



Approach Paper

El Salvador 2009-2014

Country Program Evaluation





This work is distributed under a Creative Commons license (CC BY-NC-ND 3.0). You are free to copy, distribute and transmit this work to third-parties, under the following conditions:



Attribution - You must attribute the work in the manner specified by the author or licensor (but not in any way that suggests that they endorse you or your use of the work).



Non-Commercial - You may not use this work for commercial purposes.



No Derivative Works - You may not alter, transform, or build upon this work.

Waiver - Any of the above conditions can be waived if you get permission from the copyright holder.

© **Inter-American Development Bank, 2014**

Office of Evaluation and Oversight

1350 New York Avenue, N.W.

Washington, D.C. 20577

www.iadb.org/evaluation

CONTENTS

| | | |
|------|---|----|
| I. | INTRODUCTION..... | 1 |
| II. | OVERALL CONTEXT OF THE COUNTRY | 1 |
| | A. Period under review (2010-2014)..... | 4 |
| | B. Challenges and opportunities..... | 5 |
| III. | THE BANK’S PROGRAM (2010-2014)..... | 6 |
| | A. Country Strategy | 6 |
| | B. Program | 8 |
| IV. | SCOPE OF THE EVALUATION..... | 10 |
| | A. Relevance | 10 |
| | B. Efficiency and implementation..... | 11 |
| | C. Effectiveness | 11 |
| | D. Sustainability..... | 12 |
| V. | METHODOLOGY | 12 |
| VI. | EVALUATION TEAM AND SCHEDULE..... | 12 |

ANNEXES

I. INTRODUCTION

- 1.1 As part of its 2014 annual work plan, the Office of Evaluation and Oversight (OVE) is preparing the evaluation of the Country Program with El Salvador for the 2009-2014 period, during which the country strategy for 2010-2014 was approved and implemented. This paper sets out the scope and content of the evaluation.
- 1.2 According to the Protocol for Country Program Evaluation (document RE-348-3), the main goal of a CPE is “*to provide information on Bank performance at the country level that is credible and useful, and that enables the incorporation of lessons and recommendations that can be used to improve the development effectiveness of the Bank’s overall strategy and program of country assistance.*”
- 1.3 This CPE seeks to analyze the Bank’s relationship with the country from an independent and comprehensive perspective, with particular reference to the relevance, efficiency, effectiveness, and sustainability of the program, including both financial and nonfinancial products offered by the Bank during the period under review. As established under the protocol, this exercise provides an input into the preparation process for the new Country Strategy with El Salvador for 2015-2019.
- 1.4 This is the third independent evaluation of the country program carried out by OVE. The first one (RE-307) covered the 1992-2004 period, which was characterized by rapid growth in the wake of the Chapultepec Peace Accords. The second OVE evaluation (RE-360) covered the 2004-2008 period; it was marked by the limited results of the ambitious reform program initiated towards the end of the 1990s, as well as the political polarization that affected the Bank’s program with the country.

II. OVERALL CONTEXT OF THE COUNTRY

- 2.1 **El Salvador is a small, very densely populated, lower middle-income country.** It occupies 20,720 square kilometers on the Pacific coast of Central America, making it the smallest nation in Latin America. With more than six million inhabitants distributed across an area equivalent to less than 20% of Honduras’s land area, the country’s population density of 300 people per square kilometer is the second highest in the region, surpassed only by Haiti (364 per square kilometer). El Salvador’s per capita GDP of US\$3,900 is the second highest in Central America (after Costa Rica). The country is classified by the World Bank as a lower middle-income country. Despite this, GDP per capita is only 50% to 60% of the regional average for Latin America, and this gap has widened in recent years.
- 2.2 **The Salvadoran economy exhibits a high level of economic vulnerability, particularly due to its strong economic links with the U.S. economy.** The United States is the main market for the country’s exports and the main source of direct foreign investment.¹ It is also the main destination for El Salvador’s emigrant population (estimated at between 1.5 million and 2 million people), who send back family remittances worth around 16% to 19% of GDP. These remittances—90% of

which originate in the United States—are one of the main determinants of private consumption levels among recipients.² As a result, the country is vulnerable to the North American economic cycle, as was clear during the period under review. Other sources of vulnerability relate to the country's status as a net importer of food and hydrocarbons,³ and the low share of foreign direct investment flows (around 2% of GDP) in external financing, which creates a dependence on other, more volatile financial flows.

- 2.3 **Another source of economic vulnerability is the country's environmental vulnerability, which has been intensified by high population density and deterioration in the country's natural resources.** The risk of climate impact affects 88.7% of El Salvador's territory and 95.4% of its population.⁴ According to the United Nations International Strategy for Disaster Reduction (UNISDR), the country experiences approximately 1.63 disasters per year, causing annual losses of around US\$178 million⁵ (almost 1% of GDP). The causes of this environmental vulnerability are varied. First, the country is located in an area of seismic activity that is also prone to tropical storms. In addition, high population density generates pressure to use natural resources unsustainably (deforestation, urban development in vulnerable areas). Lastly, weak management of natural resources has led to a marked deterioration in these resources (e.g. deforestation), further increasing the impact of natural disasters.⁶
- 2.4 **Since the Chapultepec Peace Accords ended the civil war, the country has enjoyed a stable—albeit ideologically polarized—democracy.** The 1992 Peace Accords between the Salvadoran government and the Farabundo Martí National Liberation Front (FMLN) paved the way for the FMLN to enter the country's political sphere. It was the main opposition party from 1992 to 2008, when it succeeded in winning the general elections. Despite the reintroduction of participatory democracy, political polarization between the country's two main parties has been intense.⁷ In fact, available measures of political polarization consistently rank the country among the most polarized in the world.⁸ This trend is cause for concern, given that ideological polarization is correlated in the literature with outcomes such as smaller governments,⁹ higher levels of inequality,¹⁰ lower economic growth,¹¹ and larger fiscal deficits and a greater likelihood of postponing fiscal adjustment.¹²
- 2.5 **The country faces growth challenges linked to low levels of investment and competitiveness.** In the immediate reconstruction period (1991-1994), the country's economy experienced one of two periods of sustained growth, expanding by 6.8%.¹³ Growth has been much slower since then, averaging 2.5% per year from 1995 to 2013. This is slightly above the historical average and well below the average for Latin America over the same period (3.4%).¹⁴ Low growth is partly explained by the low rate of private and public investment, which averaged 15.5% of GDP over the 2000-2013 period, compared with 22.09% of GDP in Central America, and 21.1% for Latin America and the Caribbean. Of particular concern has been the recent drop in this rate, which fell from an average of

16.5% of GDP in 2000-2007 to 14.1% in 2008-2013.¹⁵ The main indicators of international competitiveness have also worsened significantly: between 2006 and 2013, El Salvador dropped 34 places in the World Economic Forum's Global Competitiveness Index, and 41 places in the World Bank's Doing Business Index.¹⁶

- 2.6 **One of the possible causes of the low investment and competitiveness levels relates to weak productivity in the tradable-goods sectors.** Although the real exchange rate appears to be close to its equilibrium point,¹⁷ there are indications that the tradable-goods sector has lost competitiveness in recent years. Specifically, El Salvador's share of global exports has fallen over the last decade, and total exports have grown very slowly. Moreover, the country's traditional economic integration model, based on the maquila textile industry and traditional exports (coffee, shrimp), is showing signs of exhaustion (see Figure 3, Annex). While non-traditional exports doubled as a percentage of GDP in the 2000-2013 period, this was almost completely offset by a drop in maquila and traditional exports. Declining competitiveness may be related (at least in part) to the expansive fiscal policy (in a dollarized economy) that the country has adopted in recent years.
- 2.7 **Another possible cause of investment and competitiveness issues is the high level of insecurity, which not only implies high human costs but is also an obstacle to business competitiveness.** The country has the second highest homicide rate in the world (after Honduras), making this a major social scourge.¹⁸ Insecurity also imposes significant costs on the entire economy, estimated at 10.8% of GDP. This is the highest level in the entire Central American region, where average costs stand at 7.7% of GDP.¹⁹ In fact, 87% of Salvadoran firms pay for security (compared with 62% for Latin America and the Caribbean as a whole). The costs of security services and crime-related losses are equal to 3.4% and 1.6% of turnover, respectively—more than double the averages for Latin America and the Caribbean (1.4% and 0.8%). More than 50% of companies identify crime as one of their main problems, highlighting it as the second most significant obstacle to doing business.²⁰ The issue of insecurity is intimately linked to the presence of *maras* [gangs] and disproportionately affects the poorest members of society and smaller companies, which are often the victims of extortion.²¹
- 2.8 **Despite significant social progress in recent decades, the country continues to face serious challenges.** Substantial progress has been made in relation to almost all social indicators in recent decades. The illiteracy rate has fallen consistently, reaching 12.4% for the country as a whole. Life expectancy at birth is 72.1 years, and the infant mortality rate stands at 13.6. Poverty and inequality have declined.²² Nonetheless, the country still exhibits a significant human development gap compared with the rest of the region. The United Nations Development Program's 2013 Human Development Index places El Salvador 107th out of 195 countries, and 19th among the Bank's 26 borrowing member countries.²³ Moreover, the social indicators have revealed a recent trend toward deterioration Household poverty, which fell significantly in the 1990s, reaching 30.7% in 2006, had risen to 40% in 2008, as a result of the financial crisis and the increase in international food prices.²⁴

In the process, poverty has also gradually been transformed into an urban phenomenon. Although El Salvador is not the most urbanized country in Latin America, 54% of those below the poverty line there (including 55% of the extremely poor) continue to live in urban areas.²⁵ Lastly, gender inequality continues to be an important challenge for the country, with more women experiencing violence, illiteracy, and job market inequality.

A. Period under review (2010-2014)

2.9 **The period under review was characterized by the first handover of power between political parties since the Chapultepec Peace Accords.** The FMLN was victorious in the presidential elections of March 2009, obtaining 51.3% of the votes. This paved the way for the first democratic transfer of power between political parties. The FMLN also won in the second round of the 2014 elections, albeit by a narrower margin (50.1%).

2.10 **The 2009 transition occurred against the backdrop of an international crisis.** From 2008 onwards, the Salvadoran economy was buffeted by the global economic crisis and its impact on the U.S. economy. Real GDP dropped by 3.1% in 2009, and recovery thereafter was particularly slow: GDP growth averaged 1.7% from 2010 to 2012. Amid these events, the government opted to seek IMF support through a series of precautionary programs.

2.11 **Despite slow economic growth in the 2009-2013 period, the government succeeded in raising tax revenues by 2.5% of GDP.** In 2009, El Salvador's Legislative Assembly passed a package of tax measures aimed at closing a deficit of 5.7% of GDP.²⁶ These measures, together with efforts to improve tax administration, helped to increase tax collection by more than 2.5 percentage points of GDP, to an overall level of 15.3% of GDP in 2013.²⁷ Despite these efforts, the country still has one of the lowest levels of tax collection in the region, surpassing only Guatemala and the Dominican Republic.

2.12 **Increased public expenditure partly compromised deficit reduction objectives.** Immediately before the crisis, the government expanded public spending from 20.6% to 22.1% of GDP between 2008 and 2009. However, contrary to initial expectations, spending levels remained at 2009 levels and even trended upward over the period (to an estimated 23.4% in 2013).²⁸ Existing pressures meant that capital expenditure remained at a low level (between 3.0% and 3.5% of GDP) throughout the period. As a result of persistent fiscal deficits, public debt remained on an upward trend, rising from 42.4% of GDP in 2008 to 56.2% in 2013. Public sector external debt grew from 24.5% to 31.3% of GDP over the same period.²⁹

2.13 **Rising expenditure is linked mainly to an expansion in government social spending and the payroll.** Spending on both education and health has increased over the period.³⁰ Transfer payments (excluding pensions) have also risen, from 2% to 3% of GDP. Social protection programs of a specific nature (such as the Early Childhood Development Program run by the Santa Ana National Institute, or the Rural Solidarity Communities program) tend to be small and of limited

coverage. Subsidies for electricity, water, transportation, and propane gas represent spending equivalent to 1.5% to 2% of GDP. There was also an increase in current payroll expenditure, from 7.7% of GDP in 2008 to 8.8% in 2013.³¹ Given the expansion in public spending, there are some concerns regarding its efficiency and targeting.

Table 1. Key socioeconomic indicators, 2010-2014

| Social indicators | 2010 | 2011 | 2012 | 2013 | 2014 |
|--|-------------|-------------|-------------|--------------|--------------|
| Population (million) | 6.18 | 6.21 | 6.24 | 6.28 | 6.36* |
| GDP per capita (2005 US\$, purchasing power parity) | 5,953.3 | 6,048.3 | 6,124.7 | - | - |
| Poverty rate (national line) | 36.5 | 40.6 | 34.5 | 29.1* | - |
| Gini coefficient | 0.46 | 0.44 | 0.41 | - | - |
| Economic indicators | 2010 | 2011 | 2012 | 2013* | 2014* |
| Real sector | | | | | |
| Nominal GDP (US\$ million) | 21,418.3 | 23,139.0 | 23,813.6 | 24,259.1 | 25,600.0 |
| Real GDP growth (%) | 1.4 | 2.2 | 1.9 | 1.7 | 2.6 |
| Fiscal accounts (nonfinancial public sector, % GDP) | | | | | |
| Total revenue | 17.8 | 18.3 | 18.9 | 19.0 | 19.6 |
| Total expenditure | 22 | 22.2 | 22.8 | 22.9 | 23.8 |
| Overall balance | -4.2 | -3.9 | -3.9 | -3.9 | -4.2 |
| Gross public debt | 52.0 | 52.3 | 54.3 | 56.4 | 58.0 |
| External accounts (% GDP) | | | | | |
| Current account balance | -2.5 | -4.8 | -5.4 | -6.4 | - |
| Trade balance | -18 | -20 | -21 | -21 | -22 |
| Exports (incl. maquila) | 21 | 23 | 22 | 22 | 22 |
| Imports (incl. maquila) | 39 | 43 | 43 | 43 | 44 |
| Family remittances | 16 | 15.8 | 16.4 | 16.3 | 16.7 |
| Foreign direct investment | 0.5 | 1.7 | 2.2 | 2.3 | 2.3 |

* Projections

Source: WDI, IMF, BCR, EPHM, MEH

B. Challenges and opportunities

2.14 **The country faces the challenge of identifying activities that can drive the economy forward and overcome its low secular growth rate.** As a small and relatively open economy, integration into the global economy will be of particular importance for El Salvador. The country will have to choose among various strategic opportunities, including a focus on high value-added services, consolidation of a logistics “hub”, and improved exploitation of strategic opportunities in the Central American market. The identification of new opportunities for innovation—particularly in relation to the country’s comparative advantage in labor-intensive sectors—may be key. The identification and removal of barriers to increased investment, growth, and competitiveness are elements as important as they are constant.

- 2.15 **Looking ahead, the creation of channels for dialogue and consensus-building will be of crucial importance.** Given the situation of intense political polarization, and in light of the 2015 parliamentary elections that will determine the makeup of the Legislative Assembly, there is a need once again to create channels for dialogue and consensus-building in relation to key public policies.
- 2.16 Short-term challenges that may require consensus-building include the maintenance of macroeconomic stability and, in particular, the fiscal strategy for the coming years (for example, public spending efficiency). There are also a number of significant medium-term challenges. An effective solution will be required for the problem of contingent liabilities (e.g. the social security system). Given El Salvador's comparative advantage in labor-intensive sectors, it will also be essential to strengthen the population's capacities and ensure their effective access to the job markets. Improved labor-market access could also help to mitigate the effects of insecurity, which remains, nonetheless, a complex and multisectoral challenge. Lastly, the marked deterioration seen in the country's natural resources intensifies vulnerabilities and has already inflicted a significant economic impact.

III. THE BANK'S PROGRAM (2010-2014)

A. Country Strategy

- 3.1 **The IDB is an important development partner for El Salvador.** The country's debt of US\$2.233 billion to the IDB accounts for 61% of total nonfinancial public sector (NFPS) debt from multilateral sources, and 21% of total external debt. Although the availability of funding from bilateral sources has declined, the share of multilateral agencies in NFPS external debt has remained at 35%. Bank disbursements averaged US\$170 million per year over the 2010-2013 period, equivalent to 0.7% of GDP or 4.9% of central government current revenue.
- 3.2 **From 2004 to 2009, the country did not ratify any of the projects approved by the Bank until the very end of that period, owing to political polarization and the legislative majority required to authorize external borrowing.** Bank action in the 2004-2009 period focused fundamentally on execution of the approved portfolio, four policy-based loans (PBLs), and implementation of the non-reimbursable technical-cooperation program, which did not require parliamentary approval. OVE's evaluation of that country program warned that "political gridlock, which paralyzed the last lending program, [remained] a significant concern for the upcoming program cycle as well" (i.e. 2009-2014) (document RE-360, paragraph 5.3).
- 3.3 **It was against this backdrop that Management presented the Country Strategy with El Salvador for 2010-2014 (document GN-2575) in June 2010. A decision was made to focus on six sectors under the strategy: (a) public finance; (b) social protection; (c) the urban environment; (d) water and sanitation; (e) transportation; and (f) energy.** These areas were linked to a number of the objectives in the Five-year Development Plan, which included the following

priorities: improvement of the social protection system; the strengthening of public finances; and support for production and employment through public investment in housing and infrastructure, citizen security, and the environment and natural disasters (Government of El Salvador, 2010).³²

Table 2: Strategic Objectives of the Bank (document GN-2575) and of the Five-year Development Plan

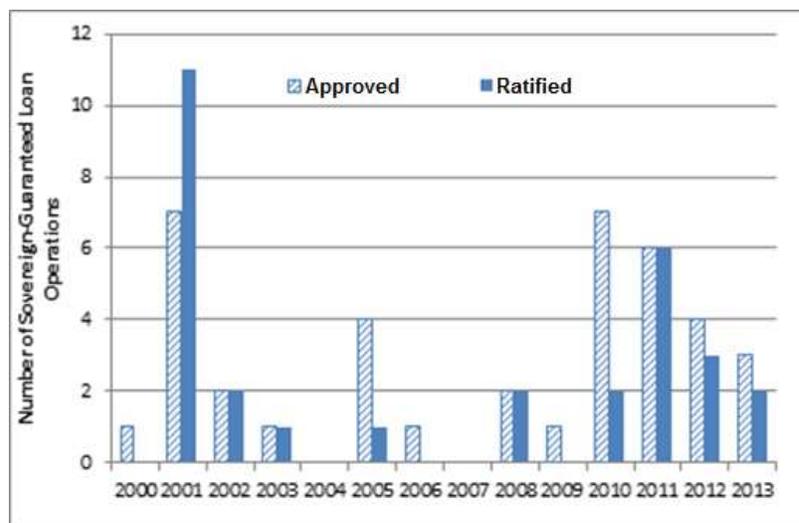
| Sector | Bank strategic objectives | Five-Year Development Plan, objectives and targets |
|--|---|---|
| Public finances | Improve tax and customs administration, focus investment and public spending on sectors that are most in need, and support the transparent management of public funds. | <p>“Substantially increase tax revenue intake, use those resources efficiently and transparently, and reduce the level of external debt.”</p> <p>“Protect the population’s purchasing power and improve the targeting of subsidies so that they benefit only those sectors that truly need them.”</p> <p>“Substantially increase tax revenue intake, use those resources efficiently and transparently, and reduce the level of external debt.”</p> |
| Social protection | Strengthen the system of universal social protection, expand violence prevention and nutrition programs, strengthen the primary health care system, and expand vocational training programs. | “Reverse the rising poverty trend recorded in recent years and expand coverage of basic social services.” |
| Urban environment | Improve living conditions in informal urban settlements, protect settlements in high-risk areas from natural disasters, and facilitate access to housing for low- and middle-income households. | |
| Water and sanitation | Improve the capacities of the National Water and Sewer Administration (ANDA), expand sewerage and wastewater treatment systems in urban areas, and improve rural access to these systems. | <p>“Enhance economic and social infrastructure, particularly in the country’s rural areas.”</p> <p>Targets:</p> |
| Transportation | Strengthen planning capacities, prepare a mass transit plan, improve rural roads, and improve ports and airports. | <p>“Expand potable water coverage in the 100 poorest municipios by 80% by the end of the period.”</p> <p>“Attain a 95% rate of rural electrification in the country’s 100 poorest municipios.”</p> |
| Energy | Improve electricity coverage in rural areas and diversify energy supply in response to the country’s requirements. | “Expand the rural road network by at least 250 kilometers.” |
| Productivity | | “Achieve a sustained increase in national output for internal consumption, export, and the efficient substitution of imports, and reduce the country’s dependence on imports of food and agrifood products.” |
| Citizen Security | | “Gradually and significantly reduce levels of violence and crime across the entire country.” |
| Institutional Capacity | Use the country’s financial management systems and strengthen procurement systems. | <p>“Advance political reforms to strengthen democratic life and consolidate the rule of law.”</p> <p>“Promote administrative reform of the State to enable progressive deconcentration and decentralization of functions.”</p> |
| Environment and Natural Disasters | | “Reconstruct the social and productive fabric of the country that has been damaged by natural disasters, and deploy both a civil protection system and an effective early warning, prevention, and risk management system across the entire country.” |

N.B. This table is a description of the main pillars of each of the strategies and does not constitute per se an evaluation of the relevance of the Bank’s strategy.

3.4 The strategy envisioned a base **estimated lending framework** for sovereign guaranteed loan approvals of around US\$1.08 billion in the 2010-2014 period (US\$216 million per year), with total disbursements of US\$998 million (US\$197 million per year).

B. Program

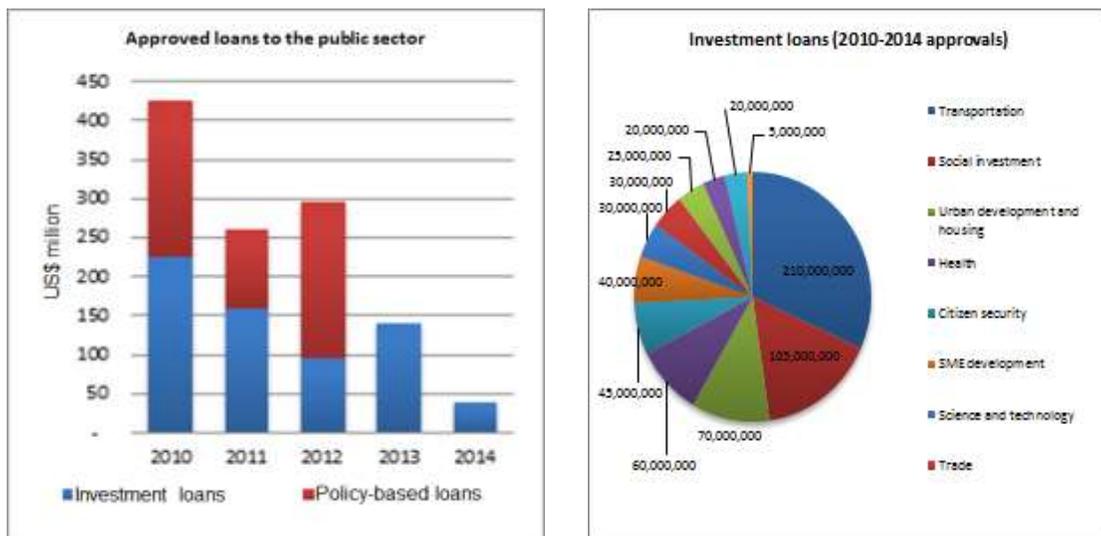
3.5 **Given that no new loans were approved for most of the previous period, the undisbursed portfolio at the beginning of the period under review was very small.** At the end of 2009, El Salvador’s active loan portfolio totaled US\$636 million, of which 98% had already been disbursed. Three loans—in the water and sanitation and housing sectors—had undisbursed balances. As indicated in the last CPE, the situation was very different with respect to nonreimbursable technical-cooperation operations, which made up most of the Bank’s portfolio. In fact, there were 30 technical-cooperation operations at the end of 2009 with a total approved value of US\$15 million and an undisbursed balance of US\$12 million. These operations were concentrated in the sectors of environment and natural disasters, public finances, and agriculture.



3.6 **Partly as a result of the non-ratification of loan agreements before the end of the period, the last country program evaluation (2004-2008, document RE-360) found that the Bank’s program had been only partly relevant.** Despite this, the diagnostic assessments carried out by the Bank were generally considered to be of value. The document also highlighted the difficulties created by political polarization, and called on the Bank to intensify its efforts to “ensure that its proposed program command a broad consensus in both the legislative and executive branches.” In terms of the size of the program, the document noted that the government had preferred a conservative scenario for approvals over the period, in light of the growth in debt (which had risen from 30% of GDP in 2001 to 40% in 2004). This conservative strategy, combined with the fact that the creation of fiscal

headroom was not a priority under the strategy itself, meant that the program was limited in terms of its ability to attain multiple objectives. The CPE therefore recommended that the Bank's objectives be commensurate with the net flow of resources that were expected to be disbursed over the period. Lastly, the CPE also made note of a series of observations regarding specific operational aspects of the portfolio. The most significant of these included the prevalence of modifications and restructurings that compromised attainment of development results; the gradual transfer of the administrative costs of the Bank's overall budget to the projects' administrative and institutional strengthening components; and the low use of country systems, despite El Salvador's high institutional standards and a recommendation by the auditor general that country systems be used.³³

3.7 **Despite the concerns expressed in the last CPE in terms of the possibility of legislative gridlock, from 2010 to 2014 the portfolio of loans to the public sector expanded as programmed under the strategy.** The amount approved over the period was US\$1.16 billion, almost identical to the agreed upon financing framework. The main beneficiary sectors were also those that had been given priority in the strategy: transportation, public administration, environment, energy, the social sectors, housing, and urban development.



3.8 **Policy-based loans (PBLs) played an important role in the Bank's actions over the period.** The following PBLs were approved (one each year from 2010 to 2012): two to strengthen public finances, one for the energy sector, and one for adaptation to climate change. The total value of these loans was US\$500 million, or 45% of the amount approved over the period. These fast-disbursing loans accounted for 75% of funds disbursed in terms of loans to the public sector, and 61% of total disbursements to El Salvador over the period.

3.9 **The main sectors targeted by investment loans were transportation, social investment, housing, and health.** These four sectors accounted for 67% of the

total amount approved (excluding PBLs), and 77% of disbursements. Seventeen investment loans were approved for a total of US\$660 million, for an average of US\$39 million per loan. Only one loan was canceled, for US\$35 million. Disbursements stand at US\$166 million, with an undisbursed balance of US\$419 million.

- 3.10 **Technical cooperation operations approved over the period, in addition to complementing investment loans, have been focused on the sectors supported by PBLs.** A total of 71 technical-cooperation operations have been approved over the period, for a total of US\$25 million. The main sectors supported by this instrument have been energy, public finances and modernization of the State, environment and natural disasters, and the social sector. Two investment grants for US\$30.5 million were also approved during the period, for the health care and water and sanitation sectors.
- 3.11 **Bank support for the private sector has increased.** The Bank's private sector window approved four loans for US\$117 million over the period, all to financial institutions. The MIF has provided small grants totaling US\$8.8 million to support small- and medium-sized enterprises.

IV. SCOPE OF THE EVALUATION

- 4.1 This CPE will evaluate the **Bank's 2010-2014 program**. It will examine all operations that were approved during the period, as well as those that were approved previously but were to complete execution during the period. Given the hiatus in ratifications from 2003 to 2009, the inherited portfolio will be very limited in this case. The evaluation will encompass all Bank sovereign- and non-sovereign guaranteed (NSG) loans, as well as the nonreimbursable technical-cooperation program. MIF and IIC projects that are related to Bank operations or the Country Strategy will also be included.
- 4.2 This evaluation will use the Protocol for Country Program Evaluations set out in document RE-348-3, as well as the categories of **relevance, efficiency, effectiveness, and sustainability** of the Bank's program established by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD-DAC).
- A. Relevance**
- 4.3 *Relevance* refers to the degree of consistency between (i) the design and objectives of the Bank's strategy and program of assistance and (ii) the needs of the country, the development plans, and the priorities of the government.
- 4.4 The question of core significance that the CPE will attempt to answer is whether the Bank's program was structured in a way that would help El Salvador take up its main structural development challenges, as well as the additional challenges that arose during implementation of the strategy (including the increasing deterioration of the fiscal situation resulting from higher spending, a loss of competitiveness and

a slowdown in growth, and political polarization). Specifically, the CPE will seek to answer the following questions:

- Were the strategic objectives set out in the Country Strategy consistent with El Salvador's development priorities?
- To what extent was there an improvement in the criteria used to target Bank interventions? To what extent was support provided for actions in all priority sectors?
- To what extent was the implemented program (including TCs) consistent with the strategic objectives set out in the Country Strategy?
- To what extent was the implemented program (including TCs) consistent with the priorities that arose during strategy implementation, such as addressing the loss of competitiveness and reducing the widening fiscal gap?
- To what extent were TCs and loan operations (SG and NSG) used strategically to support stated objectives?
- To what extent were the indicators in specific operations aligned with the indicators contained in the Country Strategy?

B. Efficiency and implementation

4.5 *Efficiency* refers to the extent to which the design and execution of the program were cost efficient. An analysis of program efficiency also includes the details of implementation. In this area, the CPE will seek to answer the following questions:

- Given that the size of the program under execution expanded significantly over the period, to what extent has the Bank reacted to the increase in the portfolio, and to what extent, more generally, has it efficiently executed the portfolio?
- How did efficiency indicators evolve over the period, and to what extent can they be explained?
- What were the main obstacles to execution of the Bank's program with El Salvador?

C. Effectiveness

4.6 *Effectiveness* refers to the extent to which the assistance instruments achieved the objectives set. An analysis of effectiveness raises a number of unique challenges in the case of El Salvador. Given that practically the entire portfolio is currently being executed and that only a few older projects were completed during the period, any analysis of effectiveness is limited. Nonetheless, to the extent possible, the CPE will seek to answer the following questions:

- To what extent were the strategic objectives laid out in the Country Strategy achieved, particularly in the case of the six priority sectors?

- To what extent have the specific objectives of the Bank's loan program been achieved (or are on track to being achieved)?
- To what extent have the Bank's TCs been useful in strengthening dialogue, galvanizing portfolio implementation, or attaining other strategic objectives?

D. Sustainability

- 4.7 *Sustainability* refers to the likelihood that the results of the Bank's assistance will persist beyond the conclusion of the program. In this area, the CPE faces challenges similar to those mentioned in the previous category. In such a recent portfolio, the effective sustainability of the program cannot be evaluated. Instead, the probability that it will be sustainable will be assessed based on the institutional and technical characteristics of the projects and their level of political priority.

V. METHODOLOGY

- 5.1 In attempting to answer these questions, the evaluation will make use of various sources of information. These will include interviews with key informants, including current and former public managers, Bank project administrators and sector specialists, international development partners (particularly the United States Agency for International Development, MDC, and the World Bank), IDB project beneficiaries, and academics and civil society representatives who are familiar with El Salvador's development challenges. The full range of Bank internal supervision and evaluation documents will be used as a source of information, subject to OVE validation.
- 5.2 Interviews and other qualitative methodologies will be supported by an analysis of the Bank's internal databases, as well as databases for the projects evaluated where available. Examples of databases used in the past include those relating to the administrative budget (BUDGET), project preparation (OPUS), contractual clauses (OPMAS), procurement (PRISM), correspondence (SISCOR), staff time reporting (TRS), staff performance evaluation, and financial transactions (LMS), as well as the Bank's monitoring and evaluation systems (e.g. PPMR/PMR). Statistical analysis of these databases will depend on the quality of the information contained therein, and may include regression analyses or, in the case of efficiency, comparisons of "synthetic" portfolios.

VI. EVALUATION TEAM AND SCHEDULE

- 6.1 **Evaluation Team:** The Country Program Evaluation will be undertaken by a team consisting of Juan Manuel Puerta, Roni Szwedzki, César Bouillon, Anna Crespo, Lynn Scholl, David Suarez, and Oscar Quintanilla, with the support of specialized consultants. The evaluation will require ongoing dialogue with Bank Management, and with the El Salvador Country Office in particular. To this end, two country missions will be arranged, with the following key tasks: (i) identifying the main aspects of the Bank-country relationship, (ii) collecting data and validating

document analyses, and (iii) visiting specific projects to interview beneficiaries and those responsible for execution.

- 6.2 Lastly, consistent with the Protocol for Country Program Evaluations, “[t]he results of a CPE should be provided at a time in which the government is willing to make strategic decisions about the use of external assistance.” In practice, timely consultation involves the “goal of having a draft report available for consideration by country authorities within the first two months of a new administration.” According to El Salvador’s electoral calendar, the new government will take office on 1 June 2014. OVE will attempt to make the necessary consultations with the new Government of El Salvador (July-September 2014) compatible with the schedule for submission of the 2015-2019 Country Strategy with El Salvador to the Board of Executive Directors (in 2015).

Timetable: The timetable for the evaluation is as follows:

| Activity | Date |
|--|--------------------------|
| Country mission | Second half of July 2014 |
| Draft CPE for review by Management/Government | 30 October 2014 |
| Review with Management/Receipt comments from Management and the Government | 1 December 2014 |
| Send CPE to SEC | 10 December 2014 |
| Discussion of CPE by the Board of Executive Directors | January 2015 |

PROGRAM APPROVED BY THE BANK (SOVEREIGN-GUARANTEED LOANS)

Sovereign-guaranteed loans approved between 2009 and 2013

| Strategic Area | Project name | Type | Year | Amount (million) | Status |
|---------------------------------------|---|------------|------|------------------|-----------|
| A. Public finances | | | | | |
| ES-L1047 | Fiscal Strengthening Program | PBL | 2010 | 200 | Completed |
| ES-L1071 | Comprehensive Fiscal Sustainability and Climate Change Adaptation Program for El Salvador | PBL | 2012 | 200 | Completed |
| ES-L1057 | Program to Support Production Development for International Integration | Investment | 2011 | 30 | Active |
| ES-L1058 | Innovation Program for Competitiveness | Investment | 2012 | 30 | Active |
| ES-L1066 | Program for the tourism Development of the Coastal-Marine Zone | Investment | 2013 | 25 | Active |
| ES-L1075 | Productive Corridors Program | Investment | 2014 | 40 | Active |
| B. Social Protection | | | | | |
| ES-L1040 | Reformulation of the Social Policy Support Program | PBL | 2009 | 300 | Completed |
| ES-L1027 | Integrated Health Program | Investment | 2010 | 60 | Active |
| ES-L1044 | Strengthening of Health, Early Childhood Development, and Violence Prevention Services in Urban Communities | Investment | 2010 | 35 | Cancelled |
| ES-L1016 | Reduction of Vulnerability in Informal Urban Neighborhoods in San Salvador | Investment | 2011 | 50 | Active |
| ES-L1063 | Comprehensive Support for Effective Labor and Social Security Policies | Investment | 2012 | 20 | Active |
| ES-L1056 | Ciudad Mujer | Investment | 2011 | 20 | Active |
| ES-L1025 | Violence Prevention Strategy Comprehensive Support Program | Investment | 2012 | 45 | Active |
| C. Urban Environment | | | | | |
| ES-L1022 | Program for Housing and Comprehensive Improvements for Informal Urban Neighborhoods | Investment | 2010 | 70 | Active |
| D. Water and sanitation | | | | | |
| ES-L1046 | Rural Water and Sanitation Program | Investment | 2010 | 20 | Active |
| E. Transportation | | | | | |
| ES-L1045 | Rural Roads for Development Program | Investment | 2010 | 35 | Active |
| ES-L1050 | Transportation Program for the San Salvador Metropolitan Area | Investment | 2011 | 45 | Active |
| ES-L1061 | Rural Connectivity Program for the Northern and Eastern Zones | Investment | 2011 | 15 | Active |
| ES-L1085 | Mesoamerican Pacific Corridor Improvement Program | Investment | 2013 | 115 | Active |
| F. Energy | | | | | |
| ES-L1059 | Programmatic Support to the Agenda of Structural Reforms in the Electric Energy Sector | PBL | 2011 | 100 | Completed |
| G. Institutional strengthening | | | | | |
| ES-L1017 | Legislative Branch Modernization II | Investment | 2010 | 5 | Active |

FIGURES

Figure 1: Real GDP growth, % (Source: BCR)

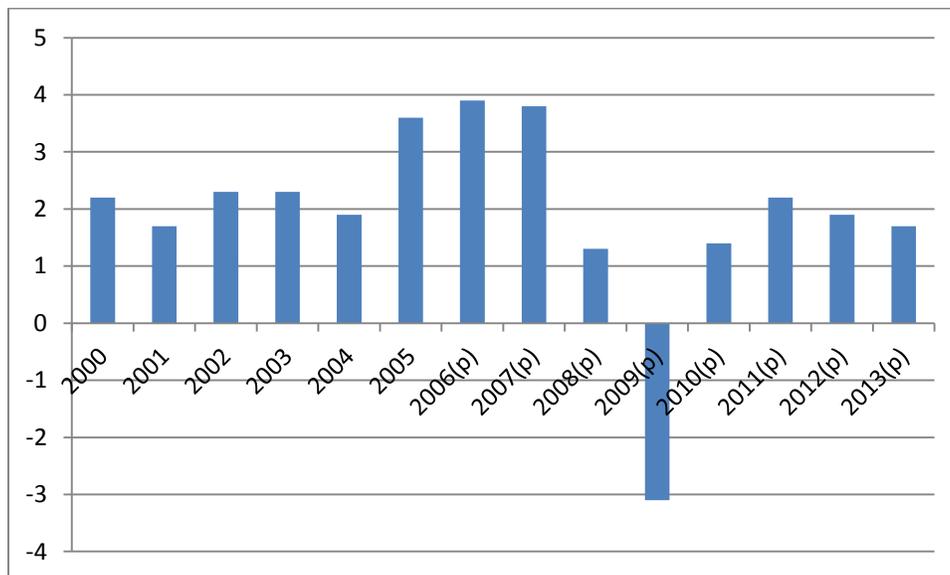
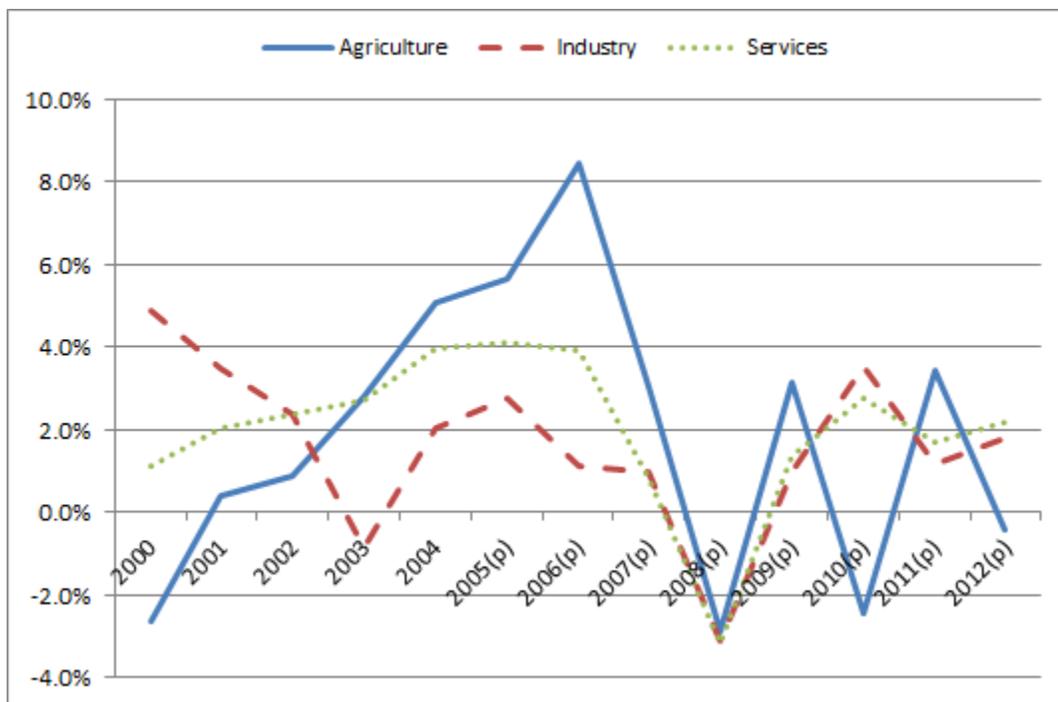


Figure 2: Real GDP growth by economic sector (Source: BCR)



(p): Projected

Figure 3: Exports by Category, % GDP (Source: BCR)

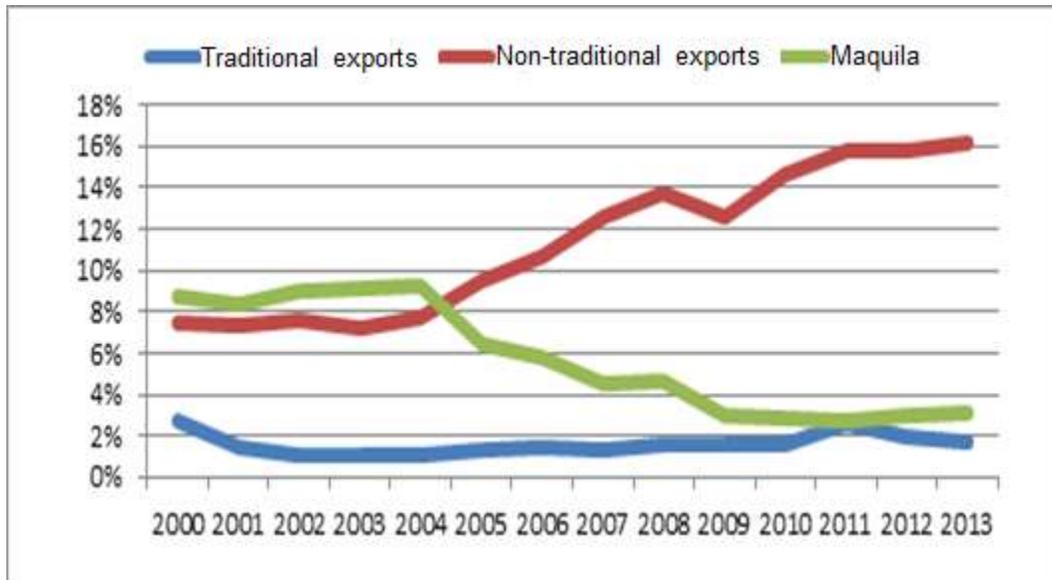


Figure 4: Imports (Source: BCR)

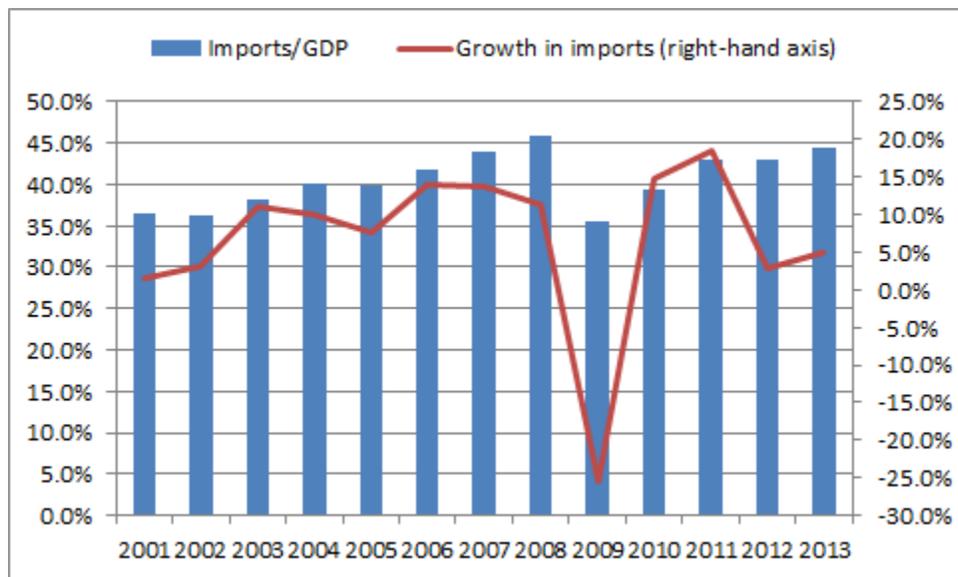
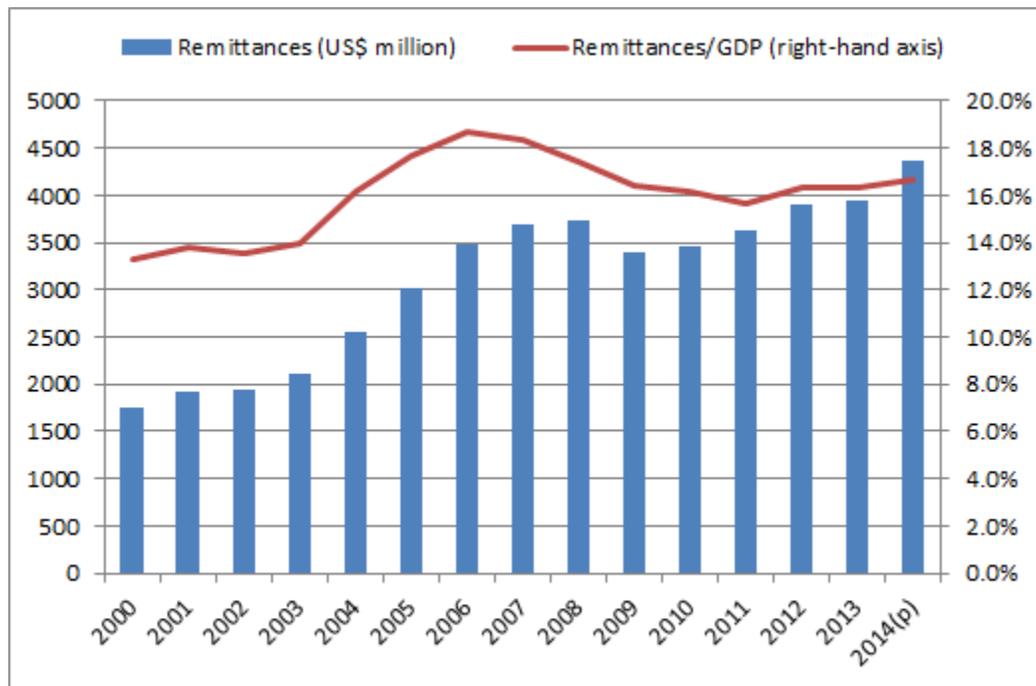


Figure 5: Family remittances (Source: BCR)



(p): Projected

Figure 6: Foreign direct investment (Source: BCR)

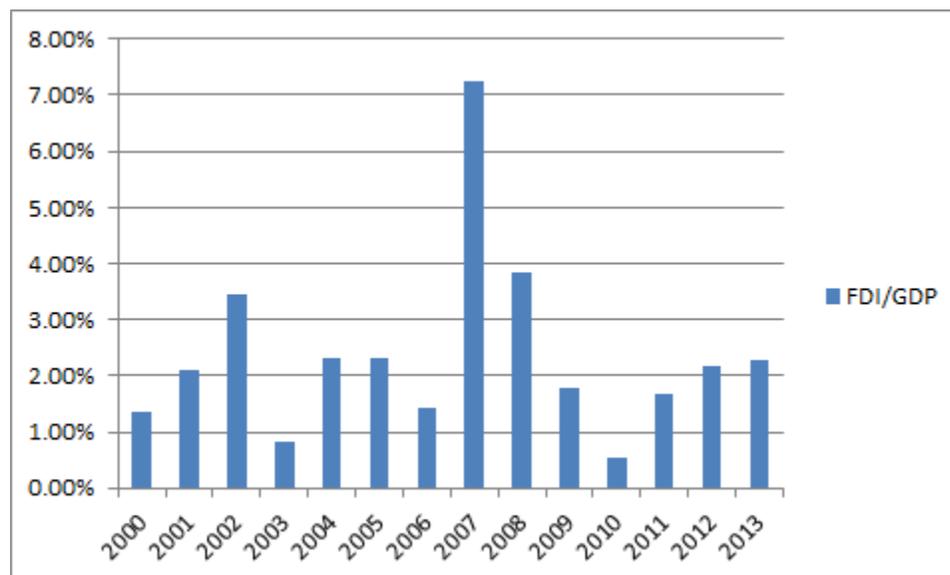


Figure 7: Trends in official rates of monetary poverty
(Source: Department of Statistics and Censuses)

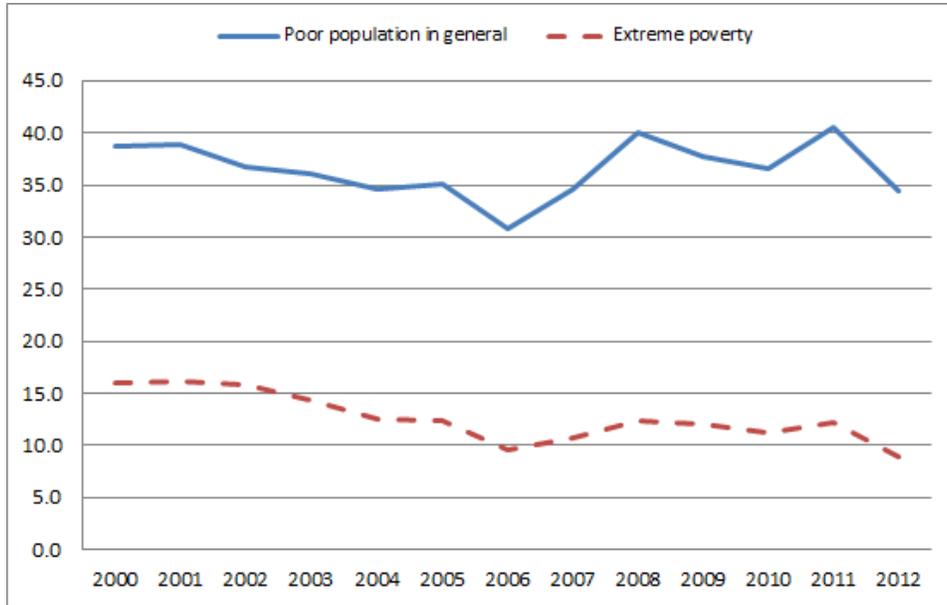
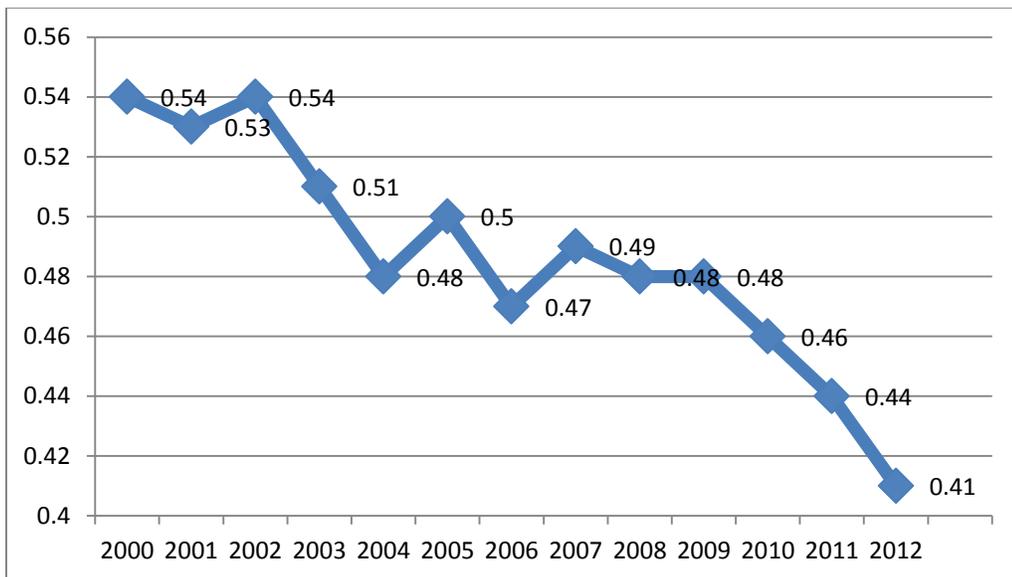


Figure 8: Gini coefficient (Source: Department of Statistics and Censuses)



ENDNOTES

- ¹ Forty-five percent of exports go to the United States (Source: Central Reserve Bank of El Salvador (BCR). In the last quarter of 2013, almost 30% of net foreign direct investment came from the United States (Source: BCR).
- ² The Ministry of External Relations estimates that 94% of Salvadoran migrants live in the United States. The U.S. Census Bureau estimates that around 1.6 million Salvadorans were living in the United States in 2010 (Source: 2010 American Community Survey). The United States is the source of approximately 90% of remittances, which stem mainly from the construction and services sectors in that country (Source: International Monetary Fund, 2013 Article IV Consultation.)
- ³ For example, the country's oil bill accounts for 18% of total imports, according to Central Bank figures for 2013.
- ⁴ Office for the Coordination of Humanitarian Affairs (OCHA) and United Nations Disaster Assessment and Coordination (UNDAC), 2010, "Evaluation of National Emergency Response Capacities". A more conservative estimate can be found in the 2005 World Bank study entitled "Natural Disaster Hotspots: A Global Risk Analysis," which estimates that 52% of the country's surface area and 78% of the population are at risk, making it the country with the second highest level of environmental risk in the world after Taiwan.
- ⁵ Figures for the 1980-2010 period. Source: UNISDR PreventionWeb project.
- ⁶ See, for example, Acevedo, Carlos, Deborah Barry, and Herman Rosa, "El Salvador's Agricultural Sector: Macroeconomic Policy, Agrarian Change and the Environment", *World Development*, 23:2, 1995, pp. 2153-2172; or Kjöllérström, Monica, "Competitividad del sector agrícola y pobreza rural: el papel del gasto público en América Latina", 2004.
- ⁷ The FMLN and the Alianza Republicana Nacionalista [Republican Nationalist Alliance] (ARENA)—which governed from 1992 to 2008.
- ⁸ See Jones, Mark P., "The Role of Parties and Party Systems in the Policymaking Process," paper presented at the IDB Workshop on State Reform, Public Policies and Policymaking Processes, Washington D.C., 2005. Based on data from Latinobarómetro, Jones identifies El Salvador as the most ideologically polarized country, and argues that this result is "perhaps not surprising given the nature of the civil war experienced by the country from the early 1970s through the early 1990s and the fact that the former rebels (FMLN) are now one of the country's dominant political parties" (page 29).
- ⁹ Lindqvist, Erik and Robert Ostling, "Political Polarization and the Size of Government," *American Political Science Review*, Vol. 104, No. 3, August 2010.
- ¹⁰ Adam Bonica, Nolan McCarty, Keith T. Poole, and Howard Rosenthal, "Why Hasn't Democracy Slowed Rising Inequality?", *Journal of Economic Perspectives*, Vol. 27, No. 3, 2013. These authors focus on the case of political polarization in the United States.
- ¹¹ Eslava, Marcela, "The Political Economy of Fiscal Deficits: A Survey," *Journal of Economic Surveys*, Vol. 25, No. 4, 2011.
- ¹² See Keefer, Philip and Stephen Knack, "Polarization, Politics and Property Rights: Links Between Inequality and Growth," *Public Choice*, April 2002, Issue 1-2, pp. 127-154.
- ¹³ Simple average of GDP growth rates at constant market prices in local currency. The other period of sustained growth (defined as three or more years of growth at above 4.8% per year, which corresponds to the 75th percentile of growth rates in the country) was from 1971 to 1977.
- ¹⁴ Figures from the World Bank's World Development Indicators (WDI). The historical average of 2.4% is calculated as the simple average of GDP growth rates at constant local currency prices from 1965 to 2013. The figure for 2013 is preliminary, taken from the International Monetary Fund's World Economic Outlook. In addition, real per capita GDP grew by 1.9% on average from 1995 to 2003.
- ¹⁵ Figures taken from World Economic Outlook, based on data supplied by the Central Bank.
- ¹⁶ Between 2006 and 2013, the country fell from 63rd to 97th in the World Economic Forum's Global Competitiveness Index. The main factors underlying this decline were relatively weak institutions, low levels of labor market efficiency and innovation, and the declining quality of higher education. Other

studies have pointed to the high cost of energy as another factor that limits competitiveness. El Salvador also dropped from 77th in the World Bank's 2006 Doing Business Index to 118th in 2013. In terms of governance indicators, the country ranks relatively low in the area of legal certainty, particularly in relation to contracts, property rights, policing and the judicial system, and crime and violence. As regards tourism, between 2008 and 2013, the country fell from 94th to 104th position in the World Economic Forum's Travel and Tourism Competitiveness Index. The main factors affecting the country are the high cost of doing business (due in part to the level of crime and violence) and the quality of the environment.

¹⁷ The annual Article IV Consultation report published by the IMF in May 2013 indicates that El Salvador's effective real exchange rate has depreciated by approximately 5% since 2000. This compares with significantly greater fluctuations in the cases of neighboring countries (such as a real appreciation of 37% in Guatemala and a real depreciation of 10% in Panama). At the same time, three methods developed by IMF staff suggest that the real exchange rate was basically in line with economic fundamentals, with results ranging from an overvaluation of 8% to an undervaluation of 2%. More specifically, the results of the three methods were as follows. Under the macroeconomic balance approach, the current account deficit norm compatible with El Salvador's economic fundamentals was 3.3% of GDP. With the underlying deficit projected at 4.4% of GDP, a comparison of both deficits (using export and import elasticities) indicated an overvaluation of 8%. Under the external sustainability approach, the current account deficit norm that would stabilize the net foreign assets position at its 2011 level was 3.4% of GDP, suggesting an overvaluation of 7%. However, if the pre-crisis level of net foreign assets was used as a benchmark, the estimated overvaluation rose to 11%. Lastly, the equilibrium real exchange rate methodology suggested a small undervaluation of 2%.

¹⁸ Data from the United Nations Office on Drugs and Crime, taking the average number of homicides for the 2005-2012 period. The homicide rates of Honduras and El Salvador average 67 and 60.2 per 100,000 inhabitants, respectively. There is a significant divergence in trends, however. While Honduras's homicide rate doubled from 2005 to 2012, from 46.6 to 90.4 per 100,000 inhabitants, El Salvador's rate dropped from 62.2 to 41.2 owing to a "truce" with the *maras* [gangs].

¹⁹ See Acevedo, Carlos, "Los costos económicos de la violencia en Centroamérica," *mimeo*, National Public Safety Council, El Salvador. This study was subsequently cited in a 2011 World Bank study entitled "Crime and Violence in Central America: A Development Challenge." This figure includes both direct security costs and indirect costs such as medical costs or loss of output.

²⁰ See World Bank Enterprise Survey, 2010.

²¹ See World Bank, "Crime and Violence," *Op. Cit.*, page 17. For the relationship between poverty, conflict, and violence, see Rodgers, Dennis and Muggah, Robert, "Gangs as non-state armed groups: the Central American Case," *Contemporary Security Policy*, 30 (2) pages 301-317, 2009. See also Cramer, Christopher, "Violent Conflict and the very poorest," *Chronic Poverty Research Center, Working Paper 129*, 2009.

²² 2012 figures from the WDI and the El Salvador Multipurpose Household Survey (EHPM).

²³ Above Bolivia, Paraguay, Guyana, Honduras, Nicaragua, Guatemala, and Haiti.

²⁴ Figures drawn from the EHPM official data and based on the national poverty line. Poverty figures prepared by the World Bank and the Socio-Economic Database for Latin America and the Caribbean (SEDLAC) based on a daily income of US\$4 suggest a 2010 poverty rate of 39.3% in El Salvador. This represents a slight decline since 2005, and it compares with an average for Latin America and the Caribbean of 25.8% in 2011 (SEDLAC). The Salvadoran population with a daily income of less than \$2.50 was estimated by the World Bank at 16.6% of the total population in 2011—higher than the corresponding figure for that same year of 12.6% for Latin America and the Caribbean as a whole.

²⁵ In 2012, El Salvador's urban population accounted for 65.2% of the total (WDI), slightly below the average for Bank borrowing member countries (65.9%). The distribution of El Salvador's poor was estimated based on EHPM data.

²⁶ The package of measures to expand the tax base included an increase in selective consumption taxes on alcoholic drinks, sodas, and tobacco; a new tax on vehicle registrations to offset a reduction in customs taxes on vehicle imports under the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR); creation of a tax on the interest earnings of foreign-owned banks (similar to the

one already levied on domestic banks); and a tax on the interest earnings of individuals. The government also took a number of steps to improve tax administration and combat evasion, particularly in the areas of audit and control of large taxpayers. On the expenditure side, several measures were put forward to streamline subsidies for propane gas, water, and electricity, as well as to modernize the road network and boost electricity generation.

²⁷ Tax revenues rose from 12.6% of GDP in 2009 to 15.3% in 2013. See the most recent IMF Article IV Staff Report (2013).

²⁸ Statistical information taken from the IMF's 2013 Article IV report, *Op. Cit.*

²⁹ IMF, 2013 Article IV report, *Op. Cit.*

³⁰ Education spending rose from around 3% of GDP in the years prior to the 2009 crisis to 3.54% in 2013. Public spending on health care increased from 3.6% to 4.3% of GDP over the 2001-2011 period. The entire increase in health care expenditure involved noncontributory public spending.

³¹ IMF, 2013 Article IV report, *Op. Cit.*

³² Government of El Salvador, 2010, "Plan Quinquenal de Desarrollo, 2010-2014."

³³ Audit Report: El Salvador, 2008, "Auditoría de controles internos básicos en las actividades operacionales del Banco en El Salvador," 14 November 2008.