory services, mobilizing not only its own expertise, but also helping the country to connect with outside sources of knowledge and information. Second, the Bank-client relationship must increasingly focus on the process rather than specific products, particularly by facilitating increased participation by society at large and improving the speed and responsiveness of the services we provide. Both of these goals require great flexibility in the design and implementation of the assistance strategy, as well as continuing efforts to draw on all parts of the Bank Group to support El Salvador's social and economic transformation.

MEMORANDUM OF THE PRESIDENT OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT TO THE EXECUTIVE DIRECTORS ON A COUNTRY ASSISTANCE STRATEGY OF THE WORLD BANK GROUP FOR EL SALVADOR

I. HISTORICAL PERSPECTIVE AND RECENT DEVELOPMENTS

The Onset of Peace

1. On January 16, 1992, the Government and the *Frente Farabundo Martí para la Liberación Nacional* (FMLN) signed a Peace Accord putting an end to the 12-year conflict. El Salvador's civil war had no winner but many losers. The conflict cost some 75,000 lives, leaving thousands of people displaced, orphaned or disabled, and provoked a mass migration which eventually left about one in five Salvadorans living outside the country. The war also caused large material losses—war-related damages are estimated to have totaled some $1.5 billion in infrastructure alone. Less easy to measure was the fraying of the country's social fabric, the political polarization and the weakening of the institutional apparatus. One major after-effect of the war has been a dramatic increase in violent crime, with which the Government is struggling to cope.

2. Over the past five years, the Government and the people of El Salvador have endeavored to rebuild the country's economic, social, political and institutional structure. The fact that there was no winner in the conflict has made it easier to begin forging a consensus on the country's development challenges. Progress has been substantial but much remains to be done. El Salvador is the smallest country in Central America and, with a population of 5.8 million people sharing an area of 21,000 km^2, it is one of the most densely populated countries in the Western Hemisphere. It has a limited natural resource base and no remaining agricultural frontier. About 60 percent of the population lives in rural areas and over 80 percent of agricultural producers work farms of less than 3 ha. With social indicators among the worst in Latin America and a per capita income of $1,580 in 1995, it also ranks as one of the poorer countries in the region.

3. Broad-based democratic elections, held in March 1994, represented a major achievement in the implementation of the Peace Accords. The ARENA party won the presidency, the largest share of seats in the Legislative Assembly, and the vast majority of municipalities. The FMLN, participating in elections for the first time, finished second in the presidential race and won a number of Assembly seats. Congressional and municipal elections are scheduled for March 1997, and general elections for March 1999.

Poverty and Social Conditions

4. **Poverty Trends.** Although the quality of household surveys is not as high as desirable (Annex B), official data probably reflect reasonably well poverty trends during the 1990s (Table 1). National poverty fell by 12 percentage points over 1991-95, which appears plausible given the 20.7 percent increase in per capita GDP over the period. The differences between urban and rural poverty, however, suggest that the economy's strong growth has disproportionately benefited urban areas, while poverty in rural areas has tended to stagnate. Urban poverty shows a marked and steady decline over the period, but rural poverty showed little change until 1995, with extreme poverty actually increasing, consistent with negative agricultural growth of 2.7 percent in 1994. This changed in 1995, when rural poverty dropped by more than six percentage points, consistent with rapid agricultural growth of 5.1 percent in 1995.

5. **Social Indicators.** The effects of the conflict, including the diversion of public resources from infrastructure and the social sectors to military expenditures, left the country with precarious social conditions. Social indicators have begun to improve but at a slow pace, reflecting the need to substantially expand the coverage and quality of social services. Although considerable progress has been achieved in

broadening access to **education**, it remains limited for rural communities and the poor. Quality of service is low, as reflected in high repetition and dropouts. In recent years, however, the basic education reform program has boosted the net enrollment rate for primary education (grades 1-6) from 76 percent in 1989 to 87 percent in 1995. Preschool public education (4-6 year olds) increased from 15 percent in 1989 to 32 percent in 1995. Quality is improving as reflected in higher completion rates. **Health** conditions are improving but not fast enough—poverty-related illnesses (especially malnutrition and infectious diseases) remain prevalent, there has been a resurgence of two vector-borne diseases—malaria and dengue—and AIDS is on the rise. More than half of Salvadorans do not have access to safe water (84 percent in rural areas), while only about a third has sewerage connections. Mothers and children are predominantly affected by poor health conditions—maternal mortality is 300 per 100,000 and infant mortality is high at 42 per 1,000 live births. Leading causes of death in children are diarrhea, acute respiratory infections and low birth weight. Teenage pregnancy is also a serious problem; the adolescent fertility rate, at 137/1000, is one of the highest in the region. Malnutrition affects more than one in five children with higher incidence in rural areas. Over the last decade significant segments of the population, particularly in urban areas, have entered the second phase of the epidemiological transition, with high prevalence of chronic diseases.

Table 1: Poverty Rates. 1991-95 (% of households)

Survey Period	URBAN			RURAL			NATIONAL		
	TOTAL	Relative	Extreme	TOTAL	Relative	Extreme	TOTAL	Relative	Extreme
1991-2	53.7	30.5	23.2	66.1	32.5	33.6	59.7	31.5	28.2
1992	52.9	31.0	21.9	65.0	31.0	34.0	58.7	31.0	27.7
1992-3	50.4	29.6	20.8	65.3	31.5	33.8	57.5	30.5	27.0
1994	43.8	27.5	16.3	64.6	29.8	34.8	52.4	28.5	23.9
1995	40.3	27.7	12.6	58.2	31.8	26.4	47.7	29.4	18.3

Source: Ministry of Planning, *Encuestas de Hogares de Propósitos Múltiples.*

6. Labor markets are flexible but **real wages** of public and private sector workers in 1995 were about half the level a decade earlier. Low and declining real wages, coupled with high economic growth, have kept open unemployment in check during the adjustment period, with the official rate oscillating between 7 and 10 percent. These figures, however, do not reflect the reality of a labor market where underemployment is estimated to affect one of every two Salvadorans and where, by some estimates, informal sector workers could rival the size of the formal labor force.

Economic Developments—Progress and Challenges

7. El Salvador has experienced a remarkable economic recovery since the advent of peace. Economic growth has been impressive, averaging 6.7 percent per annum during 1991-95. Public finances strengthened considerably, with the fiscal deficit (excluding grants) falling from 6.5 percent of GDP in 1992 to 1.9 percent in 1996. A key aspect of improved fiscal policy has been the gradual increase in the tax base and a tight reign on expenditures. Inflation, which had jumped to 18.5 percent in 1993, fell to 9.8 percent in 1996. The external current account deficit (excluding official transfers) fell from 5.5 percent of GDP in 1992 to 2.1 percent in 1996 (1.5 percent including official transfers). Remittances have continued to rise, from $708 million in 1992 to $1,3 billion in 1996 (12 percent of GDP).

8. The onset of peace coupled with policy reforms explain El Salvador's impressive economic recovery. In addition to maintaining prudent macroeconomic policies, the previous Administration implemented a comprehensive structural reform program with the aim of reorienting the economy toward private sector and export-led growth. Reforms included the elimination of price controls and state marketing boards, the liberalization of interest rates and the exchange rate, a major reduction in import tariffs and the elimination of non-tariff barriers, the reprivatization of the financial sector and other state enterprises, and a comprehensive tax reform, including the introduction of a value added tax (VAT) in 1992. As discussed in Section III, the Administration is maintaining and deepening structural reforms. Despite this impressive performance, a number of inter-related challenges remain, in terms of export competitiveness, fiscal policy, and savings.

9. **Export Competitiveness.** Export-led growth is a key aim of the Government's development strategy. A combination of wartime disruptions, adverse terms of trade and inappropriate economic policies led to a collapse of merchandise exports in the 1980s—from $1.1 billion in 1979 to only $497 million in 1989. Exports have increased rapidly in the 1990s, especially the past three years, to reach $1.8 billion in 1996. Part of this improvement was the result of favorable coffee prices but a larger share of the increase came from nontraditional exports to the Central American Common Market (CACM) and net *maquila* exports. Nontraditional exports to other markets, however, have grown more slowly. Despite this improved export performance, the trade deficit has remained high—13.7 percent of GDP in 1996—as imports have continued to expand rapidly, fueled by remittances, pent-up consumption and reconstruction needs following the advent of peace. Although the large trade deficit has been comfortably financed by remittances, export-led growth will require a considerable expansion and diversification of the country's export base.

10. Remittances have been a mixed blessing. They have helped to raise living standards and offset a gradual fall in external aid, but they have also caused a "Dutch disease" problem, posing a difficult macroeconomic policy dilemma. Remittances, which overwhelmingly finance consumption, have increased demand for imports and nontradables, and have led to real exchange rate appreciation. Real exchange rate appreciation has also limited profitability in agriculture, partly contributing to the stagnation of rural incomes and poverty. The adverse effects of a strong currency on exports have been offset by falling real wages and lower import tariffs on inputs and capital goods, which have kept exporters' costs down. Further real wage compression, however, would not be compatible with the consolidation of peace or with a longer-term competitiveness strategy. Seeking export competitiveness through lower wages is a short-term and defensive strategy. In the global economy, increasing interdependence and rapid technological changes have intensified competition to such an extent that wage reductions will not ensure longer-term competitiveness. Low labor costs in El Salvador will not continue to compensate for lower productivity, as technological changes raise productivity elsewhere, and as large suppliers with even lower wages aggressively enter international markets. There is only one way to enhance competitiveness and at the same time allow real wages to rise—sustained productivity growth.

11. The Government's strategy is to improve export competitiveness by addressing supply-side constraints through its competitiveness program and to tighten macroeconomic policies to strengthen the fiscal base and reduce inflation. Tighter fiscal policy, especially leading to a budgetary surplus, will be critical to increase domestic savings, free up resources for export expansion and to ensure that inflation can quickly converge to international levels, thus relieving pressure on the exchange rate and domestic interest rates. International experience shows that countries with a tight fiscal stance, including a budgetary surplus, have avoided the adverse effects of large foreign exchange inflows and to limit real exchange rate appreciation.

12. **Fiscal Strengthening.** Improved tax effort has played a major role in reducing the fiscal deficit. Current revenues rose from 12.2 percent of GDP in 1989 to 15.4 percent in 1996, regaining much of the ground lost during the 1980s. Tax revenues rose steadily from 8.6 percent of GDP in 1989 to 11.9 percent in 1996 as a result of improvements in administration and tax reforms—mainly the introduction of a VAT, initially set at 10 percent and raised to 13 percent in 1995, and income tax simplification. Current expenditures decreased from 14 percent of GDP in 1989 to 13.2 percent in 1996, helped by lower military expenditures, which fell from 2.3 percent of GDP in 1991 to 1.2 percent in 1995. Social spending has increased but remains substantially below pre-war levels. Capital expenditures have fallen from a peak of 6 percent of GDP in 1992—the first year of the National Reconstruction Program—to 4.3 percent in 1996.

13. Despite a considerable fiscal improvement, both tax revenues and expenditures need to rise if El Salvador is to lay the foundation for sustainable and equitable growth. While privatization will provide additional fiscal space, the country's precarious social conditions, and its large public security and infrastructure needs will require increasing the level and efficiency of public spending. A stronger tax effort will be needed both to generate a fiscal surplus as well as to permit a gradual expansion in social and

infrastructure spending. Despite recent improvements, public revenues remain among the lowest in Latin America due to low tax rates, a narrow base and high evasion. In addition, implementation of the Government's tariff reduction program would require additional revenue measures. Continuing efforts will be required to raise revenues, reduce exemptions, and improve tax administration to significantly increase compliance and reduce evasion.[1]

14. **Savings.** El Salvador's low savings rate is a serious constraint to export-led growth. Remittances stimulate consumption, thus substituting for domestic savings, and increase demand for non-tradables. Higher savings, public and private, are required to finance investment in the tradables sector and stimulate export growth. National savings have more than doubled compared to the 1980s, but they remain low fluctuating between 13 and 16.4 percent of GDP over the past five years. Domestic savings are far lower, fluctuating between 2.2 and 4.7 percent of GDP over the period. A strong fiscal effort increased public savings from -0.6 percent of GDP in 1992 to 2.1 percent in 1996. The Government expects that further tightening of fiscal policy, coupled with its pension reform program and continuing efforts to deepen capital markets would raise national savings substantially.

II. EXTERNAL ENVIRONMENT AND DEVELOPMENT PROSPECTS

External Environment

15. As a small open economy, El Salvador is vulnerable to adverse external developments. Two factors related to the external environment, however, will critically affect the country's economic prospects—vulnerability to a downturn in remittances and the impact of NAFTA.

16. **Remittances.** Should remittances decline abruptly the economy could face severe balance of payments pressures. A sudden drop in remittances precipitated by a massive return of foreign workers, while possible, appears unlikely. A more likely scenario is for remittances to continue growing, but at a decreasing rate, peaking over the medium term and then falling gradually over the next two decades as the links between migrants and their communities weaken. The vulnerability to a gradual fall in remittances is lessened by the fact that, as discussed above (para. 10), remittances themselves contribute to the high trade deficit. Thus, to a certain extent, a gradual fall in remittances would also reduce import demand and real exchange rate appreciation. The extent to which this self-correcting mechanism would work to offset balance of payments pressures, however, would depend on the supply response of tradables. The current account could adjust to a gradual decline in remittances, provided competitiveness can be significantly improved by removing supply-side constraints and diversifying export composition and markets.

17. **NAFTA.** Rapidly improving El Salvador's overall competitiveness is necessary not only to ensure a soft landing as remittances decline, but also due to increased competition from Mexico following NAFTA and the peso devaluation. The signing of NAFTA has raised serious concerns in Central America over its potential trade and investment diversion effects. For El Salvador, trade diversion would affect primarily clothing exports. Since both Mexico and El Salvador enjoyed GSP (Generalized System of Preferences) status before NAFTA, and since most agricultural products enter the U.S. tariff-free under GSP, trade diversion in agriculture is low. NAFTA will, however, erode the preference margin that El Salvador, as a member of the Caribbean Basin Initiative (CBI), enjoyed over Mexico. The adverse effects on El Salvador, however, are not expected to be large, for two reasons: (i) El Salvador has taken little advantage of free access to the U.S. market under CBI; and (ii) most textile and clothing items relevant for El Salvador are excluded from CBI. Trade diversion in the apparel sector is likely to occur as a result of the elimination of U.S. tariffs rather than quotas on Mexican exports. El Salvador has not had textile or clothing quotas on exports to the U.S., with one exception. NAFTA parity for CBI textiles and clothing has been under consideration in the U.S. Congress, but passage remains uncertain.

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[1] World Bank, *El Salvador: Meeting the Challenge of Globalization*. Report No. 14109-ES, October 19, 1995.

18. While the fallout from trade diversion is expected to be relatively small for El Salvador, the diversion of foreign investment following NAFTA is potentially larger. The fear is that those foreign companies who aim to take advantage of low-cost labor while having access to the U.S. market will now opt for Mexico rather than Central America. Entering a free trade agreement with Mexico, as El Salvador is attempting to negotiate, could help increase access to a market many times the size of CACM. However, market access counts for little, if a country is unable to take advantage of it. Just as El Salvador has been unable to significantly increase its exports to the U.S. under the CBI, it has also not taken advantage of the limited unilateral tariff preferences extended by Mexico since the early 1980s.

Economic and Social Outlook

19. The medium term will be critical for El Salvador. Growth slowed to 2 percent in 1996 due to two factors. **First**, the immediate cause was the tightening of monetary policy in 1995 to contain a credit boom that emerged earlier in the year. The boom was fueled by the elimination of reserve requirements on commercial banks' external borrowing and the rapid expansion of private credit, which led to a bank-financed import boom. To slow credit expansion, the Central Bank reimposed reserve requirements on dollar-borrowings in September 1995 and raised interest rates on its stabilization certificates, eventually choking off monetary expansion but also causing a recession in the first half of 1996. **Second**, although the economy is expected to recover in 1997, over the medium term it is unlikely to replicate the high growth rates of the post-war period. Pent-up consumption and reconstruction-driven investment fueled the initial recovery, but as these effects tail off, domestic demand alone will not be able to sustain GDP growth above 4-5 percent. Longer-term growth prospects will depend critically on ensuring macroeconomic stability, and the extent to which implementation of the Government's reform program can lead to a marked increase in productivity and savings, and reduced poverty. Base case projections (Annex A5) suggest that implementation of the Government's development agenda would lead to a gradual recovery in growth, averaging 4.8 percent over the next three years, rising to a plateau of 6 percent into the next century.

20. As discussed in the next section, implementation of the Government's development agenda will require a significant degree of social consensus, without which political and social pressures could severely test the Government's resolve. A low case scenario was developed to examine the implications of more modest progress on the development agenda. It assumes the Government faces a more difficult political environment, which slows implementation of its program, especially strengthening fiscal revenues and privatization. Growth stagnates at 2-3 percent over the medium term, fiscal and monetary policies would be somewhat looser, and poverty and social indicators would deteriorate due to falling per capita incomes and increased constraints on social spending. Lower income and import levels would help relieve balance of payments pressures, provided remittances did not fall significantly.

III. GOVERNMENT DEVELOPMENT STRATEGY

21. **Vision and Challenge.** Moving from consolidation of peace to sustainability is El Salvador's overriding development challenge. Economic, social and political achievements since the end of the conflict provide a solid foundation on which to build a lasting peace, but the remaining challenges are formidable. Competitiveness is at the center of the Government's vision for the country. El Salvador has to see the whole world economy as the basis for its economic organization and productivity. The Government's concept of competitiveness, however, is broader than merely inserting the country into the global economy—it must involve competitiveness for all. This vision also drives the way in which the Government views poverty reduction and social development. To ensure broad-based growth, the poor must be fully integrated into the competitiveness drive, both benefiting from and contributing to overall productivity. This will clearly require special efforts, but they must be geared to empower local communities to become more productive and self-sustaining, rather than waiting for the benefits of growth to trickle down or relying on social transfers from above to compensate for the poor's low productivity. The challenge will be to translate this vision into

concrete policies, actions and institutional mechanisms that can generate sustainable growth and improved living standards for the country as a whole.

22. The Government's central vision of competitiveness for all has important implications for the way it views society. The heart of all future gains in productivity and wealth creation will be knowledge—not cheap labor or natural resources. This involves viewing society as a learning nation, which not only requires improving the education system, but also broadening society's access and connections to all sources of information and knowledge. Creating a learning society and empowering communities to solve their problems also involves rethinking the types of institutions that can support this process. The Government believes that institutions must be radically transformed—from vertical and hierarchical structures to horizontal, participatory and networked institutions. It is only by adopting this horizontal view that all parts of society can be productively connected to the knowledge revolution and empowered to effectively participate in the development process.

23. The Bank's strategy for El Salvador is articulated in terms of meeting four interrelated challenges which flow from the vision of competitiveness for all: (i) social development—reducing poverty and increasing human capital; (ii) improving environmental management; (iii) enhancing competitiveness; and (iv) modernizing the public sector.

Social Development—Attacking the Root Causes of the Conflict

24. **Overall Social Strategy**. A lasting peace will not be possible without a marked improvement in the social condition of the majority of Salvadorans. The Government believes that its aim of enhanced global competitiveness must be firmly grounded on a well-educated, skilled and healthy workforce. At the same time, unless poverty can be effectively addressed globalization will leave behind a large part of the population, undermining support for the effort to create a competitive economy.

25. **Reorienting the Government's Poverty Reduction Strategy Toward Local Development.** To date, the Government's social strategy has followed a three-pronged approach, in line with the recommendations of the Bank's Poverty Assessment (Annex B)—high economic growth, improved access to social services, especially basic education, and a strong social safety net centered around the Social Investment Fund (SIF). Although the social safety net has been effective and reforms in basic education are pathbreaking, the Government believes this strategy will not be enough. The SIF has largely concentrated on delivering basic social and physical infrastructure to poor communities, but the Government is concerned that unless these investments can be made sustainable, progress in poverty reduction will be slow to materialize. Once some basic infrastructure is in place, pulling households out of poverty requires generating sustainable income and employment opportunities. Without higher incomes and jobs, social transfer programs, such as those supported by SIF, are not sustainable. In turn, the poverty alleviation benefits of improved basic education and health can only be expected to materialize over the longer term.

26. Making communities competitive will require expanding the coverage and quality of basic social services but, more importantly, also ensuring that these investments are sustainable by raising the productivity of communities. The basic idea is to move away from a vertical, top-down identification of isolated poverty-related interventions, to a more horizontal and integrated approach based on the communities' own capacity to find solutions to their problems and create wealth. At the core of this strategy is a transformation of the Government's traditional SIF into a facilitator of local development, extending in an important way the Poverty Assessment's recommendations for strengthening the social safety net. While the new SIF (the re-named Social Investment Fund for Local Development—SIFLD) will continue to meet community demand for basic social and physical infrastructure, it will increasingly focus on local development needs, acting as a catalyst to encourage private investment at the local level, offering technical support to develop the entrepreneurial capacity of communities, strengthening and developing municipal and community planning capabilities, and forging partnerships and clusters with the private sector, NGOs and

municipalities to generate employment and incomes. SIFLD would not finance productive activities directly, instead acting as a connector and facilitator, subcontracting implementation to NGOs and communities. SIFLD, which has absorbed the programs managed by the Reconstruction Secretariat, will also continue efforts to improve the capacity of municipalities currently supported under IDB, USAID and KfW programs.

27. ***Bank Support.*** The Bank would support the Government's strategy through a proposed SIFLD Project, in partnership with IDB and KfW. During 1996, the Bank, Government and key donors have carried out intensive discussions on the proposed SIFLD. This process included a two-day workshop in San Salvador organized by IDB and the Government, where the new approach was first discussed with Government representatives, the Bank and key donors. This was followed by a three-day brainstorming session in Washington with the Minister of Finance, the newly-appointed head of SIFLD and key Government officials, to discuss the overall strategy and design issues. As part of these sessions, the Bank and the Embassy of El Salvador convened a meeting of representatives of the Salvadoran community in the Washington area with the Government delegation to explain the new approach and explore areas of potential collaboration. An interesting idea that emerged from these discussions and which is being followed up by EDI, will be to connect through the Internet high schools in the Washington area that have large numbers of expatriate Salvadoran children with schools in El Salvador. In addition, El Salvador is included in EDI's Partnerships for Poverty Reduction Program, which seeks to analyze and disseminate successful partnerships among NGOs and the private sector. The proposed strategy of local development was also a key theme in the Bank/NGO meetings in October in San Salvador (Annex C). The overall strategy and concept were generally well received, although a number of issues were raised which will need to be addressed in the design phase. These included ensuring wide representation of non-Government stakeholders, avoiding politicization of the new Fund, encouraging effective community organization and participation, and the importance of strengthening the capacity of communities and municipalities, especially in poorer rural areas.

28. **Rural Poverty.** Although there is considerable debate in El Salvador on the extent of and solutions to the poverty problem, there is broad agreement that poverty in rural areas deserves close attention. Much of the debate has centered on the poor performance of agriculture, which has lagged far behind the impressive recovery of other sectors. Real exchange rate appreciation is a major factor behind low profitability in the farm sector but other factors are also important (*e.g.*, domestic marketing constraints, international prices). The rural economy, however, extends well beyond agriculture. The non-agricultural rural sector is heterogeneous but plays a key role in terms of income and employment generation. While this sector has not received the same attention as agriculture, there is a growing appreciation of its potential in terms of poverty alleviation and growth more generally. The Bank's ongoing Rural Development Study shows that about 36 percent of the economically active population in rural El Salvador is employed in the non-agricultural sector, with high participation of women—nearly three quarters of economically active women in rural areas are employed in the non-agricultural sector. The least poor in rural areas are households which are heavily engaged in the non-agricultural sector, while the highest incidence of rural poverty is observed among households engaged in agricultural labor and farming, whether landed or landless.

29. Improving agricultural growth and productivity remains a priority, but sustained progress in poverty reduction will also require increasing access by the poor to non-agricultural rural activities which can yield higher and more stable incomes. Moreover, it is difficult to see how improvements in natural resource management could be achieved and sustained without simultaneously addressing the underlying causes of rural poverty. A growing and dynamic rural sector, in turn, needs to be a key pillar of the Government's longer-term competitiveness and social development strategy. The Government's poverty reduction strategy, based on an integrated approach to local development, aims to place increasing emphasis on the generation of jobs and incomes in the non-agriculture rural sector, but it also needs to be complemented by a strategy to reactivate agriculture and improve natural resource management at the community and farm levels.

30. ***Bank Support.*** The Government plans to use the results of the Bank's two ongoing studies on Rural Development and on Rural Finance as the basis for a national dialogue on a longer-term strategy for agricultural and rural development. The Bank would support the emerging national agenda through a proposed Rural Development and Natural Resource Management Project. Although details would depend on the Government's redefined strategy and priorities, Bank support could focus on facilitating investment flows to the rural sector, encouraging the diffusion of information for production and exports, strengthening community organizations and their integration into clusters for better access to business opportunities and marketing chains, improving natural resource management working through municipalities and communities at the farm level, and strengthening rural credit systems. Given that a rural development and natural resource management strategy would necessarily cut across sectors and Ministries, it may be necessary to unbundle Bank support into several, smaller and coordinated operations. The Government would like to move quickly with reforms to the rural credit system, in order to expand credit access by small farmers.

31. **Human Capital—Education and Health.** Improving human capital will require increased public spending in the social sectors and more efficient service delivery. Education and health spending has increased in recent years—from 1.8 and 0.9 percent of GDP respectively in 1991, to 2.2 and 1.4 percent in 1995—but still represents a significant underinvestment in human capital. Considerable scope exists for further increasing budgetary resources for the social sectors. The Government aims to raise the social sector share from 30.2 percent of budgeted outlays in 1995 to 50 percent by 1999. Since 1989, the Government has made great progress in rehabilitating the **education** system, especially basic education, which was severely affected by the conflict. A key program has been the community-managed school (EDUCO) program (Box 1) and improvements in the delivery of basic education (pre-school through grade 6) in rural areas

Box 1: Letting Communities Manage Schools in El Salvador—the EDUCO Program

During the conflict, many rural areas had no public education. By 1989, national enrollment in basic education was only 76 percent and 1 million children were not in school. In response, some communities began organizing to hire teachers from their own resources and fix schools. Recognizing the potential, in 1991 the Government decided to develop a community-based approach to expand basic education in rural areas through its EDUCO (*Educación con Participación de la Comunidad*) program, supported by the Bank's Social Sector Rehabilitation Project.

Self-management makes this program distinctive. Schools are operated by parents organized in a locally-elected community education association (ACE). ACE hires and fires teachers, following Ministry of Education (MOE) selection guidelines, closely monitors their attendance and performance, enters into annual contracts with MOE and receives funds monthly to cover teacher salaries and operating costs. MOE provides teaching and learning materials and teacher training programs; ACEs provide classroom space, furniture and school maintenance.

The overall costs of the program appear to be slightly higher than for traditional schools, but the benefits seem to more than compensate. Enrollments under the program have increased significantly, especially in former conflict areas. In 1991, there were 8,416 students enrolled in EDUCO schools; by 1996 this had grown to 168,928 students, accounting for about 41 percent of rural enrollment at the pre-primary and basic levels in public schools and about 20 percent nationally. ACEs increased from 236 to 1,700 and EDUCO teachers from 263 to 3,884 over the period.

What of student performance? Despite class sizes averaging 36 students, compared with 30 in nonprogram schools, and the fact that students are among the poorest, performance stands up well against traditional schools. A recent evaluation showed that test scores in language and math were similar to those of students in traditional (urban and rural) schools. In some cases, (*e.g.*, math for 1st and 2nd graders) scores were significantly better. Teachers in EDUCO schools use more innovative practices and expose their students to more group and pedagogical games that teachers in traditional schools. Most EDUCO teachers also have better attendance records, spend more hours in the classroom and develop close links with the community.

32. Government priority has appropriately focused on basic education, as recommended in the Poverty Assessment, but as reforms take hold, there is an increasing need to consider constraints at the secondary level. Higher enrollments and completion rates, coupled with a growing demand for skilled labor, will soon begin to exert pressure on the secondary level, where coverage and quality are low. Only about one quarter of 15-19 year-olds are enrolled in secondary schools—less than half of the enrollment rate in the region. About two-thirds of the labor force is unskilled, with an average of 4.4 years of education, about one fourth has no formal education, and only 12 percent has more than 10 years of schooling. Rural areas account for only 6 percent of all secondary schools.

33. Although the health status of the population is improving, health indicators lag considerably the rest of the region. Access to health services is geographically uneven, equity objectives are far from being met, the quality of service delivery is administratively and clinically poor, provider efficiency in the public sector is low, and costs are high relative to outcomes The Government initially assigned high priority to health reform as part of its overall development strategy, in line with the Poverty Assessment, but the process of developing a sector strategy and reform program has been slow. It has proven difficult to agree on reform priorities, identify new alternative health delivery models, and reach consensus among public and private sector actors involved in the health sector.

34. Because of these difficulties, the Government has decided that health reforms should proceed in phases based on a 10-year plan. Under the first phase, to be implemented over the next two years, the emphasis would be on preparing the sector for reform through studies and pilots that could show concrete results. The second phase would take place in years 3-5, and would expand successful pilots for contracting services, define the role of the social security agency (ISSS) and private health insurers, expand new cost-control mechanisms and improve training. The third phase would take place in years 5-10, when the Ministry of Health would have a policy-setting and regulatory role, hospitals would operate autonomously, competing and providing high-quality services, a new system for health insurance would be in place with increased private participation, and successful models for contracting health services would be the norm.

35. ***Bank Support for Education and Health.*** The **education** sector will remain a priority in the Bank's assistance strategy. We will maintain our support for basic education through the ongoing Basic Education Modernization Project but, in line with the Government's sector strategy, will broaden our support by focusing on improving and decentralizing secondary education. The ongoing Secondary Education Study will assist the Government define a longer-term strategy, to be supported by the proposed Secondary Education Modernization Project. This will include the expansion of coverage in rural areas, improvements in cost effectiveness, the role of the private sector, improved content and relevance of the curriculum, and increased attention to the needs of female students. In addition, EDI will support dissemination of El Salvador's experience with the EDUCO program and organize study tours for Salvadorans to learn from the educational reform experience of New Zealand and Australia. The first phase of the **health** reforms would be supported by IDB through a Technical Assistance (TA) operation. The Bank would participate through policy advice followed by a Health Reform Project to support the second phase of reforms. EDI would support these reform efforts by including El Salvador in the Regional Seminar Program on Health Sector Reform and Sustainable Financing. IDB would continue as the lead donor in the health and sanitation sector.

36. **Gender.** In 1996, the Government created the Salvadoran Institute for Women's Development to act as an advisory body on issues affecting women, replacing the previous Women's Office in the Secretariat of the Family (SNF). At a seminar held in May 1996, the Government endorsed the recommendations and strategies proposed by the Bank's recent gender study,[2] which proposed three strategic goals: (i) raising overall educational levels, taking into account male and female determinants of educational attainment; (ii) balancing men's and women's economic opportunities by, for example, ensuring that credit schemes and financial services are adapted to consider male and female needs; and (iii) eliminating negative gender stereotypes through educational and media

Box 2: Violence Against Women

Violence, particularly domestic violence, against women and girls, is an increasing concern in El Salvador. According to SNF, 60 percent of girls who reported an aggressive first sexual experience were under 15. SNF studies also indicate that close to a quarter of rape and sexual crimes are related to incest. Over half of violent sexual acts reported to the Office of the Human Rights Ombudsman involved girls under 14. In 1995, ISDEMU set up a 24-hour toll free number for women affected by domestic violence. Over the past year it received 10,072 calls. In addition to providing immediate police, medical and legal protection, it provides social and psychological counseling to the victim as well as the aggressor.

[2] World Bank, *El Salvador, Moving to a Gender Approach: Issues and Recommendations*, June 12, 1996, No. 14407-ES.

channels. In addition, the Government requested Bank support to incorporate a gender approach in its ongoing public sector modernization program.

37. Within government line agencies, the National Center for Agricultural Technology (CENTA) stands out as an institution where the gender approach is being adopted in practice. In 1994, CENTA adopted a plan to mainstream gender in its operations, which included: (i) eliminating its segregated women's program, which had previously limited women's access to extension services; (ii) revising CENTA's policies to reflect gender differences in agricultural production; (iii) revising extension methodologies to include gender analysis; (iv) adding crops predominantly grown by women to its research agenda; and (v) including gender in staff job descriptions and training programs. CENTA's efforts represent a good beginning—the challenge will be to mainstream gender concerns throughout public sector structures.

38. ***The Bank's Gender Strategy.*** In addition to targeted interventions through its ongoing and proposed projects, the Bank's strategy is to promote gender through institutional development and public sector modernization. The aim is to encourage institutions to become more client-oriented and, within this framework, to consider the needs of a gender differentiated population It is promoting this approach through three mechanisms. **First**, the Bank will sponsor a seminar for staff of the Presidential Commission for Public Sector Modernization on gender issues and implications of the modernization process. Depending on the outcome of the seminar the Bank would provide technical assistance to the Commission to incorporate a gender variable in activities such as staff training and client service delivery surveys. This strategy is somewhat innovative, because it deviates from the standard approach of justifying gender on equity grounds, which tends to create cultural resistance. The strategy would promote gender as an integral aspect of public sector reform, on the premise that institutions should be more client-oriented and accountable to male and female populations with different needs. **Second**, CENTA will participate in the Bank's Gender and Institutional Innovation Program (GINO)—a two-year research effort designed to identify institutional constraints to gender responsiveness and institutional change processes that make organizations more accountable to male and female client groups. **Third**, gender will be incorporated in the IDB/ECLAC/World Bank project to improve living standards surveys, of which El Salvador is one of the pilots. For gender data to be meaningful for policy and improved targeting, we need to know more about household dynamics and their interactions with the economic, social and political environment. This will involve holding in-country workshops, assisting in the design of a subset of household survey questions on gender and intrahousehold income distribution and consumption, and developing models to better analyze gender within the household.

39. In addition, sector-specific gender issues are being addressed through the ongoing Basic Education Modernization Project. In line with the Gender Report's recommendations, the project is providing career guidance programs to reduce gender stereotypes in the labor force, revising curricula to include sex education as a strategy for reducing teenage pregnancy and the incidence of sexually transmitted diseases, reducing gender stereotypes in school texts, and including gender issues in teacher training. This approach will be extended to the secondary level through the proposed Secondary Education Project. The proposed Health Project would support public education efforts targeting domestic violence and consider support for agencies and NGOs providing counseling services to women affected by domestic violence and rape.

Improving Environmental Management—Making Economic Growth Sustainable

40. El Salvador faces severe environmental degradation. Due to population pressure and agricultural encroachment on forest and marginal lands, only 2 percent of primary forest cover remains and only 12 percent of the territory has any forest cover. The country's topography is rugged and about 65 percent of the land is non-arable, with slopes of over 12 percent. The destruction of forests has contributed to soil erosion, affecting productivity growth and limiting the capacity of aquifers to absorb rain water. Soil erosion affects about one half of the territory, exacerbating seasonal flood damage. Inappropriate pesticide use, and industrial and municipal effluents affect crops and fisheries, contaminating drinking water, and aggravating the incidence of gastrointestinal disease. The problem of natural resource degradation is inextricably linked

with rural poverty. In the early 1990s, 87 percent of farm units cultivated basic grains in plots of 3 ha or less. The overwhelming majority of these farmers are below the poverty line. At the same time, between 60 and 70 percent of basic grains cultivation occurs on steep slopes, which exacerbates soil erosion, affecting farm productivity and causing severe environmental effects. Poor subsistence farmers thus contribute to environmental degradation and also suffer the most through low yields and productivity. In addition, rapid urbanization has outstripped the public sectors' capacity to provide infrastructure and services. About half of all urban solid waste is not collected, while rural municipalities have no waste disposal capacity.

41. The lack of an appropriate institutional and legal framework for the environment, as well as unrestrained urbanization are major concerns raised by NGOs and stakeholders. The Government acknowledges this lack of progress, especially in terms of strengthening environmental institutions and policies. The Environment Secretariat (SEMA) in particular has lacked a clear institutional mandate, work program and adequate funding. A comprehensive Environmental Law was submitted to the Assembly during the previous Administration but was not approved due to lack of political consensus. The current Administration submitted a revised Law in late 1996 which is expected to be approved by March. The Government has also decided to place SEMA in the Office of the President, to give it the necessary status and visibility, and will have adequate funding to enable it to perform a more active role under the new legal framework. This work is being supported by IDB's Environmental Program and USAID's Green Project. In addition, IDB will also continue actively involved in strengthening the capacity of municipalities to deal with environmental and urban development problems. Over the next three years, IDB will also consider operations to support decontamination in critical areas and a program to manage and preserve coastal areas.

42. ***Bank Support.*** IDB and USAID will continue to take the lead in addressing policy and institutional environmental issues. The Bank will focus on three complementary areas: land titling, environmental consensus-building, and natural resource management at the farm level. The Bank's ongoing Land Administration Project is supporting regularization of land registration for the country's estimated 1.6 million urban and rural parcels, and the development of a self-sustaining national land registry and cadastral system. Greater land security should lengthen farmers' planning horizon and improve access to credit, thereby improving incentives for soil conservation investments and income diversification. The Bank will also complement IDB and USAID environmental programs by assisting to build national awareness and consensus on broad environmental issues. The dialogue and consensus-building efforts will be supported by EDI through its Regional Program on Economy-Wide Policies and the Environment, and a proposed National Environment Seminar. The latter would involve working with stakeholders to explore the application of the policy-oriented action impact matrix (AIM) to land degradation issues. In addition, the Bank's proposed Rural Development and Natural Resource Management Project will consider support for improved natural resource management practices, working at the municipality and farm levels.

Enhancing Competitiveness—The Road to Globalization

43. **The Competitiveness Agenda.** Although economic recovery has been impressive, per capita GDP remains below pre-war levels, economic expansion has been led by the nontradable sectors, and merchandise exports, although growing, remain substantially below levels in the early 1970s. High growth needs to be sustained but it must also be broad-based to reduce poverty. The Government's strategy is to shift El Salvador's competitive base from low-cost labor to high productivity—moving from a comparative to a competitive advantage. It believes that higher productivity growth lies in enhanced competition, improved infrastructure, investment in human capital and access to knowledge. The Competitiveness Program, supported by the Bank's ongoing Competitiveness Enhancement TA Project, has three major components: (i) improving the business environment by adopting a new Investment Law, consumer protection legislation, private sector provision of infrastructure services, deepening of financial and capital markets, deregulation of remaining barriers to trade, development of a cluster-based approach to key sectors and reform of legal registries; (ii) improving technology absorption through quality enhancement (ISO 9000 program), and

strengthened technical training policies; and (iii) building a national consensus on the competitiveness agenda through a public information program and study tours to evaluate international experience. Study tours to East Asia and the Pacific organized by EDI have played an important role in familiarizing a cross-section of Salvadoran society with successful reform experiences. EDI will organize a third study tour in 1997 and is working on developing a network and permanent forum to ensure follow-up after the visits.

44. **Financial and Capital Markets.** A priority of the Government is to ensure that the financial sector facilitates productivity-based growth. Although as described in Annex D, the financial sector appears to be sound and relatively efficient, more diversified financial and capital markets will be needed to improve the ability of internationally-oriented firms to finance expansion. Deeper and more diversified markets will also be essential to provide more varied and attractive investment vehicles for the contractual savings sector, complementing the role of the new private pension funds in improving the environment for private savings (para. 55). The ability of small and medium-scale enterprises to underpin broad-based growth will also depend on improved access to financing. In this context, it will be important to improve the regulatory environment for development of non-lending financial services such as leasing and factoring.

45. ***Bank Support.*** Advice and technical assistance for the financial sector is a major component of the Bank's support for the Government's competitiveness agenda. During 1996, the Central Bank adopted most of the Bank's recommendations for improving payment systems. A study on Strategic Options for Financial Sector Development is underway, supported by the Bank's Competitiveness TA Project, which is reviewing the banking legal regulatory framework, development of securities markets, access to financing by small and medium enterprises, leasing and factoring. Technical support for capital markets will be provided through a joint Bank/IFC program during 1997. The Bank has also maintained an active dialogue on management of financial crises, and is supporting a series of studies on intervention and resolution of failed banks, lender-of-last-resort facility, and deposit insurance. IDB has played a key role in strengthening prudential supervision, and will continue to take the lead in programs to improve credit access for small-scale enterprises.

46. The Government has identified access to information and knowledge as a key element in its competitiveness and social development strategy, and has requested Bank support for the development of a learning society. This is a new area for the Bank and the modalities for specific support have yet to be defined. As a preliminary step, we have agreed with the Government on the preparation of a National Knowledge Assessment. The Assessment would pilot the conceptual framework presented in the recent study commissioned by FPD from the U.S. National Research Council (NRC).[3] During initial discussions with the Government and NRC, it was agreed that the basic framework proposed in the study would be followed but expanded beyond a focus on enterprises to encompass community development needs. The results of the Knowledge Assessment would be used to prepare a proposed Learning Society TA Project.

47. During the Bank-NGO dialogue in October, it became clear that while most stakeholders understand the need and rationale for a competitiveness strategy that supports rapid growth and increased productivity, there is a concern that parts of society will be left behind. Unless complemented by strong social policies, the strategy could lead to increased inequality and marginalization of poor communities, especially in rural areas. The Government and the Bank share these concerns, and as part of CAS preparation have been discussing ways to ensure a fuller integration of the social and competitiveness agendas. The cluster-based approach, which is being applied to economic sectors such as coffee, tourism and the financial sector, will be extended to encompass wealth-creating and community development initiatives in line with the Government's vision of competitiveness for all. The goal is to approach cluster-based competitiveness simultaneously from the top (industrial or sectoral clusters) and the bottom (local and rural development). As part of this process, the Bank team working on the design of the new SIFLD includes staff working on the Competitiveness project. The aim is to tap Bank expertise in private sector development to assist in the design of a SIFLD focusing on clusters of local productive activities. In addition, the Bank and the Government are exploring ways to

[3] National Research Council (1996). *Prospectus for National Knowledge Assessment.* Washington, D.C. National Acad. Press.

involve the overseas Salvadoran community, not only to support community development, but also to establish marketing and investment links that can open opportunities for their exports.

48. **IFC** is playing a key role in support of the competitiveness program. El Salvador was chosen as one of the countries in IFC's Extended Reach Initiative pilot program. The program includes the establishment of a field presence, which will deepen IFC's understanding and links with smaller private sector firms. It also includes a separate financing facility, the Small Enterprise Fund, which will enable IFC to make smaller investments in a less costly and timely manner. In particular, the Initiative is expected to lead to new investment opportunities in export-oriented manufacturing and small agro-based activities. In its regular activities, IFC will continue to emphasize modernization of local industries which can become internationally competitive, such as a large cement investment approved recently. Over the next three years, IFC will also seek opportunities to assist in the development of physical and financial infrastructure, both in El Salvador and across Central America. In physical infrastructure, IFC has made two telecommunications investments in El Salvador, and will explore possibilities in power generation (particularly in cogeneration from sugar mills, where IFC has been a pioneer in the region) and transport. IFC stands ready to provide technical assistance as the privatization framework for infrastructure is being put in place and is prepared to consider financial assistance to meet post-privatization rehabilitation and expansion needs. It is also participating in the joint IBRD/IFC/MIGA task force examining the issue of inter-country power trading, and could play a role where such trading takes place between private utilities.

49. In the financial sector, IFC aims to assist firms which are constrained by the relative lack and cost of capital for expansion, and expects to assist export-oriented businesses through one or more commercial bank credit lines. The Bank and IFC have both been requested to assist in capital market development, and are coordinating their approach under the framework provided by the Strategic Options study (para. 45). At the request of the Central Bank, IFC has been advising on the design of the private pension law, and may support one of the pension fund management companies with equity capital and help in bringing a technical partner. IFC may also provide technical assistance on mortgage securitization. IFC expects to support regional initiatives to create an active Central American stock market, including a possible regional rating agency and proper clearing and custody mechanisms. It would also support financial groups which are looking to expand regionally, with equity capital and long-term debt facilities.

50. **FIAS** is supporting the Government's Competitiveness Program, in four areas: (i) design and drafting of a new Investment Law; (ii) institutional design and automation of a "one-stop-window" for the facilitation of investments; (iii) development of an investment promotion strategy; and (iv) institutional design and operating strategy for a joint private-public investment promotion agency.

51. **MIGA**. El Salvador has been a member of MIGA since 1991. MIGA has one ongoing operation with one guarantee for $9 million. MIGA has received 4 Preliminary Applications for investments in power, telecoms, and manufacturing. In addition, El Salvador will participate in MIGA's program to promote foreign investment in the region's tourism sector. MIGA is also discussing with the Government ways to make better use of its Internet-based information dissemination facility (IPAnet) to promote El Salvador's image, target foreign investors and improve the access of prospective investors to country information.

Modernizing the Public Sector—Improving Service Delivery in a Competitive Economy

52. The Government is aware that the current structure of the public sector, and its inability to deliver adequate and efficient services would be a hindrance in its efforts to implement the social and competitiveness agendas. Despite considerable political and economic progress in past years, El Salvador's public sector still suffers from major weaknesses: (i) an overextended and centralized state; (ii) low efficiency caused by its organizational structure, weak financial and human resources management, and low professionalization of the civil service; (iii) poor service delivery; and (iv) and inadequate administrative infrastructure and equipment.

53. Under the Government's Public Sector Modernization Program, the state will withdraw from activities that can be better left to the private sector. The aim is to create a leaner yet stronger state, with overriding responsibility for implementing social policies and facilitating private sector-led development. Public sector functions are being pared down to a set of strategic social and economic management tasks, including: (i) strengthening capacities to formulate and implement public policies, focusing on poverty reduction, human capital development and environmental protection; (ii) managing a legal and regulatory framework that assures competition, efficiency in markets, and the rule of law in civil society; (iii) leading the country's integration in the global economy; and (iv) delivering or contracting for delivery only those services with public good attributes that the private sector should not be expected to provide.

54. Privatization of the telecoms company (ANTEL), the power company (CEL), and the pension system are key elements of the Government's reform program. These are to be followed by privatization and concessioning in water, ports and airports. Recently-approved legislation includes the break up of ANTEL into two companies, which would be sold separately to ensure competition, and opening the sector to new entrants. In the power sector, recently-approved legislation permits privatization of power distribution companies and opening of the sector to all forms of private investment in generation, transmission and distribution. The Government intends to use revenues from privatization largely to finance investments in human capital and infrastructure. In water, the Government is working on legislation to establish a regulatory framework for the sector and aims to promote private sector involvement in the operation of water and sanitation services. The Bank has not been involved in the water sector, where IDB has been the major donor with two ongoing projects totaling $214 million, and a proposed project to expand water coverage.

55. Pension reform legislation approved in December 1996 will convert the current pay-as-you-go system into a fully-funded system with individual accounts managed by the private sector. The current system does not impose a fiscal burden, but through privatization the Government aims to increase the presently low coverage and provide a strong stimulus to private savings. El Salvador's pension system is not very large, so it would not require very active trading in financial instruments initially. Deeper capital markets, however, will be required for the system to expand and ensure competition. As discussed above (para. 41) the Government is considering options to widen the availability of financial instruments and stimulate capital markets. Moreover, pension reform is being implemented in concert with the privatization program, which the Government expects will considerably boost the stock market in the near term. Several major offerings are planned for the telecoms and power sectors in 1997, to coincide with the start of private pensions.

56. ***Bank Support.*** IDB will continue to take the lead in financing investments in infrastructure and urban development. Given IDB's heavy involvement, we do not foresee Bank financing for infrastructure. The Government views the Bank Group's comparative advantage in the field of policy advice, particularly in attracting private participation and establishing appropriate regulatory frameworks. Several parts of the Bank Group, including FPD and IFC, have provided and will continue to provide, advisory services on privatization and regulatory frameworks. EDI will organize a National Seminar on Privatization and Public Sector Management, to disseminate best practices and build domestic support. Two recent Bank projects, the Competitiveness Enhancement and Public Sector Modernization TA Loans (the latter cofinanced with IDB) are supporting the development of appropriate regulatory frameworks, restructuring and privatization of public enterprises. A Power TA Loan and the recently-approved Energy Sector Modernization Project are supporting preparation and implementation of a regulatory and legal framework for the sector, restructuring of CEL, and establishment of a wholesale market for power. Depending on progress made in the privatization agenda, the Bank would consider additional technical assistance beyond ongoing operations. A follow-on Public Sector TA Project could be considered, focused on support for appropriate regulatory and institutional structures in water, ports and airports, provided there are unmet needs in these sectors.

57. A guarantee operation to facilitate major private sector investments in infrastructure would also be considered. The Government has indicated it would be interested depending on the investments in question. Preliminary discussions suggest a guarantee could be considered in: (i) water supply and sanitation; (ii)

power generation, particularly the development of hydro or geothermal resources, which have longer payback times; and (iii) ports. A specific guarantee would be discussed with the Government as the privatization process advances and there is a better sense of private sector interest and financing options.

IV. BANK GROUP COUNTRY ASSISTANCE STRATEGY

Progress Since the Last CAS

58. **The Previous Strategy.** The CAS for El Salvador, presented to the Board in September, 1993, argued that the overriding priority was to consolidate peace and deepen economic reforms in order to achieve a permanent turnaround in social and economic development. The aim was to transform the country from a war-driven, highly-divided society, to one based on greater economic and social participation, with a dynamic market-based economy. It identified four challenges in addition to ensuring a stable macroeconomic environment: (i) modernizing the public sector; (ii) creating an enabling environment for private sector and export-led growth; (iii) reducing poverty and investing in human capital; and (iv) strengthening environmental and natural resource management. The CAS aimed to support the Government meet these interrelated challenges, recognizing that not all interventions would directly address each challenge.

59. **Implementation.** CAS implementation was to be judged on: (i) an appropriate macroeconomic framework, emphasizing prudent fiscal policies, and continued progress in reducing the fiscal deficit and improving public savings: (ii) successful implementation of the reform program supported by SAL II; (iii) implementation of a comprehensive public sector reform program; and (iv) continued Government commitment to poverty alleviation and improved environmental management. In addition to external risks, the CAS identified the main risks confronting the program as political and institutional. Political risks were related to the change in Government and the possibility that a new Administration would face a more politically diverse Congress, making it more difficult to mobilize domestic support for stabilization and adjustment. There was also a risk that public sector weaknesses could constrain program implementation.

60. **Results.** As discussed in Section I, the Government has maintained an appropriate macroeconomic framework, including a lower fiscal deficit, continued expansion in the tax base, and increased public savings. Reforms supported by SAL II were successfully implemented and the Government is continuing efforts to deepen and expand the structural reform process. Moreover, although the CAS envisaged possible Bank support for the reform program through further adjustment lending, the Government has requested only technical assistance to support its reform agenda. A key element of the reform effort has been a comprehensive Public Sector Modernization Program, which although subject to some initial delays due to the change in Administration and the establishment of a new economic team, is under implementation. The Government has not only maintained a strong commitment to poverty alleviation, but it is also reformulating its strategy, adopting a more comprehensive approach to poverty reduction and social development, seeking full complementarity between its economic and social agendas.

61. Improving environmental management, however, has been a major weakness. There has been little improvement in strengthening environmental management and policies. This has been due in large measure to the lack of clarity or absence of a comprehensive strategy for rural development and natural resource management and, as yet, failed attempts to establish an appropriate legal and institutional framework for the environment. A comprehensive Environmental Law was submitted to the Assembly during the previous Administration but there was little political consensus and eventually could not be approved. The current Administration, begun working on a new Law during mid-1996 and resubmitted a revised draft toward the end of last year. The current version has also been controversial, with much of the debate centering on the relative balance between the extent and severity of penalties for environmental transgressions and the more promotional aspects of encouraging better management practices and consciousness. The new Law is expected to be approved by the Assembly by March. The Government has also decided that SEMA will be

placed within the Office of the President, to give it the necessary status and visibility, and will have adequate funding to enable it to perform a more active role under the new legal framework.

The Proposed Country Assistance Strategy

62. The current assistance strategy does not propose a major change but rather adjustments in line with the evolving vision and priorities of the Government. While the key aim of the previous strategy was the consolidation of peace, the current aim is to make peace sustainable. This will require not only high economic growth but also ensuring that growth is broad-based and environmentally sustainable. While the Bank agrees with and supports the Government's development agenda and priorities, two aspects of the strategy will be critical. **First**, we must ensure that the Government's strategy of competitiveness for all can be made operational. Because the Government's strategy has a number of innovative features, its success will critically depend on designing appropriate implementation mechanisms. **Second**, as part of this process, we and the Government need to ensure we do not lose sight of the continuing need to substantially expand the quality and coverage of basic services for the poor. The need to continue working on reforms in the social sectors will be especially important as we support Government efforts to reorient the roles and functions of SIFLD and strengthen rural development. Over the medium term the Bank's poverty alleviation strategy will rest on two pillars—support for local development, and revitalization of the rural sector. Over the longer term, the critical growth-to-equity link is human capital, especially education and access to knowledge. The Bank's strategy will thus focus heavily on education and support for Government efforts to create a learning society. At the same time, there is a sharper focus on increasing competitiveness to speed up El Salvador's insertion into the global economy and to encourage broad-based productivity growth. Meeting the Government's social and economic objectives will not be possible unless the public sector is substantially modernized and the private sector increasingly takes responsibility for managing and investing in the country's infrastructure. To this end, the Bank will continue to support reform of the public sector and improvements in the business climate.

Lending Program

63. The proposed base case lending program would amount to $300 million over FY98-00, for a program of 8-10 operations. A key priority would be to support the Government's social development agenda through operations to finance the proposed SIFLD, secondary education, and health sector reforms. A proposed rural development operation would also support the Government's poverty reduction objective by revitalizing the rural and agriculture sectors, while helping to mitigate the country's serious environmental problems through improved natural resource management at the farm level. The Bank would also support the Government's competitiveness strategy through an Information Society TA Project, which would broaden and deepen the current competitiveness agenda focusing on the development of a knowledge-based society. Further support for public sector reform would consider a follow-on Public Sector Modernization TA Loan, covering the remaining reform agenda and the second phase of privatization and design of regulatory frameworks. The Bank would also consider an infrastructure guarantee operation if requested by the Government.

64. The proposed **base case** of up to $300 million would constitute a ceiling, which we and the Government believe provides ample room to support client and CAS priorities over the next three years. For this reason we do not propose a high case lending scenario. A **low case** would be considered in the event of inadequate progress in implementation of the Government's development agenda. Key triggers would be a more protracted implementation of the reform program, especially inadequate strengthening of fiscal revenues, and deterioration in portfolio quality. Revenue pressures would constrain availability of counterpart funds for ongoing projects and prospects for the effective implementation of new operations. Under this scenario, the Bank would postpone some projects (Learning Society and Public Sector Modernization TA) and scale down others (Rural Development, Education and Health). Lending would fall to $150-200 million, depending on the severity of the fiscal problem and its impact on the Bank's portfolio.

Non-Lending Services

65. **Analytical Work.** There are three studies currently underway (Annex A3). The Secondary Education Study, is assisting the Government design a strategy for expansion in the coverage and quality of secondary education, and will support preparation of the Secondary Education Project. At the request of the Government, the Bank is carrying out a Rural Development Study in collaboration with FUSADES, a local NGO, and a parallel study of Rural Finance. The Government request for a Bank study was the result of concerns over the stagnation of the agriculture sector and the persistence of high rural poverty. The studies would assist the Government and the Bank define a set of activities to be supported under the proposed Rural Development and Natural Resource Management Project.

66. Over the next three years, we plan only one formal report, a National Knowledge Assessment which would begin in 1997. In terms of further analytical work, it has been agreed with the Government that the Bank would focus on the preparation of informal and quick-response policy notes as requested by the Government. Although this type of support cannot be defined in advance, we foresee the need for analytical and informal policy advise in the following areas: (i) support for the health sector reform program; (ii) various aspects of the competitiveness and public sector modernization agendas; (iii) analysis of remittance flows and potential for channeling them into productive activities; and (iv) in the outer years, a critical review of progress in implementation of the Government's local development and poverty reduction strategy.

67. **Mobilizing the Bank Group.** A major thrust of the strategy for the provision of lending and non-lending services has been to continue working closely with different parts of the Bank Group in an effort to provide seamless service to the client. This collaboration has materialized through support for the preparation and implementation of projects, such as the Competitiveness and Public Sector Modernization TA Loans, as well as active support to the El Salvador Country Team and a willingness to respond promptly to requests from the Government and private sector for advice in specific areas. In addition to the important contributions of EDI (Annex E), IFC, FIAS and MIGA, key support is being provided by the Central Vice Presidencies (Annex F). The responsiveness and wide range of services offered by the Bank Group is appreciated by the client and has shaped its perception of the Bank as a knowledge-based institution. This approach will continue to be a driving force in the services we provide during CAS implementation.

68. **Development Impact and Progress Benchmarks.** Annex G presents the expected development impact from CAS implementation and a set of proposed progress benchmarks that we would use to evaluate progress. The matrix is organized following the four priority areas articulated in the CAS, as well as the proposed Bank dialogue with civil society. Continued reduction in poverty rates, especially in rural areas, expansion in the quality and coverage of primary and secondary education, increased foreign investment flows, and the establishment of effective regulatory frameworks for privatization, will be key outcomes to measure the development impact of the proposed strategy.

Coordination with IDB

69. IDB has a large portfolio in El Salvador, amounting to $1.4 billion, of which $860 million for 23 operations were undisbursed as of mid-1996. Since the reactivation of the Bank's portfolio in El Salvador, we have worked in close coordination with IDB. In addition to cofinancing in two operations, the Basic Education Modernization and the Public Sector Modernization Projects, we are working closely to support health sector reforms, rationalization of the power sector and the Government's proposed local development strategy. In a number of areas, future IDB operations will complement Bank programs, including: reform of the judiciary and legislature as part of public sector modernization; IDB support for distance learning, complementing secondary education and information society efforts; and IDB's support for microenterprise financing and multisectoral credit operations, complementing the competitiveness agenda. Given IDB's considerable ongoing and proposed involvement in infrastructure and urban, the Bank would only focus on

selective technical and policy advice on regulatory frameworks and privatization. IDB would also take the lead in strengthening the institutional, policy and legal framework for the environment. Bank operational support for the environment would concentrate at the micro level through efforts to improve natural resource management, in line with a redefined rural development strategy. The Bank and IDB would work closely on the development of a national consensus in this area, where IDB is considering Technical Cooperation to support a dialogue on agricultural policies.

Relations with the IMF

70. The Government has requested a new 12-month stand-by arrangement from the IMF to support its 1997 economic program. Negotiations have been completed and the Fund expects to present the stand-by arrangement to its Board in late February. The Government has indicated it intends to treat the arrangement as precautionary. The economic program for 1997 aims to strengthen public finances, maintaining a tight monetary policy stance and accelerating privatization efforts. The Bank will continue to work closely with the IMF to monitor macroeconomic developments and implementation of the Government's reform program.

Portfolio Management

71. **Portfolio Performance.** The Bank's portfolio in El Salvador is expanding. As of mid-FY97, it included 7 projects, totaling $240 million, of which $211 was undisbursed (Annex A7). Portfolio implementation is good. All projects were rated Highly Satisfactory or Satisfactory for Development Objectives and Implementation Status as of mid-FY97, and currently there are no projects at risk. The generally satisfactory status of project implementation is due to a firm Government commitment to all projects. Implementation has been smooth and budget allocations have been generally adequate. Procurement problems, which had been identified as a key issue in the FY95 Annual Review of Portfolio Performance, have lessened, with procurement rated as 1 or 2 for all projects under implementation. This improvement is due to greater familiarity with Bank procedures, helped by two procurement workshops organized by the Costa Rica Regional Mission in FY96. A helpful feature has been that project implementation units have made an effort to exchange information and experiences on common problems and solutions. Compliance with financial and auditing requirements has been relatively good. The quality of audit reports is generally satisfactory, with only one recently-closed project, Social Sector Rehabilitation, having overdue audits, and only three audits having received qualified opinions at any time during implementation. The Social Sector Project suffered audit delays due to the need to establish an auditing system for more than 1,000 ACEs. Now that the system has been set up, it will greatly facilitate auditing under the ongoing Basic Education Project.

72. **Key Issues.** Disbursement delays have been largely due to general public expenditure management problems and, in one case, time spent adjusting the project to changed sectoral priorities. Slow disbursements have been largely due to general public expenditure management problems. A new information system, developed with USAID support, is expected to gradually improve the situation, and further improvements are expected from implementation of the Bank's recently approved Public Sector Modernization Project. The Social Sector Rehabilitation Project was an exception to the problem of delayed disbursements because the Government established a special revolving fund, allowed as an exception by the National Procurement Office. The mechanism has been adopted in the Agriculture and Basic Education Projects in FY96 and we are discussing extending it to other projects. Although implementation is relatively good, portfolio management will remain a priority to ensure implementation remains strong as the lending program expands.

73. **Regional Implementation Mission (RIM).** Implementation in El Salvador benefits from support from the Costa Rica RIM. The RIM conducted one project implementation workshop and two procurement launching seminars in El Salvador in FY96, as well as one regional disbursement seminar for Central America. At the beginning of FY96, we had two long-term consultants in the RIM, now increased to seven. Using the RIM increasingly for supervision is expected to result in unit cost savings.

Exposure and Creditworthiness

74. **External Debt.** El Salvador has a relatively low external debt burden. At $2.4 billion in 1996, the total debt stock was equivalent to 22.3 percent of GDP, of which 49.1 percent was on concessional terms and 69 percent from multilateral sources. Public and publicly-guaranteed long-term debt stood at $2.2 billion in 1996. Given the large concessional component of external obligations, total debt service is low, equivalent to 8.3 percent of exports of good and services (including worker remittances) in 1996. Due to the conflict and a conservative external debt strategy, the Government has incurred little private commercial debt. In 1996, Standard & Poor's gave El Salvador a BB rating for long-term foreign currency debt and a B rating for short-term foreign currency debt.

75. In 1995, one-half of the country's public and publicly-guaranteed debt was denominated in dollars and 41 percent in mixed currency. El Salvador has recently taken advantage of the Bank's new loan product offer through three decisions: (i) it has already contracted five LIBOR-based US dollar single-currency loans; (ii) it has requested conversion of its fully and almost fully disbursed loans from currency pool loans to US dollar single-currency pools; and (iii) it has converted two loans with significant undisbursed balances to LIBOR-based US dollar single-currency. El Salvador has made these choices to reduce exchange rate risk, because most of its trade is linked to the US dollar, and aims to simplify its debt management. The Government considers LIBOR to be a transparent "market-to-market" interest rate.

76. **Exposure Indicators.** The Government aims to maintain a conservative debt management strategy, limiting the contracting of new public external debt. In line with its development strategy, it expects direct foreign investment flows to finance an increasing share of its external financing needs. External debt is expected to stabilize at around 26 percent of GDP over the next decade and the debt service ratio would also stabilize at under 7 percent of total exports. IBRD debt service as a share of total public debt service would increase somewhat from the current 16 percent to around 20 percent over the next ten years. IBRD debt service as a share of exports, however, would remain substantially below 2 percent. Given that over the medium term, El Salvador's public external financing needs will be increasingly met from multilateral sources, especially IBRD and IDB, the share of debt service to preferred creditor would rise from the current 56 percent of total debt service and remain above 70 percent over the next ten years. Despite the inflexible structure of El Salvador's external debt, credit risks are low due to: (i) high foreign reserves amounting to $1.1 billion (over 4 months of imports); (ii) low overall debt burden coupled with the country's good record in servicing its external debt; and (iii) prudent macroeconomic management and external debt strategy.

CAS Preparation—Client Consultation and Stakeholder Dialogue

77. **Government CAS Partnership.** The CAS is based on extensive consultations with the Government, initiated in June 1996, through a half-day brainstorming meeting, chaired by the President of El Salvador, and including the Cabinet, the Bank CAS Team and an IDB team. This initial session focused on a wide and open discussion of the country's development challenges, Government priorities and the broad themes to be addressed in the CAS. Additional meetings were held between Bank staff and line agencies to agree on Bank and Government priorities. In late October, the Finance Minister participated in a two-day brainstorming meeting with the El Salvador Country Team to discuss in greater detail the Government's vision and development agenda, and the way in which the Bank Group could help meet the country's development challenges. This was followed in early December by a 3-day workshop in Washington focusing on the links between the social agenda and the vision of competitiveness for all. The workshop was attended by the Minister of Finance, the President of SIFLD, the Minister of Agriculture, key Government officials, and representatives from USAID, GTZ and IDB.

78. **Initiating a Dialogue with Stakeholders.** As part of CAS preparation and with the support of the Government, the Bank initiated a dialogue with representatives of Salvadoran civil society. Although the

Bank has had a dialogue with NGOs and other stakeholders, and in some cases, close working relations in sectors or projects, this was the first time the Bank sought to engage civil society in a dialogue on broader development issues. As discussed in Annex C, the dialogue sessions produced a lively and instructive discussion. In addition, the Bank is working with the Embassy of El Salvador to explore ways in which the community can be informed and participate in addressing the country's development challenges. A broad outline of the proposed CAS was discussed in October with over 20 representatives of Salvadorans living in the Washington area. With EDI support, we aim to maintain a regular dialogue with stakeholders during CAS implementation. Through this process, supported by EDI, we expect to gain a better understanding of the country's development agenda and establish closer working relations with NGOs that can participate in Bank programs and projects. This will be particularly important as the Bank seeks to strengthen support for community and rural development.

CAS Risks

79. There are a number of risks associated with CAS implementation, in addition to those posed by the external environment. As discussed in Section I, attainment of the Government's vision of competitiveness for all will require addressing important macroeconomic challenges. Improved fiscal performance lies at the center of the Government's agenda. A stronger fiscal stance is necessary both to improve overall economic competitiveness, especially in the farm sector, but also to allow increased investment in social capital. While the Government's poverty strategy of focusing on the competitiveness of local communities is an important innovation, it must be complemented with additional fiscal resources to finance a marked expansion in social spending and in improving basic infrastructure on which poor communities must rely to become more productive. Without a strong fiscal effort to finance the country's large social and infrastructure gaps, there is a risk that the Government's community development strategy will be left without an important plank.

80. The Government has articulated a bold development agenda and vision, which must be shared by society at large if it is to succeed. Consensus, in turn, needs to be built on the basis that the fruits from the attainment of this vision will be shared more evenly. Although the Government's social development agenda aims to address this problem, there is a danger that unless it can point to some early successes, support for the broader development strategy will not materialize. The need to give local communities a stake in the globalization agenda and to revitalize rural areas will be particularly critical. The country is making progress in strengthening democratic and participatory institutions, but the political economy aspects of the development agenda remain complex and risky. Continued stagnation and extreme poverty in rural areas pose the risk of increased social instability as well as the emergence of strong political pressures to backtrack on reforms. A return to armed conflict is not foreseen, but there is a clear sense that unless El Salvador's pressing social needs are effectively addressed, the stage will be set for increased social unrest and political polarization.

81. A further risk is posed by the innovative nature of the vision itself. The driving force behind the development vision can become overly dependent on a few individuals who articulate and energize it, but it must be fully shared not only by society at large but also by those charged with implementing what will inevitably be a complex and far-reaching program. While we believe that the social and economic program articulated by the Government is appropriate to meet El Salvador's development challenges, the Bank must also guard against complacency. The highly participatory nature of the CAS inevitably draws the Bank into a close association and partnership with the architects of the vision. If the vision is not a shared one or it does not improve living standards for the majority of society, the Bank too will be associated with its failure. To guard against these risks, we will need to pay particular attention to the implementation details of the strategy and continue efforts to reach out and maintain an open dialogue with civil society.

82. Although there is a risk that implementation of the Government's development strategy could prove more difficult than expected, especially in terms of translating the vision into concrete actions, or that raised

expectations would not be met, we believe that the expected benefits outweigh the potential risks. The Bank Group has much to offer but also much to learn from our partnership with El Salvador.

V. AGENDA FOR BOARD CONSIDERATION

83. The Board may wish to consider the following:

- ***Is the proposed social development strategy an appropriate response to the country's development needs?*** Is the balance between poverty reduction efforts through local development and a revitalization of the rural sector, and investments in human capital, appropriate?

- ***Is the proposed division of labor between the Bank Group and other development partners appropriate?*** Does the proposed strategy build on the Bank Group's comparative advantage?

- ***Are CAS implementation risks realistic and acceptable?*** Is the CAS sufficiently flexible to be able to respond to country and implementation risks?

James D. Wolfensohn
President

Attachments

Washington D.C.
February 19, 1997

El Salvador: Selected Indicators of Bank Portfolio Performance and Management

Indicator	FY94	FY95	FY96	FY97[h]
Portfolio Performance				
Number of projects under implementation[j]	6	6	9	9
Average implementation period (years)[a]	2.6	3.6	3.1	3.1
Percent of problem projects rated U or HU[b]				
Development objectives[c]	0.0	0.0	0.0	0.0
Implementation progress (or overall status for past years)[d]	0.0	0.0	11.1	0.0
Canceled during fiscal year ($ million)	0.0	0.0	0.0	0.0
Disbursement ratio (%)[e]	25.9	26.8	38.7	5.0
Disbursement lag (%)[f]	27.3	15.9	27.1	46.0
Memorandum item: % completed projects rated U by OED[i]	33.3	28.6	25.0	25.0
Portfolio Management				
Supervision resources (total $'000)	482.0	212.3	463.0	317.1
Average supervision ($'000/project)	80.3	35.4	51.4	35.2
Supervision resources by location (in %)[g]				
Percent headquarters	100.0	100.0	73.0	79.3
Percent Regional Implementation Mission (Costa Rica)	0.0	0.0	27.1	20.7
Supervision resources by rating category ($'000/project)				
Projects rated HS or S	80.3	35.4	52.1	35.0
Projects rated U or HU	0.0	0.0	46.1	0.0
Memorandum items: date of last CPPR: FY96				
Problem projects: None				
Potential problem projects: None in current QAG listing				
Total projects at risk:[k] None				

a. Average age of projects in the Bank's country portfolio.
b. Rating scale: HS = Highly Satisfactory; S = Satisfactory; U = Unsatisfactory; and HU = Highly Unsatisfactory
c. *Extent to which the project will meet its development objectives.*
d. Assessment of overall performance of the project based on the ratings given to individual aspects of project implementation (*e.g.*, management, availability of funds, compliance with legal covenants) and to development objectives. The overall status is not given a better rating than that given to project development objectives.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year; investment projects only.
f. For all projects in the Bank's country portfolio, the percentage difference between actual cumulative disbursements and the cumulative disbursement estimates as presented in the original SAR/PR Forecast or, if the loan amounts have been modified, in the Revised Forecast. The country portfolio disbursement lag is effectively the weighted average of disbursement lags for projects comprising the Bank's country portfolio, where the weights used are the respective project shares in the total cumulative disbursement estimates.
g. Supervision resources include salaries, benefits, and travel for all sources of funds, but excludes FAO staff and ICR task costs.
h. Actuals as of date indicated below.
i. This figure reflects the percentage of projects in El Salvador rated unsatisfactory by OED since 1980. It does not reflect all projects closed since 1980, as several recent ones have not been reviewed yet by OED. Eight projects have been reviewed, of which 2 projects (the Industrial and Agricultural Training Project, and the Fourth Education Project, closed in FY84 and FY88, respectively) were rated unsatisfactory in Project Completion Reports and by OED. Implementation of both projects was disrupted by the conflict, and adversely affected by financial and institutional weaknesses.
j. Number of projects under implementation at any one time during the FY.
k. Projects at risk comprise two types of projects: actual problem projects based on the latest Form 590 ratings, and potential problem projects which are associated with at least 3 of 12 leading indicators of future problems. The data is compiled by the Quality Assurance Group (QAG).

Data as of: February 10, 1997

El Salvador: Bank Group Fact Sheet
IBRD Lending Program, FY94-00

	Past			Current	Planned		
Category	FY94	FY95	FY96	FY97	FY98	FY99	FY00
Commitments ($m)	52.5	0.0	165.0	24.0		[300][a]	
Sector (%)							
Education	0.0	0.0	20.6	0.0	50.0	0.0	0.0
Health	0.0	0.0	0.0	0.0	0.0	0.0	42.1
Natural Resource Management	0.0	0.0	30.3	0.0	0.0	0.0	57.9
Non-Sector	95.2	0.0	9.7	0.0	50.0	73.7	0.0
Power	0.0	0.0	39.4	0.0	0.0	0.0	0.0
Public Sector Management	4.8	0.0	0.0	100.0	0.0	26.3	0.0
Urban	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Lending instrument							
Structural adjustment loans	95.2	0.0	0.0	0.0	0.0	0.0	0.0
Specific investment loans and others	4.8	0.0	100.0	100.0	100.0	100.0	100.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Disbursements							
Structural adjustment loans	30.0	20.0	0.0	0.0	0.0	0.0	0.0
Specific investment loans and others	27.1	21.5	22.7	37.2	44.5	42.3	22.0
Repayments ($m)	18.2	20.7	21.4	24.9	25.3	21.2	22.2
Interest ($m)	16.4	20.7	22.3	20.9	21.6	22.5	23.2

a. Reflects the base case.

IFC and MIGA Programs, FY94-97

	Past			Current
	FY94	FY95	FY96	FY97
IFC Approvals ($m)	1.9	0.0	8.0	25.0
Sector (%)				
Cement and Construction	0.0	0.0	0.0	100.0
Infrastructure	100.0	0.0	100.0	0.0
Other	0.0	0.0	0.0	0.0
TOTAL	100.0	0.0	100.0	100.0
Investment Instrument (%)				
Loans	89.0	0.0	100.0	80.0
Equity	11.0	0.0	0.0	20.0
Quasi-equity	0.0	0.0	0.0	0.0
TOTAL	100.0	0.0	100.0	100.0
MIGA guarantees ($m)	0.0	0.0	9.0	9.0
MIGA commitments ($m)	0.0	0.0	0.0	0.0

a. Includes quasi-equity types of both loan and equity instruments.

El Salvador: Summary of Analytical Work ($ '000), FY96-00

	Actuals		Planned		
	FY96	FY97	FY98	FY99	FY00
Economic and Sector Work					
Agriculture/Rural Sector	122.7	48.9			
Education	47.0	102.0			
Multi sector	32.1				
Financial Sector	34.1	25.6			
Other	22.6	5.0	X		
Informal Analytical Work					
Policy Notes			X	X	X
Social Development/Poverty					X
TOTAL	258.5	181.5			

Major Outputs—FY95-97

⇨ El Salvador. ***Community Education Strategy: Decentralized School Management***, December 8, 1994, Report No. 13502-ES (Gray Cover).

The study evaluated the Government's basic education strategy, and the effectiveness and impact of the Community Decentralization Program (EDUCO). The analysis and recommendations formed the basis for the recently-approved Basic Education Project.

⇨ El Salvador. ***The Challenge of Poverty Alleviation***, June 9, 1994, Report No. 12315-ES (Gray Cover)

This was the first comprehensive poverty alleviation study of El Salvador. Main findings and policy recommendations are reviewed in Annex D.

⇨ El Salvador. ***Meeting the Challenge of Globalization: Country Economic Memorandum and Private Sector Assessment***, October 13, 1995, Report No. 14109-ES (issued in Red Cover in August 1996).

The report was a combined Country Economic Memorandum and Private Sector Assessment. The report reviewed the Government's emerging globalization agenda and included an in-depth analysis of the macroeconomic framework, including the need to strengthen fiscal policies and the macroeconomic problems associated with the "Dutch disease" syndrome. The Private Sector Assessment section, provided a comprehensive and detailed set of recommendations on micro-level reforms to stimulate private sector-led growth and to support the Government's competitiveness and globalization agenda. The set of recommendations provided the basis for the Bank's Competitiveness Enhancement TA Project, and continues to be used by the Government as a check list and overall framework for the reform program. At the request of the Government, the report was issued in Red Cover in August 1996.

⇨ El Salvador. ***Moving to a Gender Approach: Issues and Recommendations***, June 12, 1996, Report No. 14407-ES (Gray Cover).

The report identifies and discusses gender differences and inequities that affect women's and men's contributions to human and economic development. It focuses on health, education, labor, land tenure,. credit, and rural water. The report defines a gender approach in institutional terms, and forms the basis of Bank's gender strategy discussed in the CAS.

Ongoing Reports

⇨ **Rural Development Strategy**

The report is based on a survey of rural households and analyzes the causes of stagnation in rural areas, the incidence of rural poverty, the role of land markets and natural resource management problems. The report is being prepared jointly with a local NGO, FUSADES.

⇨ **Rural Credit Markets**

As the Bank began work on the Rural Development Study, it became clear that improving the functioning of rural credit markets would be critical in developing a longer-term strategy for revitalizing agriculture and the rural sector. As a result, it was decided to carry out a separate study of rural credit, in parallel with the Rural Development Study and based on the same rural survey which included detailed information on access to credit by smallholders.

⇨ **Secondary Education Study**

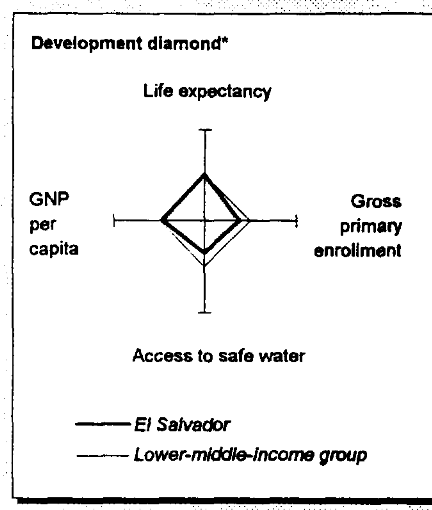
As reforms in basic education progressed and as the Government began to articulate its competitiveness and globalization agenda, it started to focus on the need to expand the coverage and quality of secondary education. The study is analyzing the need for reforms at the secondary level, the scope for replicating the successful community participation program in basic education, and cost-effective means of expanding secondary education, including he role of the private sector.

Informal Analytical Work

As discussed in the CAS, informal analytical work will respond to client requests and priorities, and is therefore difficult to define precisely in advance. We expect, however, to prepare informal analytical pieces in a number of areas critical to the Government's development agenda. This may include: (i) targeted analysis of specific elements of the proposed **health reform program**, where IDB will take the lead in identifying technical assistance and institutional strengthening needs; (ii) various, and as yet to be defined, aspects of the **competitiveness and public sector reform agenda**; (iii) analysis of the potential for channeling **remittances** into productive activities, working through the financial system and exploring interest among the Salvadoran expatriate community in the Washington area; and (iv) in the outer years, we will consider an informal review of progress in implementation of the Government's **poverty reduction strategy**, focusing on lessons from the proposed reorientation toward local development. Provided we have made progress in improving LSMS surveys in El Salvador (under the joint IBRD/IDB/ECLAC program), we would consider expanding the analysis into a formal Poverty Assessment Update.

El Salvador at a glance

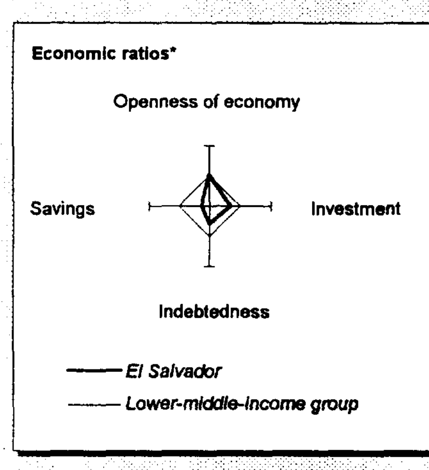
POVERTY and SOCIAL	El Salvador	Latin America & Carib.	Lower-middle-income
Population mid-1995 *(millions)*	5.8	480	1,154
GNP per capita 1995 *(US$)*	1,580	3,300	1,700
GNP 1995 *(billions US$)*	9.1	1,584	1,962
Average annual growth, 1990-95			
Population *(%)*	2.2	1.8	1.4
Labor force *(%)*	3.3	2.4	1.8
Most recent estimate *(latest year available since 1989)*			
Poverty: headcount index *(% of population)*	38	..	..
Urban population *(% of total population)*	45	74	56
Life expectancy at birth *(years)*	67	68	67
Infant mortality *(per 1,000 live births)*	40	41	36
Child malnutrition *(% of children under 5)*	22	..	..
Access to safe water *(% of population)*	55	81	78
Illiteracy *(% of population age 15+)*	29	13	..
Gross primary enrollment *(% of school-age population)*	79	110	104
Male	79	..	105
Female	80	..	101


Development diamond*

KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1975	1985	1994	1995
GDP *(billions US$)*	1.9	3.8	8.1	9.5
Gross domestic investment/GDP	22.1	10.8	18.7	19.1
Exports of goods and non-factor services/GDP	33.0	22.3	20.1	21.0
Gross domestic savings/GDP	17.0	3.3	3.8	6.2
Gross national savings/GDP	16.1	2.3	15.0	13.6
Current account balance/GDP	-5.1	-6.9	-3.8	-2.9
Interest payments/GDP	1.0	2.1	1.1	1.1
Total debt/GDP	21.9	48.8	27.0	23.8
Total debt service/exports	16.7	24.7	14.6	9.5
Present value of debt/GDP	..	..	20.1	..
Present value of debt/exports	..	..	69.7	..

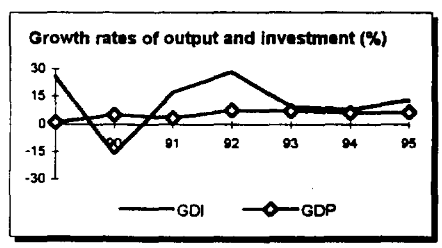
	1975-84	1985-95	1994	1995	1996-04
(average annual growth)					
GDP	-2.8	4.1	6.0	6.3	6.4
GNP per capita	-4.5	2.5	4.2	4.9	4.3
Exports of goods and nfs	-1.9	5.1	11.1	7.6	10.3

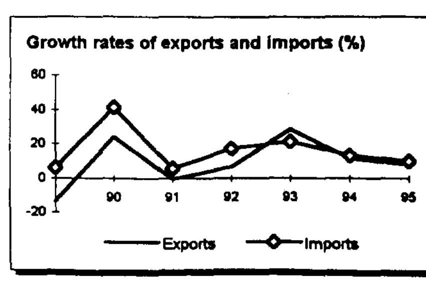

Economic ratios*

STRUCTURE of the ECONOMY

	1975	1985	1994	1995
(% of GDP)				
Agriculture	35.3	26.9	13.8	13.5
Industry	26.5	23.4	23.9	21.6
Manufacturing	20.0	17.8	..	..
Services	38.2	49.7	62.3	64.9
Private consumption	71.9	81.2	87.9	85.9
General government consumption	11.2	15.5	8.2	7.9
Imports of goods and non-factor services	38.2	29.9	35.0	34.2

	1975-84	1985-95	1994	1995
(average annual growth)				
Agriculture	-1.5	1.3	-2.4	5.1
Industry	-5.8	2.8	-0.5	-3.1
Manufacturing	-6.1	..	..	..
Services	-1.6	5.6	10.9	11.3
Private consumption	-3.5	6.9	7.8	7.0
General government consumption	1.6	-4.8	3.0	4.5
Gross domestic investment	-8.8	11.0	7.9	13.0
Imports of goods and non-factor services	-5.7	12.3	13.2	9.6
Gross national product	-3.1	4.5	6.5	7.4


Growth rates of output and investment (%)

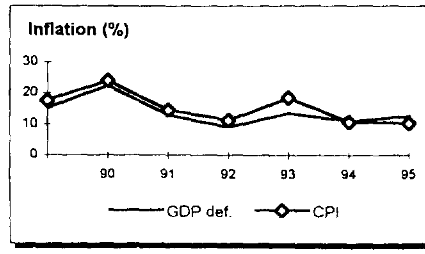

Growth rates of exports and imports (%)

Note: 1995 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

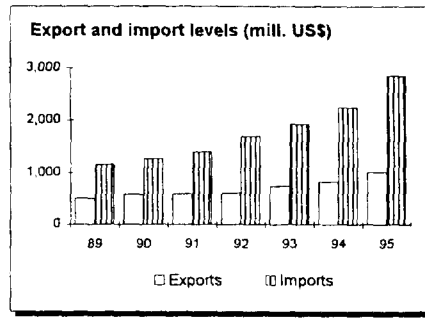
PRICES and GOVERNMENT FINANCE

	1975	1985	1994	1995
Domestic prices				
(% change)				
Consumer prices	19.1	22.3	10.6	10.1
Implicit GDP deflator	9.3	20.3	10.8	12.4
Government finance				
(% of GDP)				
Current revenue	..	17.2	15.2	16.0
Current budget balance	..	0.9	2.0	3.2
Overall surplus/deficit	..	-4.3	-1.9	-0.9



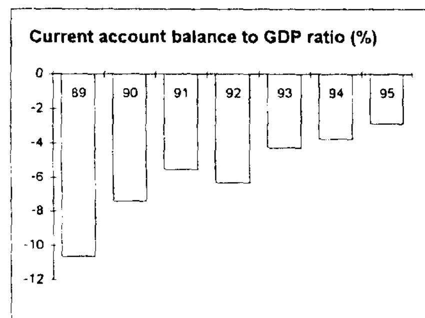
TRADE

	1975	1985	1994	1995
(millions US$)				
Total exports (fob)	..	695	821	1,005
Coffee	..	464	271	362
Cotton	..	29	0	0
Manufactures	..	..	340	406
Total imports (cif)	..	961	2,252	2,853
Food	..	211	504	534
Fuel and energy	..	133	111	130
Capital goods	..	158	669	783
Export price index *(1987=100)*	..	104	113	137
Import price index *(1987=100)*	..	97	108	114
Terms of trade *(1987=100)*	..	108	104	121



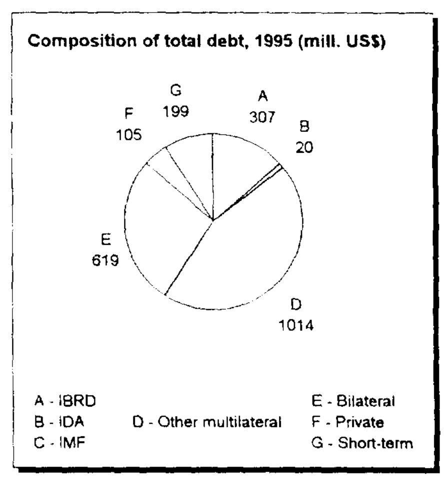
BALANCE of PAYMENTS

	1975	1985	1994	1995
(millions US$)				
Exports of goods and non-factor services	593	930	1,198	1,482
Imports of goods and non-factor services	673	1,189	2,519	2,868
Resource balance	-80	-260	-1,321	-1,386
Net factor income	-40	-117	8	43
Net current transfers	25	113	1,001	1,071
Current account balance, before official transfers	-95	-263	-312	-272
Financing items (net)	125	221	455	452
Changes in net reserves	-30	42	-143	-180
Memo:				
Reserves including gold *(mill. US$)*	175	333	788	968
Conversion rate *(local/US$)*	2.5	3.5	8.8	8.8



EXTERNAL DEBT and RESOURCE FLOWS

	1975	1985	1994	1995
(millions US$)				
Total debt outstanding and disbursed	412	1,854	2,188	2,264
IBRD	41	119	290	307
IDA	17	26	21	20
Total debt service	100	259	341	260
IBRD	4	16	36	43
IDA	0	0	1	1
Composition of net resource flows				
Official grants	5	203	87	105
Official creditors	41	119	111	80
Private creditors	11	-50	-60	-31
Foreign direct investment	13	12	20	19
Portfolio equity	0	0	0	0
World Bank program				
Commitments	0	0	0	34
Disbursements	14	14	70	26
Principal repayments	2	8	20	22
Net flows	13	6	50	4
Interest payments	3	8	17	22
Net transfers	10	-2	33	-18



El Salvador: Key Economic Indicators

	Actuals					Projected			
	1991	1992	1993	1994	1995	1996	1997	1998	1999
National Accounts (% GDP, current mp)									
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture[a]	17.1	14.2	13.9	13.8	13.8	14.0	13.8	13.5	13.1
Industry[a]	26.7	29.6	28.2	28.1	28.0	22.1	22.5	23.1	24.1
Services[a]	56.2	56.2	57.9	58.1	58.3	63.9	63.7	63.4	62.8
Total Consumption	97.9	97.8	95.9	96.1	96.7	96.7	96.0	95.0	93.9
Gross Domestic Fixed Investment	15.2	17.2	17.9	17.7	18.1	19.1	19.1	19.9	20.5
Government investment	2.8	4.0	4.0	3.7	3.4	3.9	3.9	4.0	4.0
Private investment[b]	12.3	13.2	13.9	13.9	14.7	15.4	15.2	16.0	16.5
Exports (GNFS)[c]	17.2	16.1	19.5	20.0	21.4	21.7	22.7	24.0	25.3
Imports (GNFS)[c]	30.5	32.4	34.0	35.0	37.2	37.7	37.9	38.9	39.7
Gross Domestic Savings	2.1	2.2	4.1	3.9	3.3	3.3	4.0	5.0	6.1
Gross National Savings[d]	10.5	13.1	15.4	16.1	15.6	15.3	15.7	16.2	17.0
Memorandum Items:									
Gross Domestic Product ($million at current prices)	5313	5961	6981	8125	9710	10581	10631	11216	11777
Gross National Product ($ per capita Atlas method)	970	1090	1220	1360	1580	1700	1780	1840	1860
Real Growth Rates (%1990 prices)									
Gross Domestic Product m.p.	3.6	7.5	7.4	6.0	6.4	3.0	4.5	5.0	5.0
Gross Domestic Income	3.7	6.9	9.3	6.5	8.5	1.5	4.8	5.6	5.5
Real Per Capita Growth Rates (% 1990 prices)									
Gross Domestic Product m.p.	1.5	5.3	5.1	3.7	3.6	0.8	2.3	2.8	2.8
Total Consumption	1.0	5.3	5.6	5.1	7.9	-0.3	1.9	2.2	1.7
Private Consumption	1.0	6.0	6.3	5.5	8.6	10.2	1.3	1.6	1.2
Balance of Payments ($ million)									
Exports (GNFS)[c]	880	891	1370	1641	2049	2188	2418	2689	2981
Merchandise FOB	588	598	1032	1249	1661	1754	1941	2176	2429
Imports (GNFS)[c]	1616	1920	2284	2736	3522	3799	4026	4367	4679
Merchandise FOB	1406	1699	1995	2416	3118	3290	3486	3785	4058
Resource Balance	-737	-1029	-914	-1096	-1473	-1611	-1608	-1677	-1698
Net Current Transfers (including official current transfers)	543	708	823	1001	1195	1279	1365	1454	1534
Current Account Balance (after official capital grants)	-118	-152	-119	-35	-276	-318	-292	-348	-341
Net Private Foreign Direct Investment	11	16	17	20	27	50	60	80	120
Long-Term Loans (net)	109	99	296	52	110	112	298	238	169
Official	92	113	295	111	61	155	290	245	183
Private	17	-14	1	-60	50	-44	8	-7	-14
Other Capital (net, including errors and omissions)	40	97	-49	106	286	320	60	170	160
Change in Reserves[e]	-42	-60	-144	-143	-147	-164	-127	-140	-108
Memorandum Items:									
Resource Balance (%GDP current m.p.)	-13.9	-17.3	-13.1	-13.5	-15.2	-15.2	-15.1	-15.0	-14.4
Real Annual Growth Rates (1990 prices)									
Merchandise exports FOB	0.3	14.1	19.8	-9.2	11.5	12.3	9.9	8.9	7.8
Main Primary	-7.2	12.7	22.2	-27.7	6.0	10.4	5.0	4.0	3.0
Manufactures	9.5	27.3	20.5	6.0	14.5	4.6	6.2	7.0	7.5
Others[i]	5.8	-3.5	11.6	11.0	15.5	31.8	23.2	17.8	13.6
Merchandise imports CIF	12.8	18.6	13.7	8.3	9.9	5.3	6.1	7.6	5.1

(Continued)

El Salvador: Key Economic Indicators (continued)

	Actuals					Projected			
	1991	1992	1993	1994	1995	1996	1997	1998	1999
Public Finances (% GDP m.p.)									
Current Revenues	12.6	13.6	13.7	15.2	16.0	15.5	17.0	18.3	19.0
Current Expenditures	13.7	14.2	13.0	13.2	12.8	13.1	13.4	13.9	14.4
Current Account Balance	-1.0	-0.6	0.8	2.0	3.2	2.4	3.6	4.4	4.7
Capital Expenditure	4.1	5.7	4.6	4.1	4.1	4.3	4.2	4.2	4.2
Foreign Financing	4.5	5.9	4.0	3.4	2.1	1.1	2.1	2.3	1.6
Monetary Indicators									
M2/GDP (current market prices)	21.4	23.9	26.1	29.8	25.6	23.3	21.3	21.3	21.3
Growth of M2 (%)	16.0	30.7	27.4	24.9	21.3	16.5	10.8	10.8	10.3
Private Sector Credit Growth/ Total Credit Growth (%)	77.3	75.3	85.2	82.0	93.5	90.3	115.4	116.3	112.4
Price Indices (1990=100)									
Merchandise Exports	123.3	119.4	129.3	172.5	205.6	193.4	194.8	200.5	207.6
Merchandise Imports	106.4	109.9	111.8	123.9	146.8	146.4	146.2	147.6	150.5
Merchandise Terms of Trade	115.9	108.7	115.7	139.3	140.1	132.1	133.3	135.9	138.0
Real Exchange Rate ($/LCU)[g]	100.0	98.0	91.9	86.1	78.6				
Real Interest Rates[h]	-1.6	3.1	-3.5	1.4	11.4				
Consumer Price Index (% change)	14.4	11.2	18.5	10.6	10.1	8.3	5.7	5.1	4.8
GDP Deflator (% change)	12.7	8.8	13.1	10.8	12.4	5.8	6.0	5.5	5.0

[a] *GDP components estimated at factor cost.*
[b] Includes changes in stock.
[c] Goods and non-factor services.
[d] Includes net unrequited transfers, excluding official capital grants.
[e] Includes use of IMF resources.
[f] Consolidated non-financial public sector.
[g] LCU denotes local currency unit. An increase in $/LCU denotes appreciation.
[h] Data refers to interbank loans.
[i] Includes maquila exports, other primary (non-traditional) and items not classified.

KEY ASSUMPTIONS: Base Case Projections

Economic growth is assumed to recover gradually from the slowdown in 1996, but over the medium term remains below the high rates achieved during the post-peace boom. The projections assume successful implementation of the Government's reform program and a stable macroeconomic framework. Direct foreign investment responds to the Government's competitiveness program and privatization of public utilities. Projections of export growth are conservative, assuming that merchandise exports grow approximately in line with GDP over the medium term. Remittances continue to grow, but at a slower rate. Official capital grants fall gradually, which is more than offset by increased foreign investment. Domestic savings and investment improve gradually in response to the pension privatization program, Government efforts to deepen financial and capital markets and microeconomic reforms under the competitiveness program.

Inflation is assumed to converge to international levels over the next two years. In terms of the fiscal accounts, it is assumed that progress is maintained in improving fiscal revenues, which rise gradually as a share of GDP. Current expenditures are assumed to grow more slowly, as the Government's public sector reform program rationalizes state functions and allows more fiscal space to increase spending for the social sectors and basic infrastructure. As a result, public savings continue to rise during the period. Capital expenditures stabilize at 4.2 percent of GDP which, given the Government's extensive privatization program, would allow adequate expansion in basic social and physical infrastructure.

El Salvador: Key Exposure Indicators

	Actuals					Projected			
	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total Debt Outstanding and Disbursed (TDO) ($million)[a]	2180	2261	2012	2188	2310	2392	2621	2857	3026
Net Disbursements ($million)	2	91	309	135	368	82	229	237	171
Total Debt Service (TDS) ($million)[a]	248	233	293	341	281	295	264	290	300
Debt and Debt Service Indicators (%)									
TDO/XGS[b]	148.0	135.1	87.4	79.2	68.4	67.5	67.9	67.5	65.6
TDO/GDP	41.0	37.9	28.8	26.9	23.8	22.6	24.7	25.5	25.7
TDS/XGS	16.9	13.9	12.7	12.3	8.3	8.3	6.8	6.9	6.5
Concessional/TDO	59.3	58.8	51.7	50.3	48.9	49.2	46.6	43.1	40.4
IBRD Exposure Indicators (%)									
IBRD DS/Public DS	9.9	12.2	11.2	10.8	16.9	16.1	20.3	18.8	19.8
Preferred Creditor DS/Public DS	39.3	46.1	37.7	49.5	53.9	56.2	73.0	74.7	76.7
IBRD DS/XGS	1.6	1.6	1.4	1.3	1.3	1.3	1.4	1.3	1.3
Share of IBRD Portfolio	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IFC ($million)									
Loans	0.0	0.0	0.0	1.4	0.0	2.8			
Equity and Quasi-Equity[c]	0.0	0.0	0.0	0.2	0.0	0.0			
MIGA Guarantees ($million)	0.0	0.0	10.4	10.4	10.4	9.9			

[a] Includes public and publicly-guaranteed debt, private non-guaranteed, use of IMF credits and net short-term capital.
[b] XGS denotes exports of goods and services, including workers' remittances
[c] Includes equity and quasi-equity types of both loan and equity instruments.

Status of Bank Group Operations in El Salvador
IBRD Loans in the Operations Portfolio

					Original Amount in $ million				Difference between	Last ARPP Superv. Rating[b]	
Project ID	Loan No.	Fiscal Year	Borrower	Purpose	IBRD	IDA	Canceled	Undis-bursed	expected & actual disb.[a]	Develop. Objectives	Implementa. Progress
Number of closed loans: 28											
Active Loans											
SV-PE-7164	L40820	1997	Rep. of El Salvador	Public Sector Moderniza.	24.0			24.0			
SV-PE-&!&$	L39820	1996	Rep. of El Salvador	Land Administration	50.0			50.0	5.9	S	S
SV-PE-40824	L39460	1996	Rep. of El Salvador	Competitiveness Enhanc	16.0			14.3	3.3	S	S
SV-PE-7169	L39450	1996	Government	Basic Education	34.0			31.3	0.4	HS	HS
SV-PE-7173	L39200	1996	Government	Energy Sector	65.0			65.0	21.9	S	U
SV-PE-7167	L35760	1993	Govt. of El Salvador	Agric. Sector Reform	40.0			24.2	15.8	S	S
SV-PE-7170	L33890	1992	Govt. of El Salvador	Power Technical Assist.	11.0			1.9	1.9	S	S
TOTAL					240.0	0.0	0.0	210.7	49.2		

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.
b. HS = Highly Satisfactory; S = Satisfactory; U = Unsatisfactory; and HU = Highly Unsatisfactory.

	Active Loans	Closed Loans	TOTAL
Total disbursed (IBRD & IDA)	29.3	451.5	480.8
Of which repaid	0.2	197.9	198.1
Total now held by IBRD & IDA	239.8	255.3	495.1
Amount sold	0.0	5.2	5.2
Of which repaid	0.0	5.2	5.2
Total undisbursed	210.7	1.7	212.4

Data as of: February 10, 1997

El Salvador: Statement of IFC Investments
Committed and Disbursed Portfolio
(in $ million)

		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1994/96	TELEMOVIL	9.2	0.2	0.0	13.8	4.0	0.2	0.0	6.0
	Total Portfolio	9.2	0.2	0.0	13.8	4.0	0.2	0.0	6.0

		Approvals Pending Commitment			
		Loan	Equity	Quasi	Partic
1997	CESSA	20.0	5.0	0.0	24.0
	Total Pending Commitment	20.0	5.0	0.0	24.0

Data as of: December 31, 1996

POVERTY: ASSESSMENT AND PROGRESS

The Bank's Poverty Assessment

The Bank's Poverty Assessment for El Salvador (**The Challenge of Poverty Alleviation**, June 9, 1994, Report No.: 12315-ES) pointed out that widespread poverty was a major threat to peace and political stability, and a constraint to sustained and equitable growth. The study based its analysis on a poverty profile built from the 1991-92 National Household Survey (*Encuesta de Hogares de Propósitos Múltiples*—EHPM) which sampled 18,954 urban and rural households. Due to considerable under-reporting, reported incomes were adjusted based on 1990-91 national accounts data. The corrections increased urban and rural incomes by 16.4 percent and 17.6 percent, respectively. Thus, the World Bank's Poverty assessment estimated national poverty of 48.2 percent, of which 9.9 percent was extreme poverty. This compares with an uncorrected estimate from the National Household Survey of 59 percent national poverty, of which 28 percent was extreme poverty (Table 1).

Table 1: Poverty Comparisons, 1992

	Urban	Rural	TOTAL
Relative Poverty	43.1 (53.0)	55.7 (66.0)	48.2 (59.0)
Extreme Poverty	6.9 (23.0)	14.3 (34.0)	9.9 (28.0)

Note: Figures in brackets are poverty rates with uncorrected income figures. Relative includes extreme poverty.
Source: The Challenge of Poverty Alleviation (1994).

The methodology used by the Bank suggests that Government poverty rates presented in text Table 1 considerably overestimate poverty in El Salvador. As noted in the text, there are considerable data problems with Government poverty measurements, so it is not possible to assess official figures based on the EHPM Surveys. Although poverty rates cannot be reliably calculated, the trends are likely to be a good reflection of what has been happening with poverty overall.

In Government estimates, poor households are divided into two groups: those who are in extreme poverty, meaning that their income is insufficient to purchase a basic food basket (CBA), and those in relative poverty, whose incomes are between one and two CBAs. Quality of the data is not as high as desirable because of incomplete income coverage (especially for the top and bottom income deciles), differences in the months during which the surveys have been constructed, changes in geographical coverage, errors in expanding the sample, and other problems.

Recommendations of the Poverty Assessment

The Poverty Assessment pointed out that the Government's poverty alleviation strategy was based on two key elements. **First**, an economic program to enable sustained economic growth as the basis for employment creation, poverty reduction, and social equity. **Second**, a two-pronged poverty alleviation strategy, including: (i) a social safety net to alleviate the impact of adjustment on the most vulnerable groups in the short-term; and (ii) improved access to basic services, especially pre-primary and primary education, basic health, and nutrition, to help the poor take advantage of economic opportunities in the medium- to long-term.

In addition to encouraging strong economic growth, the Poverty Assessment recommended a number of actions:

- Public sector modernization to improve service delivery, especially in the social ministries, and increased resource mobilization to finance expanded social programs benefiting the poor;

- Improved agricultural policies to enhance access to credit, improve land security, and strengthen research and extension, especially in basic grains.

- Remove labor market rigidities that discourage employment creation in the formal sector.

- Improve the targeting of the Government's social programs.

- Strengthen social safety net programs to eliminate duplications, set tighter priorities, improve coordination mechanisms, develop consistent targeting criteria, and establish adequate information systems.

- Improve nutrition policy by assigning clear institutional responsibilities, and support a limited number of cost-effective and well-targeted programs;

- Carry out a comprehensive reform of the health sector, and focus on improvements in the coverage and quality of basic health services.

- Continue with education sector reforms, expand the EDUCO program to increase coverage in rural areas, and streamline the Ministry's role and functions;

- Arrest environmental degradation, strengthen water and sanitation services, improve waste management, and improve agricultural practices; and

- Improve the system for monitoring living conditions and for analyzing the impact of policy initiatives on the poor.

Box 2: *Escuela Saludable* (Healthy School)

The National Secretariat for the Family, the Ministry of Health, the Secretariat of National Reconstruction, MOE and SIF have implemented the *Escuela Saludable* program in order to improve the health, nutrition and education of children in the 135 poorest municipalities. The program, delivered at the pre-school and basic level, provides health services (including psychological counseling and dental services) to students, and distributes vitamins and other nutritional and health supplements. The program also provides orthopedic shoes and orthopedic protesis for children who need them, provides school meals and teaches participants nutrition practices. It also finances improvements in school infrastructure to ensure that children have access to potable water and sanitation. The Bank is supporting the program through the Social Sector Rehabilitation and the Basic Education Modernization Projects. By July 1996, 250,000 students had benefited from *Escuela Saludable*, or about 53 percent of total rural students.

Progress and Remaining Challenges

The Bank's 1994 Poverty Assessment presented a comprehensive and long-term poverty alleviation agenda. Although over the past three years there has been considerable progress in a number of areas and less so in others, poverty alleviation remains the overriding objective of the Government's development program and the Bank's assistance strategy. Economic growth has been impressive and likely explains a gradually declining trend in urban poverty. Public sector reforms are allowing the Government to gradually increase allocations to the social sectors and safety net programs. Labor markets have remained flexible and help to explain the low rates of open unemployment, although as argued in the CAS, the marked decline in real wages remains a concern. In an important sense, the Government is going beyond the Poverty Assessment's recommendation to improve existing social safety net programs by completely rethinking its approach. As discussed in the text, this largely involves redesigning the SIF into a permanent institution with a wider mandate involving not only the provision of basic social and physical infrastructure for poor communities, but also moving gradually to support a wider concept of local development. Improvements in expanding the coverage and quality of basic education in rural areas based on the EDUCO model have been impressive and pathbreaking.

There has been little progress in improving agricultural policies, with the exception of land security, and in arresting environmental degradation. Progress on developing and implementing a comprehensive health sector reform strategy has also been slower than expected. Although the Government has continued with its nutrition programs, largely channeled through schools and health clinics, many of these interventions are not well targeted and there appear to be substantial leakages. While the Government has implemented a regular system for monitoring living standards through annual household surveys, survey design and analysis continues to require improvements.

As discussed in the text, the proposed CAS aims to assist the Government address the key remaining challenges. We will continue to support public sector modernization which includes institutional reforms in social ministries, and should help the Government create additional fiscal space to permit higher budgetary allocations for the social sectors. Proposed support for a longer-term rural development and natural resources management strategy, would begin to gradually address environmental problems affecting poor farmers and help generate additional non-farm employment opportunities. An agreed health sector reform strategy should address the need to improve coverage and quality of basic service delivery targeted on poor communities, and improved targeting of nutrition interventions. In order to improve monitoring of poverty conditions, El Salvador will be included in the IDB/ECLAC/World Bank program to strengthen the institutional capacity for the design, implementation and analysis of living standard surveys.

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BANK DIALOGUE WITH NGOs/STAKEHOLDERS

As part of CAS preparation, the Bank organized a first dialogue with NGOs and other stakeholders. Around 60 organizations were invited to attend the dialogue organized around 4 half-day thematic sessions and a concluding plenary session. Preliminary discussions and preparation for the event were carried out by the Bank's NGO Coordinator for Central America, based in the Costa Rica Regional Implementation Mission. A small committee of 7 leading NGOs was established as a working group for the organization of the dialogue and to try to address some of the concerns of the participants. EDI attended this first meeting and is designing a process to continue the dialogue throughout CAS implementation.

NGO Concerns Prior to the Meeting

A number of issues were raised prior to the meeting. **First**, NGOs felt the Bank needed to present considerably more background documentation than had been made available. The Bank had made available copies of its recent ESW, which included a Poverty Assessment, the most recent Country Economic Memorandum, and the Gender Report, as well as some general Bank material. In addition, the Bank had prepared a 10-page document, organized in the form of questions and answers, to try to explain the purpose of the meeting, the broad outlines of the Bank's previous CAS, the nature of a CAS, some of the constraints the Bank faced, and some preliminary ideas or themes that would drive the next CAS. This document was produced in Spanish. Despite these efforts, the NGOs felt that Bank material was insufficient. One particular source of irritation was the fact that CASs remain confidential documents.

Second, while some NGOs appreciated the material provided by the Bank, a general complaint was that most of the reports and documents were not in Spanish.

Third, NGOs objected to the term consultation. There was an initial feeling shared by a number of NGOs that the Bank had already decided what its strategy for El Salvador would be (some asked if the CAS had already been written) and that they would have no chance to influence it or participate in its design. They felt that the term consultation inappropriately conveyed the sense that the strategy could be modified to take into account their views. Underlying this concern over terminology was a deeper fear that the Bank wanted to use the discussion merely to validate or justify its CAS, and to be able to claim that it had consulted civil society. Despite assurances to the contrary by the Bank team, this concern remained and a number of NGOs decided not to participate in the dialogue. In the event, it was agreed that the term consultation, as understood by NGOs in El Salvador, was inappropriate and we would instead refer to it as a first dialogue or *acercamiento* between the Bank and representatives of civil society.

Fourth, related to the point above, some NGOs were concerned that there would be little or no follow up to the event once the Bank had met its obligation of presenting a CAS to its Board, having been able to claim it had "consulted" with civil society. The Bank team explained that this was a first step in what it saw as an ongoing process of dialogue and greater mutual understanding. One of the purposes of the meeting was to agree on the way in which this dialogue would be maintained on a regular basis.

Fifth, some NGOs felt that the Bank should have provided considerably more lead time to allow the NGOs to study more carefully the material provided by the Bank, and for them to reach common positions which could be conveyed to the Bank. The Bank team explained that the aim of the event was not to seek common or agreed positions on Bank views or documents, but to begin an ongoing process of open dialogue on the main development issues affecting the country. We emphasized that the intention was to reach out to stakeholders other than Government and private sector representatives, with whom we meet regularly, to broaden the Bank's understanding of the main development issues in El Salvador and the ways to address them. We were not interested in consensus positions on the Bank but a frank and open dialogue, listening to voices we normally do not hear.

Sixth, to our surprise, the El Salvador Country Seminar organized during the Annual Meetings had created considerable resentment among some NGOs. Some interpreted the country seminar, and the wide publicity it received in El Salvador, as the launching of the Bank's country strategy, and in their view therefore, leaving the dialogue without a substantive and negotiable agenda. The Bank team explained that this had not been the intention, and that the purpose of the Country Seminar was to improve the country's image abroad and to interest potential foreign investors.

Seventh, some NGOs wondered how the Bank had selected participants for the dialogue. The Bank explained that in a country where there are well over 1,000 NGOs, it was always difficult to ensure representativeness. In terms of participation, we had done our best to invite what we considered a representative sample based on our knowledge of the country, the issues we were interested in, what we knew of the NGO sector and their own suggestions. We emphasized the meetings did not aim to exclude anyone and that as we moved to establish an ongoing dialogue we would seek to correct any unintended omissions.

During a preliminary meeting with the small committee, the Bank was able to address some of these concerns, but a number of NGOs remained skeptical and decided not to participate. Although NGO concerns were expressed in different ways, underlying these was a deep mistrust of the Bank and its intentions. This is not surprising, as the NGO sector in El Salvador is in a state of flux as it adapts to the country's changing political and social circumstances. With the end of the Cold War and the advent of peace in El Salvador, many of the NGOs that were set up in strong opposition to the Government, had a strong ideological orientation, or were primarily organized to assist specific groups affected by the conflict, are finding that they have to redefine their mission and approach. A number of NGOs have clearly done this and are rapidly adapting to a changing environment. Others appear to be still uncertain as to their role and the niches they should try to fill. When an institution such as the World Bank approaches them for a dialogue, it brings to the fore some of these tensions. Many NGOs have to decide whether to participate, and thus risk being perceived by their constituencies as being co-opted by the Bank, or whether an unyielding opposition to the Bank and what it represents will be more appropriate. In addition, tensions within the NGO community were exacerbated at the time, by the fact that a Government-sponsored NGO Bill was being debated in the Assembly. Many of the NGOs opposed the Government Bill.

The Sessions

In the end, more than 30 organizations were represented during the 5 sessions. The first session was designed to discuss El Salvador's broad economic challenges. However, most of the first meeting was taken up with a discussion of the process of dialogue and the methodology that would be used.

The second session covered the social sectors, poverty alleviation, the Government's proposed local development strategy and gender issues. The session was lively and interesting. Poverty, local and community development, and gender issues dominated the dialogue. The Government's proposed reorientation of the SIF toward a strategy of local development was generally well received, but a number of important issues and concerns were raised. Many NGOs felt it was important that the new institution have wide representation, that it be transparent and that it not be politicized. The issue of how to ensure greater and meaningful community participation was extensively debated, especially because a strong criticism of the previous SIF was that although effective in constructing community works quickly, a major weakness was the lack of effective community participation. This was also felt to be critically important to ensure that the works built by the new SIF were of acceptable quality and that they could be maintained by the community. Some NGOs related instances where the contractors were not properly supervised, resulting in shoddy work which quickly deteriorated. This could be avoided if the communities themselves take greater responsibility for the design, supervision and subsequent maintenance of the works. Another important topic of discussion was the role of municipalities. Most NGOs agreed that as the strategy focuses increasingly on the community level, we should not loose sight of the fact that municipalities have a role to play but they are extremely weak. Some NGOs pointed out that there were many ongoing donor efforts to strengthen municipalities, so that perhaps what was needed was better coordination and clearer strategies and priorities. In contrast, some NGOs also expressed concerns that some municipalities would be highly politicized.

Although there was no agreement on the extent of poverty and recent trends, it was agreed that poverty is especially serious in rural areas. The discussion focused on the need to create off-farm employment and the need to improve support for small farmers.

Gender issues emerged throughout the discussion. There was criticism of the Bank in general, underlined by the perception that it has not been very effective in translating its good intentions into concrete measures—moving from speech to actions, as one participant put it. In the specific case of El Salvador, some NGOs working on gender issues underlined that they did not want to be approached only on gender topics or on implementation of specific projects. They felt that gender is an issue that should transcend the whole development agenda, and not be raised only when its time to talk about women issues.

The third session was organized around he theme of agriculture, natural resources and rural development. The discussion echoed many of the issues raised in the previous session, especially in terms of rural poverty and the stagnation of agriculture. There was broad consensus among NGOs that dealing with rural poverty was critical and that the Government did not appear to have a clear strategy to deal with the problem. Many felt that in its rush toward globalization, policy-makers had neglected agriculture, and that the Government had implicitly adopted a *laissez faire* approach to agriculture—just getting prices right and letting markets work in agriculture was not enough to deal with high rural poverty. Although most speakers acknowledged that the economic share of agriculture would inevitably drop over time, nonetheless agriculture and rural development needed to be one of the planks of the Government's globalization strategy, even if a smaller one.

There was less agreement on solutions. Many NGOs argued for subsidized credit or directed credit to small farmers or women. Others recognized that these schemes tended to be financially and fiscally unsustainable, and that access was a more important constraint. Some argued for a state role in agricultural marketing as the only way to reduce the high margins charged by intermediaries. Rural infrastructure was also identified as a priority. Gender issues also figured prominently, especially women's access to credit and agricultural extension. Some NGOs pointed out that the Agrarian Reform implicitly focused on male farmers, as if women farmers or women-headed households did not exist.

The cooperative sector and its problems was also a source of concern. Many in the meeting criticized the Bank's support for flexible land markets. The Bank's efforts to improve land security through titling and registration was recognized as valuable but there was little understanding of why the Bank agreed with the Government's position that land titling should encourage the development of flexible land markets. This was seen by some as a direct attack on the cooperatives (and implicitly on the achievements of the Agrarian Reform) although there was a quiet acknowledgment that the cooperativization of production has not worked as expected, and that there are serious problems with the management and governance of cooperatives. Underlying these fears is a deep concern that by allowing cooperative members to have individual titles, land reform will be undone and result in a reconcentration of land. The Constitutional prohibition on owning more than 245 ha is not seen as sufficient protection against land reconcentration. The fact that El Salvador's civil war is often described as having been about land, makes this debate an emotional one. The idea that cooperatives could gradually evolve into associations of producers with individual titles, and who by virtue of their greater numbers could secure better access to credit, inputs and marketing services, and in some instances create rural enterprises was seen as having some potential, but it was difficult to move the debate away from the emotionally charged topic of land.

The lack of an appropriate legal and institutional framework for the environment was a frequent concern. It was felt that environmental issues were not a priority for the Government and this largely explained the lack of progress in improving laws, setting up strong institutions, allocating sufficient funds, and enforcing existing regulations. While there was consensus on the need for a stronger legal framework, many felt that the way in which laws were to be enforced was equally important. There was a fear that large and powerful polluters would be able to evade penalties, while the full force of the law would be applied to small, subsistence farmers who have no choice but to degrade the environment.

The fourth session was to cover public sector modernization and the competitiveness agenda. A large number of the participants were representatives of the labor movement, especially state enterprises that have been slated for privatization. Not surprisingly, the discussion was dominated by privatization. Most of the participants stated that they and their unions were not opposed to privatization—they either accepted the rationale for privatization or considered it inevitable. Most of the criticism centered on concerns over the transparency of privatization. It was felt that the Government had not adequately consulted workers that would be affected by privatization, or when consulted, they felt their suggestions had not been taken into account. A parallel was drawn between the proposed privatizations and the earlier experience with the reprivatization of the banks, which many felt had not been transparent. Some also indicated the Government should provide some assistance for workers to buy shares in the privatized companies. A second area of concern was a lack of understanding on what was to be done with the proceeds of the privatizations. Many participants expressed the view that the funds should be invested in the social and infrastructure sectors, and that care should be taken not to waste a resource that would be available only once. The funds should not go to finance recurrent expenditures. This suggests that the Government has not been effective in communicating and explaining how it intends to use the privatization proceeds. Most participants called for a clear statement from the Government on the use of privatization proceeds.

The last meeting was a plenary session where the Bank team attempted to distill some of the lessons and messages heard during the previous two days. We did not attempt to summarize what turned out to be a wide-ranging and complex discussion, but tried to point out where we had benefited from the dialogue and where we felt the country strategy and its subsequent implementation needed to take account of the concerns raised. The plenary also discussed a number of alternatives we could work on to ensure that we could establish an agreed process by which to continue the dialogue. During the plenary, it was agreed that the small committee would consider these options and after internal discussion would present to the Bank a proposal for an ongoing dialogue. A number of additional NGOs asked to be consulted on next steps.

Lessons Learned

Although this first dialogue was difficult and we did not succeed in fully allaying the fears and mistrust of all NGOs, the Bank team learned much from the discussion and debates. We have attempted to reflect some of these inputs in the design and articulation of the proposed CAS, but equally important will be our ability to follow-up throughout CAS implementation. Informal feedback received following the meetings has been positive, with some of the NGOs indicating surprise at the Bank's willingness to have an open and candid dialogue, and at the fact that the sessions were able to generate substantive discussions on some of the key development issues in the country. Most NGOs found the dialogue useful and expressed a willingness to participate in an ongoing process.

The Bank team discussed the main points raised in the NGO dialogue with the Government. The Government acknowledged that most of the issues raised were valid and useful. It also expressed a desire for the Bank to continue to assist in opening spaces and acting as a catalyst for greater dialogue among representatives of civil society. It believes the Bank can play a valuable role in bringing stakeholders to the table and mobilizing its international experience to help develop a constructive national debate.

In terms of lessons learned, the following are key:

- It was a mistake to focus on the product (*i.e.*, the CAS) and not the process. Given the state of play in El Salvador, we should have downplayed the role of the CAS and instead focused on how to begin a process of dialogue and debate with civil society. Merely consulting or dialoguing with NGOs before writing a CAS does not produce a participatory CAS. NGOs and other stakeholders justifiably fear that the Bank is merely trying to validate or legitimize its assistance strategy, especially in the eyes of the Board. In the case of El Salvador, the onus should be on the Bank to demonstrate its sincerity and openness.

- The dialogue has to be a continuous process. Some NGOs asked whether we would only hold these types of meetings when we were required to prepare a CAS (*i.e.*, about every three years).

- NGOs do not understand why the CAS is a restricted document and perceive a contradiction in the Bank's stated desire to involve them more fully but not to share the final product.

- It is very difficult to organize a dialogue and consultation without a field presence in El Salvador. Although we maintain frequent contacts with NGOs and the Regional NGO Coordinator traveled frequently to El Salvador to prepare the meeting, there was a feeling that many of the concerns and fears raised by the NGOs prior to the meeting could have been addressed if the Bank had had a Resident Mission in the country.

- We have to do a better job of disseminating information about the Bank and our analytical work. Many of the concerns raised by some NGOs reflect a lack of understanding of the Bank, what it does and its constraints. Also, making documentation available in Spanish will need to be priority.

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EL SALVADOR'S FINANCIAL SYSTEM

Financial Sector Crisis and Reforms

In 1980, the Government nationalized El Salvador's banking system and begun adopting policies that led to considerable financial repression—artificially low interest rates, credit subsidies, mandatory credit allocations for particular sectors, and high reserve requirements. By the late 1980s, the financial system was in crisis. At the end of 1989, delinquent loans carried by the financial system (banks, financieras, Banco Hipotecario and Specialized Financial Institutions) reached ¢3,861 million, accounting for 37.4 percent of the total loan portfolio. Their negative equity amounted to ¢2.2 billion or 26 percent of deposits, while administrative costs were high in all institutions. The insolvency of the banking system prompted the intervention of the Government to restore public confidence in the system, and avoid a bank run that would have compounded the critical situation of the country in a period of civil-war and economic instability.

Beginning in 1989, the Government has taken a number of measures to promote sound development of the financial system, including: reform of the regulatory framework for financial institutions, reform of the supervisory agency (SSF), privatization of commercial banks and savings and loan associations, liquidation of three state-owned banks, establishment of a special fund (FOSAFFI) to purchase the worst performing loans from commercial banks, liberalization of interest rates, abolishment of directed credit programs and unification of reserve requirements across all types of financial intermediaries (competitive neutrality).

As a result of these reforms, the financial system was able to move from a state of crisis and financial repression to one where liberalization and prudential financial regulation prevail. The results of the financial reform of the 1990s are promising. At the end of 1995, lending and deposit interest rates were positive in real terms, privatized banks and financieras had over ¢6 billion of net capital, and the number of financial institutions had almost doubled with respect to 1989 (Table 1).

Table 1: Summary Statistics of the Financial System. 1989. 1995.

Indicator	1989	1995
Quasi-money/GDP	16.0	27.3
Real Interest Rates (% pa)		
Lending	0.7	8.2
Deposit	-1.2	3.9
Banks and Financieras		
No. of Branches	230	270
No. of Institutions	11	21
No. of Employees	7,681	12,635
Capital of Privatized Banks and Financieras (million)	- ¢2,212	¢6,066
Loan Quality (D and E)	36.7%	3.4%
H-H Index	1,690	1,569

In 1989, the Government began strengthening commercial banks and financieras by changing the boards of directors, and evaluating and reclassifying loan portfolios. Loans were reclassified into five risk categories. The Central Bank (BCR) required banks to set aside reserves for each loan risk category according to new rules. At the end of 1989, 36.7 percent of the loan portfolio was classified in categories D and E. The loan portfolio classified in categories D and E was exchanged for

Government bonds issued by FOSAFFI (¢5,286 million). In addition to debt exchange, the Government had increased the capital of banks and financieras by ¢630 million by June 1993. The Banco Hipotecario, Banco Salvadoreño and Financiera Atlacatl received a capital boost of ¢475 million, accounting for 75.4 percent of the total increase in capital. During this process, three commercial banks were closed, two were merged and four were capitalized. Specialized financial institutions such as FEDECREDITO and FIGAPE were also recapitalized.

Privatization

In November 1990, the *Ley de Privatización de Bancos Comerciales y de las Asociaciones de Ahorro y Préstamos* was enacted to regulate the privatization process and avoid concentration of ownership. The general objective of the law was to allow for the gradual privatization of the nationalized banking system. It established a two-stage process for sale of stock to facilitate selling of shares to commercial bank employees and to small investors, with the Government providing incentives (through FOSAFFI) for these preferred purchases. After a period of 120 days, other investors had the opportunity to buy stock through a public auction in which the minimum price was the book value. A limit of 5 percent was established for equity participation of single investors or members of the same family. International investors were allowed to own up to 20 percent of an institution's capital.

A total of five banks and four financieras were privatized during 1991-94. These five banks were sold in a period of 12 months, starting in November 1991. A total of 10,453 new investors bought ¢756 million worth of stock, out of which ¢88.4 million corresponded to employees. The four financieras were sold between July, 1993 and April 1994. A total of 5,479 new investors bought ¢387.6 million of stock in these financieras, out of which ¢47 million corresponded to employees. The last institution to be privatized was financiera Atlacatl in April 1994, and there are ongoing negotiations for the privatization of Banco Hipotecario.

The privatization process did not achieve the objective of ensuring wide ownership. The limits on equity participation were bypassed, as employees and small investors bought stock for other investors. These other investors provided the downpayment required by FOSAFFI in exchange for voting rights which were obtained through private contracts (proxies).

The privatization of banks and the removal of barriers to entry into the banking sector have had little effect on the structure of the system. Although the number of financial institutions has almost doubled, the new entrants held only 9 percent of total system assets in 1995. An instrument to measure the concentration of an industry is the H-H index.[1] Comparing 1991 with 1995, the H-H index decreased slightly from 1,690 to 1,569. The current distribution of assets of the banking system is concentrated in three banks (Banco Agrícola, Salvadoreño, and Cuscatlán) which in 1995 have the same share of total assets of the banking system as in 1991 (61 percent).

Interest Rate Liberalization

Interest rates were liberalized in November 1990, which has resulted in positive real deposit and lending rates. In addition, positive real deposit rates appear to have attracted a large number of depositors. Unlike some other Latin American countries, the percentage of the population that maintains bank accounts is fairly deep—the system holds 552,000 checking accounts and 1.9 million

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[1] The index is equal to the sum of square of the market shares of assets of each firm. Higher values imply a greater concentration of the industry. For reference, if all 13 banks had equal market shares, the H-H index would be 769.

savings accounts, which is high for a population under 6 million. The volume of quasi-money (time deposits, current savings, and foreign currency deposits) as percentage of GDP has been increasing, probably reflecting increased public confidence in the financial system. In 1994, quasi-money and M2 reached levels of 29.9 and 40.5 percent of GDP, respectively, the highest levels since 1980. Finally, the liberalization of interest rates together with other measures have created the conditions to attract new financial intermediaries into the market due to the increased profitability of financial activities.

The most recent modification of the Banking Law enhances the accuracy of interest rate information. Banks and financieras are required to publish their interest rates monthly and every time a change occurs. Furthermore, they must establish a common reference rate for their credit operations (Art. 61). This measure will ensure that interest rate differentials among institutions reflect a spread around that reference rate. In addition, BCR is required to publish at least monthly the average lending interest rate of banks and financieras.

After 1991, the Government imposed uniform reserve requirements on savings and time deposits in all types of financial intermediaries (currently at 20 percent) thus removing the bias against banks and in favor of savings and loans. Demand deposits in commercial banks have a reserve requirement of 30 percent. The uniformity of reserve requirements for all types of financial intermediaries is consistent with the objective of competitive neutrality.

BCR currently uses selective reductions in reserve requirements as an instrument to stimulate long-term sources of funds for the financial sector and channel funds to housing and agriculture. The funds raised with these savings instruments have a reserve requirement of 15 percent, and all the reserves are remunerated. These savings instruments are CEDEVIV which targets housing and CEDEAGRO (introduced in 1996) which targets agricultural production. CEDEVIV has grown rapidly reaching a market share of 11 percent of total savings in 1995. Since 1992, the real growth rate of CEDEVIV has been more than 50 percent per annum. In order to attract long-term deposits, both CEDEAGRO and CEDEVIV offer an interest rate premium to depositors for locking their money for at least two-years.

Regulatory Framework

The Superintendency of the Financial System (SSF). The reorganization of SSF was initiated with approval of the *Ley Orgánica de la Superintendencia del Sistema Financiero* in November, 1990. The reorganization aimed to expand SSF's mandate, increase its independence and strengthen its supervision system. To perform its new responsibilities, SSF was reorganized into four divisions: (i) bank and finance companies; (ii) insurance and pension funds; (iii) securities exchange; and (iv) administration and finance. Under an ongoing reform program, SSF would be restructured into three independent superintendencies: one for the *mercado de valores*, one for pension funds, and one for banks and financieras. The latter would have three intendencies: banks and financieras, insurance, and credit cooperatives.

SSF currently supervises 140 institutions with about 200 employees, of whom 140 are involved in inspection. It undertakes off- and on-site supervision. The department of financial analysis executes off-site supervision by doing a monthly analysis of financial statements with a completely computerized system. The main goal of this off-site supervision is to provide an early-warning mechanism on changes in the financial performance of an intermediary that may become insolvent, illiquid or both. SSF requires from banks and financieras: (i) monthly balance sheets and income statements; (ii) quarterly publication of financial statements in widely-read newspapers; and (iii) monthly submission of risk classification of borrowers. Off-site supervision consists of a series of reports that the financial intermediaries have to send to the SSF. On-site supervision takes place only when off-site surveillance data show that a particular intermediary is experiencing problems.

Regulation and Legislation. Over the past five years a number of reforms have been carried out to strengthen the regulatory framework. The new Law for the BCR increased its administrative autonomy, while prohibiting the BCR from directly or indirectly financing Central Government or public enterprises, setting interest or exchange rates. The Law for Banks and Financieras considerably tightened prudential norms. At present, there are a number of draft laws under review by the Authorities. These are: *Ley de Instituciones Auxiliares de Crédito, Ley de las Instituciones Oficiales de Crédito, Ley de las Instituciones de Seguros, Ley de Fondos de Inversión, Fondo de Garantía de Depósitos, Ley de la Superintendencia, Ley de FEDECACES y del Sistema Cooperativo*

Entry Regulation and Chartering. The permission to charter new banks was delayed until July 1993. Since then, two new banks have entered the market, six financieras have been converted to banks stimulated by high returns on capital (in the order of 27.2 percent for 1995), and seven new financieras have been authorized to operate.

Limitations of Ownership. The banking law imposes limits on ownership based on nationality and on a one percent restriction on capital ownership which can be lifted subject to SSF approval. The legislation assigned to Salvadoran nationals the majority ownership of financial intermediaries, *i.e.*, foreigners could not own more than 50 percent of total capital. However, the last modification to the banking law allows foreign banks to own 75 percent of stocks. This measure should foster the participation of foreign banks in the financial system through the purchasing of existing banks or through the incorporation of new institutions. The Government is currently evaluating a proposal to sell Banco Hipotecario to a foreign bank.

Capital Requirements. The minimum capital required to enter the market is ¢50 million for banks and ¢25 million for financieras. The capital adequacy ratio, the ratio of equity to risk weighted assets, was raised from 8 to 10 percent in January 1996. SSF established a transitional period of six years to allow banks and financieras to meet the new capital adequacy ratio. For the purpose of this ratio, equity consists of: (i) primary capital such as stocks and legal reserves; and (ii) secondary capital such as retained earnings and 50 percent of net income. Furthermore, any investments in other institutions are subtracted to prevent artificial infusions of capital or the so-called double leveraging. Assets are classified into three categories that receive a weight of 100 percent (loans), 50 percent (lines of credit), 20 percent (government bonds) and zero percent (cash) according to risk.

The main merits of the risk-based capital requirement are the recognition of a risk differential among assets, and the inclusion of off-balance sheet items. However, the main drawbacks are that it *ignores other types of risk, such as liquidity and interest rate risk, correlation among assets or between* liabilities, establishes arbitrary categories, and it does not use the market value of assets. In addition, it is difficult to appraise the value of off-balance sheet items.

Diversification Rules. The legislation also restricts the concentration of outstanding loan balances on a single customer (Art. 104). This limit is set to up to 15 percent of the equity capital of the financial intermediary. However, this limit can be raised up to: (i) 30 percent if the loan is guaranteed with real collateral; (ii) 50 percent if the collateral consists of deposits; and (iii) more than 50 percent if guaranteed with a line of credit of foreign banks, or deposits.

Limits on Loans to Insiders. The amount of outstanding loan balances that may be granted to bank insiders was reduced from 50 percent to 15 percent of stock and capital reserves in January 1996

(Art. 110). Banks have two years to adjust to the new ratio requirement. Insiders are those employees involved in the administration of the institution as directors or managers and those stockholders that own more than 3 percent of the stocks.

Limits on loans to insiders is an important aspect of prudential regulation since the intermediary's owners may use these loans to recapture a proportion of their equity contribution. Under the new limit, a stockholder that owns 3 percent of the stock can receive an average loan size up to 6.4 times his/her actual ownership.[2] The previous 50 percent requirement implied that the same stockholder could receive 21.2 times his/her actual ownership.

Loan Risk Classification. The main objective of loan risk classification is to make risk exposure explicit and to require lending institutions to protect their solvency by making adequate provision for loan losses. SSF classifies loans to enterprises, consumption loans, and mortgage loans with three different criteria. For enterprise loans, there are five credit risk categories—A, B, C, D, and E (Table 2)—with an attached required provision for expected loan losses.

Table 2: Loan Risk Categories

Risk Type	Borrower Characteristics	Required Loan Reserves
A	Excellent capacity to repay and solid project proposal.	0 %
B	Good project, however technical and marketing risk exist	1 %
C	Projects with weak financial conditions. Delinquent less than 60 days. Collateral value becomes important.	10 %
D	Dubious repayment possibilities. Delinquent less than 180 days on previous loans.	50 %
E	Insolvent clients. Delinquent more than 180 days on previous loans, no guarantee.	100 %

Consumption and mortgage loans are classified into categories A to E depending on the days of arrears of the loan. These loans are classified as type A if they have been less than 30 days late. Consumption loans are categorized as type E if the number of days in arrears is more than 121 days. In contrast, mortgage loans must be classified as type E when they are late for more than 361 days.

Each bank gives a credit rating to its clients according to SSF instructions. SSF supervises the risk classification of loans performed by banks and financieras. Its department of risk assets samples 35 percent of risk assets of the system three or four times per year, and it requires banks to sample up to 80 percent of their risk assets balances.

Asset quality indicators are strong, which is to be expected given that bank balance sheets were cleaned up only five years ago and the economy's strong growth since. At end-March 1996, D and E loans of banks totaled 3.4 percent of total loans, unchanged from a year ago. For financieras, D and E loans increased during the period from 1.8 percent to 2.4 percent. Loans have increased strongly during this period, by 27 percent, well above inflation. Such growth is not sustainable and could portend future asset quality problems if the economy falls into a prolonged slump or experiences a severe external shock.

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[2] The calculation used the formula: [ratio of loans to insiders / % ownership]*[1 + (reserve capital / stocks)].

Deposit Insurance. The government guarantees deposits up to ¢30,000. This guarantee, however, is not backed by dedicated reserves.

Credit Bureaus and Information Sharing. Current legislation requires SSF to manage a risk classification system for borrowers of banks and financieras. The institutions that report to the credit bureau are banks and financieras, insurance companies, FOSAFFI, FEDECREDITO, FIGAPE, FONAVIPO, Fondo Social para la Vivienda, Instituto Nacional de Pensiones de los Empleados Públicos, and Instituto de Previsión Social de la Fuerza Armada.

Access to borrower credit risk classification reduces borrower and lender transaction costs. Currently, lending officials use the database operated by SSF as a preliminary screening device for potential clients. Banks have a clear preference for borrowers classified as type A or B because their lower reserve requirements imply a higher rate of return. Banks and financieras must provide SSF with the credit rating of borrowers when the loan is approved. In addition to credit rating, banks and financieras must provide other information such as: sector of economic activity, date of the loan, outstanding debt, and type of collateral.

SSF provides banks and financieras a monthly report with the credit ratings of borrowers who are identified by their Tax Identification Number. Although the outstanding debt of borrowers or the number of loans are not shared, banks and financieras can explicitly request that information from SSF. Upgrading of the credit rating of a borrower must be approved by SSF if the total debt of the borrower is more than ¢500,000. SSF uses the information provided by banks to calculate delinquency problems by sector of economic activity.

Overall Assessment[3]

The institutional and regulatory framework currently in place represent important and decisive steps in the process of providing a favorable and safe environment for financial intermediation. To highlight a few, the tightening of capital adequacy requirements, the revised limitations on loans to insiders, and the establishment of a system of loan risk classification are particularly important in improving the overall soundness of the financial system. Moreover, Salvadoran banks appear to be among the more efficient in Latin America. System-wide, noninterest expense averages 3 percent of average assets. The figure is somewhat distorted, however, by the strong growth in total assets. Intermediation spreads, at about 4.5-5.0 percent, are tight by Latin American standards.

Improvements are still needed in several areas, some of which are likely to be accomplished by the new regulations currently in preparation. Unresolved issues relate to the supervision of FEDECREDITO affiliates, thus far delegated by SSF to the federation, and the regulatory framework for more effective financial intermediation in the credit-union sector. In addition, the rules that govern non-lending financial mechanisms such as leasing, factoring, and warehouse receipts is an area that the upcoming legislation does not appear to fully cover, and where the effect of adequate regulation may be significant. As discussed in the CAS, this an area where the Bank and IFC plan technical support during 1997.

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[3] The Competitiveness Enhancement Technical Assistance Loan is supporting preparation of a Financial Sector Strategic Study. The Study will address options for the development of the Salvadoran financial system over the medium term, and will cover: universal banking; internationalization and product innovation; legal and accounting infrastructure for financial transactions; and actions to ensure stability (*e.g.*, establishment of deposit insurance).

Debt refinancing programs have been the main strategy used by the Government to deal with debt delinquency, especially for the agriculture sector. These programs raise two main concerns: (i) the creation of disincentives for borrowers in good standing to stop paying their loans with less favorable terms than delinquent borrowers; and (ii) the encouragement of large-scale strategic default.

Risks to the system arise from three main sources. First, the economy's narrow base can exacerbate the credit cycle. Second, the rapid increase in consumer debt following the post-conflict boom is a concern, although it appears to be still within manageable levels. Third, loan growth has been rapid, which may portend future asset quality problems. Thus far, these risks appear to be manageable. Financial reforms have been accompanied by a significant strengthening of the supervisory framework.

Economic Development Institute (EDI)
El Salvador Country Assistance Strategy: Training Activities FY97-00

CAS Priorities	Training Activity	Main Goals	Timing
Social Development			
Poverty reduction	• Partnerships for Poverty Reduction (Regional Program)	• Promote new approaches to poverty reduction that involve partnerships between NGOs, the private sector and Government.	FY97-98
	• LAC/NGO Poverty Network	• Strengthen NGO capacity to become more effective in the process of poverty reduction—urban poverty focus.	FY97-00
Education	• Effecting School Change in Latin America (Regional Seminar)	• Strengthen local capacity to design strategies to improve primary education.	FY97
	• Study Tour to New Zealand and Australia (National)	• Raise awareness on impact of education reforms.	FY97-00
	• School-to-school Network (Internet Forum for Salvadoran students in El Salvador and in the U.S.)	• Promote distance learning and strengthen expatriate community ties.	FY97-00
Health	• Health Sector Reform and Sustainable Financing (Regional Seminar)	• Improve understanding of health reform and financing options, and the do's and don'ts of implementation.	FY97
Public Sector Modernization	• Privatization and Public Sector Management (National Seminar). • Improving Service Delivery (National Seminar).	• Strengthen local capacity to manage privatization and regulation, and improve public sector management and client orientation.	FY97
Competitiveness Enhancement	• Fourth study tour for cross-section of Salvadorans.	• Raise awareness of successful reform experiences.	FY98
	• Establish network and set up permanent forum for study tour participants.	• Provide forum for discussion of applicability to El Salvador, make recommendations and monitor progress.	FY97-00
Environment	• Economy-Wide Policies and the Environment (Regional Seminar).	• Raise awareness and contribute to consensus for sustainable development.	FY97
	• Workshop on application of action impact matrix to policy issues pertaining to land degradation and soil erosion.	• Explore with stakeholders the nature of environmental problems and viable solutions to address them.	FY97
	• Via the Internet program and other education initiatives and networks, provide teachers in El Salvador with tools and resources (print materials, Web site, CD-ROM, training programs, etc.) for teaching and learning about critical issues of sustainable development		FY97-98
NGO/Stakeholder Dialogue	• Economic Reforms (Series of National Workshops).	• Improve civil society's understanding of the reform process.	FY98-00
	• Launch communication strategy agreed with NGOs for the next 3 years, including workshops and other outreach programs.	• Improve Bank understanding of development issues, potential of civil society to participate in development dialogue and Bank efforts.	FY97-00

MOBILIZING THE BANK GROUP

The ability to mobilize different areas of experise within the Bank Group to support the Bank's assistnace strategy for El Salvador has been extremely valuable and appreciated by the cllient. Through this effort, the Bank Group has been able to increase the speed and quality of its response, aiming to provide seamless service to the client. This collaboration has materialized through support for the preparation and implementation of projects, such as the Competitiveness and Public Sector Modernization Technical Asistance Loans, as well as active support to the El Salvador Country Team and a willingness to respond promptly to requests from the Government and private sector for advice in specific areas. In addition, EDI is playing a major supportive role in reaching out to other stakeholders, both as part of CAS preparation as well as the effort to maintain an ongoing dialogue with NGOs and other stakeholders in civil society. In addition to the important contributions of EDI, IFC, FIAS and MIGA mentioned throughout the CAS document, key support is being provided by the Central Vice Presidencies. Some of these services include:

- Finance and Private Sector Development (FPD) has played a major role in articulating the strategic vision for the competitiveness program and is supporting the piloting of the National Knowledge Assessment. It is also supporting regulatory reform, competitiveness analysis by clusters, advisory services for the privatization program, and adoption of the ISO 9000 quality enhancement program.

- The Economic Development Institute (EDI) has developed a three-year program of training activities and dissemination efforts for El Salvador, to support CAS priorities (described in Annex E)

- External Affairs (EXT) and the Corporate Secretariat (SEC) supported the El Salvador Country Seminar during the Annual Meetings, which will be followed up during IDB's 1997 Annual Meeting in Barcelona targeting European investors. EXT is also advising the Government on focused communication program, to build consensus for globalization and to improve the country's image abroad.

- The Learning and Leadership Center (LLC) supported an initial team building effort to kick-off CAS preparation, has supported two team-building workshops between the Bank team working on the Basic Education Modernization Project and Salvadoran counterparts and stakeholders, and supported the recent Government/Bank workshop to discuss the new approach to local development.

The responsiveness and wide range of services offered by the Bank Group is appreciated by the client and has shaped its perception of the Bank as a knowledge-based institution. This approach will continue to be a driving force in the services we provide during CAS implementation.

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EL SALVADOR: Country Strategy and Progress Benchmarks

Priority	Development Impact	Progress Benchmarks	Year	Services/Products
Poverty Alleviation and Social Development	Reduce national poverty rate, as measured by Government household surveys, to 35-40 percent by the year 2005. Reorient poverty alleviation strategy, expanding the role of the SIF by adopting a local development focus, and encouraging cluster-type partnerships between, local communities, NGOs and private sector.	Agree with Government and key stakeholders on the strategy and operational mechanisms that will guide the new SIF. Begin implementation of the new SIFLD project, and extend piloting of local development concept, expand cluster concept to include private investors, NGOs and productive activities generated by local communities.	FY97 FY98 to FY00 FY97 to FY98	Lending Services • Proposed **Social Investment Fund for Local Development Project** (IDB; KfW). • Carry out extensive stakeholder consultation throughout the project cycle. Non-Lending Services • **EDI**: (i) Regional Program of Partnerships for Poverty Reduction; and (ii) LAC NGO Poverty Network
Rural Development and Natural Resource Management	Raise rural growth and reduce rural poverty by improving agricultural policies and support systems, encouraging off-farm employment, and improving natural resource management.	Agree with the Government on a longer-term agriculture and rural development strategy, following wide national consultations with stakeholders to develop consensus. Begin implementing the agreed strategy. Strengthen institutional and financial support for improved natural resource management and diversification of rural incomes.	FY97 FY97 FY99 to FY00	Non-Lending Services • Ongoing **Rural Development and Rural Credit Studies**. • Workshops on rural development strategy (IDB) Lending Services Proposed **Rural Development and Natural Resources Management Project(s)**.
	Improve poverty monitoring, and strengthen local capacity to design, implement and analyze surveys for policy-making and impact evaluation.	• Agree on an action plan to improve the design and analysis of Living Standard Surveys, including developing a gender module. • Implement agreed action plan for the 1998 Household Survey.	FY97 FY98	Non-Lending Services • Implementation of **Program to Improve Living Standards Surveys** (IDB/ECLAC/World Bank). • Proposed **IDF Grant** to support Program.
Education	**Basic Education**: Improve coverage, quality and community participation in basic education through extension of EDUCO	Expand pre-school coverage by 21,000 students (20%) and basic coverage by 52,000 students (6%); build 2,500 classrooms; train 7,600 Community Association (ACE) members.	FY99	Lending Services Ongoing **Basic Education Modernization Project** (IDB, UNDP).
	Secondary Education: expand coverage and quality to support globalization agenda and to meet expected increase in demand, focusing on cost-effectiveness and community involvement.	Agree with Government on strategy and policy framework for expanding the coverage and quality of secondary education; develop appropriate mechanisms to encourage community participation following lessons from EDUCO; improve cost effectiveness of service provision; agree on role of private sector; and target expansion in coverage in rural areas.	FY97 FY97 to FY00	Non-Lending Services • Ongoing **Secondary Education Study** • **EDI**: (i) Study tour to New Zealand and Australia to review impact of education reforms; (ii) Regional Seminar on Effecting School Change in LAC; and (iii) school-to-school Network (Internet forum for Salvadoran students in El Salvador and the U.S.)
		Implement reforms in secondary education to improve quality and expand coverage, especially in rural areas.	FY98 to FY00	Lending Services Proposed **Secondary Education Modernization Project.**
Health	Increase coverage and quality of basic health services, targeting poor rural areas, women and children.	Support institutional strengthening measures in the Ministry of Health, including the testing of at least 5 pilots for alternative delivery systems, development reform proposals, and development of a strategy to increase community participation and decentralization in health.	FY97 to FY00 FY00	Non-Lending Services • Policy advice on health reform. • **EDI**: Regional Seminar on Health Sector Reform. Lending Services Proposed **Basic Health Reform Project** (IDB)

EL SALVADOR: Country Strategy and Progress Benchmarks

Priority	Development Impact	Progress Benchmarks	Year	Services/Products
Gender	Promote gender as an integral aspect of public sector modernization and the encouragement of greater client orientation among public agencies; enhance gender responsiveness in CENTA; and improve living standards survey design to better analyze gender issues within the household.	• Agree on and carry out a set of activities to incorporate gender as integral part of the Public Sector Modernization Program. • Develop 2-year action research plan for CENTA, within the Bank's GINO Program. • Incorporate gender component in IDB/ECLAC/World Bank program to improve living standards, starting with the 1998 *Encuesta De Hogares de Propósitos Múltiples*; hold 2-3 in-country workshops in 1997 to help design subset of questions.	FY98 to FY00	Non-Lending Services • Participation in the Bank's **GINO Program**. **Workshops and seminars** targeting stakeholders, government agencies, CENTA, staff responsible for survey design and analysis, and the Commission for Public Sector Modernization. • Proposed **IDF Grant** to support Program to Improve Living Standards Surveys (IDB, ECLAC).
	Address gender-specific issues in education and health, particularly in opening more career opportunities for female students, reducing teenage pregnancy, and reducing domestic violence and sexual crimes.	Reduce gender stereotypes in textbooks, include sex education in school curricula, provide career guidance to counteract labor market stereotypes, and include gender issues in teacher training. Support public education efforts to reduce domestic violence, and seek ways of providing support to women affected by sexual crimes.		Lending Services Ongoing **Basic Education Modernization Project** (IDB, UNDP); proposed **Secondary Education Project**; and proposed **Basic Health Reform Project** (IDB)
Competitiveness Enhancement	Increase domestic competition and consumer protection.	•Draft Competition and Consumer Protection Laws presented to Congress and establishment of implementation units.	FY97	Lending Services Ongoing **Competitiveness Enhancement Technical Assistance Project**.
	Simplify investment procedures and improve investor services.	•Draft Investment Law and design of software for the one-stop-window.	FY97	Non-Lending Services **FIAS** advisory and technical support.
Quality/Standards	Promote adoption of international quality standards by local firms.	•Create system for certification and training in ISO 9000 and other firm-level quality management programs.	FY98	**FPD** advisory support.
	Crate movable assets registries and strengthen registries and protection for intellectual property.	•Implement action plan for legal reforms and institutional design of registries for movable assets, modernization of commercial registries, and upgrading for intellectual property protection.	FY98	
Communications	Improve public awareness of competitiveness program, and strengthen cooperation between public and private sectors.	•Implement program of seminars, media campaign and study tours to examine international experience; develop consultative and monitoring mechanisms that can analyze and disseminate this experience, and continue work on parts of the competitiveness program.	FY97 to FY99	**EDI:** (i) third study tour for cross-section of Salvadorans; (ii) organize in country network of participants in competitiveness study tours, and agree on follow-up activities.
Learning Society	Enhance access to information and the diffusion of knowledge throughout society.	•Carry out a pilot National Knowledge Assessment, targeting key economic sectors, also extending methodology to local communitiesand consultation.	FY98	Non-Lending Services Prepare National Knowledge **Assessment** (NRC)
		•Develop medium-term Learning Society Program based on the results of the pilot National Knowledge Assessment.	FY98	Lending Services Proposed **Information Society Project**.
Public Sector Modernization	Institutional restructuring to eliminate overlaps, and increase efficiency in the provision of public services.	Complete 8 institutional restructuring programs, eliminate 12 programs, transfer 4 institutions to the private sector, and relocate 9 institutions.	FY97 to FY99	Lending Services Ongoing **Public Sector Modernization Technical Assistance Project** (IDB)
Debureaucratization	Simplify and redesign bureaucratic processes to increase efficiency and customer orientation.	Launch 3-4 debureaucratization projects in 1996, and an additional 12-16 projects thereafter. Survey public opinion on a regular basis to ascertain improved efficiency in service delivery from client perspective.	FY97 to FY00	Non-Lending Services **EDI**: (i)National Seminar on Privatization and Public Sector Management; (ii) National Seminar on Improving Service Delivery

EL SALVADOR: Country Strategy and Progress Benchmarks

Priority	Development Impact	Progress Benchmarks	Year	Services/Products
Human Resources Management	Improve capacity to manage civil service, monitor pay and employment policies. Establish new legal framework to manage human resources.	Install and use Human Resources Information System in all ministries. Approve and implement new Civil Service Law	FY99 FY97	
Privatization	Increase efficiency and service quality through privatization of infrastructure.	Approve legal framework for privatization, develop and adopt regulatory frameworks for telecoms and power, restructure power and telecoms companies for privatization, and privatize.	FY97	**FPD** advisory services.
	Privatize pension system to deepen capital markets, improve coverage and stimulate private savings.	Prepare and approve new legislative framework for social security reform, including establishment of private pension funds.	FY97	**IFC** advisory support.
Environment and Natural Resource Management	Build consensus and awareness of broad environmental issues. Complement efforts of other donors to strengthen institutional, policy and regulatory framework	Carry out series of dissemination seminars and workshops to improve awareness and understanding of serious environmental problems, provide a forum to link policy makers and stakeholders, and support informed consensus-building on required measures to address environmental issues.	FY97 to FY00	Non-Lending Services **EDI:** (i) Regional Seminar on Economy-Wide Policies and the Environment; (ii) National Workshop on application of Action Impact Matrix to policy issues in land degradation and soil erosion; and (iii) via the Internet program and other development education initiatives, provide teachers with tools and resources on sustainable development.
Land Security	Improve land security to improve farmer incentives to make investments in soil conservation.	Regularize the registration of 25% of the national territory and provide technical assistance and agricultural support services for 80,000 small producers. Regularize the land tenure of cases pending from the 1992 Peace Accords. Develop a financially self-sustaining cadastral system for mapping and registration.	FY97 to FY99	Lending Services • Ongoing **Agriculture Sector Reform Project.** • Approved **Land Administration Project**.
Natural Resource Management	Stimulate rural growth and improve natural resource management at farm and Municipality levels.	See section above on rural development and natural resource management.		See above.
Dialogue with NGOs/Civil Society	Contribute to better understanding of development issues, the structural adjustment process, the role of the Bank Group and potential for NGO and civil society involvement in Bank programs and projects.	• Launch a communication program agreed with NGOs for the next 3 years. Provide institutional support to facilitate the dialogue. Increase availability of Bank material in Spanish. Ensure the dialogue becomes self-sustaining and includes the private sector as well as the overseas Salvadoran community. • Enhance Bank learning on structural adjustment programs from the bottom up and involving civil society to review experience.	FY97 to FY00 FY98	Non-Lending Services • EDI: Organize a number of theme-specific workshops, develop and Internet forum to improve communications, and consider establishment of regular newsletter. • Carry out joint NGO/Bank (PRD) study of structural adjustment in El Salvador

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IMAGING

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