

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

## **EL SALVADOR**

### **SOCIAL POLICY SUPPORT PROGRAM**

**(ES-0140)**

### **REFORMULATION PROPOSAL**

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## CONTENTS

### PROJECT SUMMARY

I.	FRAME OF REFERENCE .....	1
A.	Background.....	1
B.	Rationale for increasing the loan amount.....	2
C.	Rationale for changing the instrument .....	5
D.	Reformulation strategy .....	6
E.	Country strategy in the sector .....	7
F.	The Bank's strategy.....	7
II.	PROPOSED PROGRAM REFORMULATION .....	8
A.	Objective of the reformulated program .....	8
B.	Structure of the reformulated program .....	8
1.	Macroeconomic environment.....	8
2.	Strategic actions (conditionalities) .....	8
3.	Budget protection and priority social programs .....	12
C.	Cost and financing.....	13
III.	RISKS .....	13
IV.	RECOMMENDATION .....	14

ANNEXES
Annex I. Policy action matrix

ELECTRONIC LINKS
<b>Mandatory:</b>
Means of verification <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1665766">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1665766</a>
Matrix of indicators <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1665608">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1665608</a>
Original loan proposal <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1665612">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1665612</a>
Policy letter <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1713220">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1713220</a>
<b>Optional:</b>
Priority budget programs
Technical rationale for the adjustments to the strategic actions

## APPENDICES

Proposed resolution

## ABBREVIATIONS

CCT	Conditional cash transfer
CESI	Committee on Environment and Social Impact
EPBA	Enhanced Performance-based Allocation
FISDL	Fondo de Inversión Social para el Desarrollo Local [Social Investment Fund for Local Development]
FOP	Fideicomiso de Obligaciones Previsionales [Pension Obligations Trust Fund]
FOSEDU	Fideicomiso para Inversión en Educación, Paz Social y Seguridad Ciudadana [Trust Fund for Investments in Education, Social Peace, and Citizen Security]
FSO	Fund for Special Operations
GDP	Gross domestic product
IFAS	Integrated Financial Administration System
IFF	Intermediate Financing Facility
IMF	International Monetary Fund
MDGs	Millennium Development Goals
MSPAS	Ministry of Public Health and Social Assistance
NFPS	Nonfinancial public sector
NGO	Nongovernmental organization
OC	Ordinary Capital
PBL	Policy-based Loan
PMT	Proxy means test
SAFI	Sistema de Administración Financiera Integral [Integrated Financial Management System]
UNDP	United Nations Development Programme

**PROJECT SUMMARY**

**EL SALVADOR**

**SOCIAL POLICY SUPPORT PROGRAM**

(ES-0140)

Financial Terms and Conditions				
<b>Borrower:</b> Republic of El Salvador			Amortization period:	OC: 20 years EPBA: FSO: 40 years OC (SCF): 30 years
<b>Executing agency:</b> Ministry of Finance			Grace period:	OC: 5 years EPBA: FSO: 40 years OC (SCF): 5 1/2 years
			Disbursement period:	24 months
Loan	Source	Amount (US\$ millions)	Interest rate:	OC: LIBOR EPBA: FSO: 0.25 fixed OC (SCF): Variable
Original loan Approved 1782/OC-ES*	IDB (OC)	48.5	Inspection and supervision fee:	OC: ** EPBA: FSO: N/A OC (SCF): **
	IDB (OC-IFF)	51.5		
	<b>Original subtotal</b>	<b>100.0</b>		
Additional loan	IDB (OC)	50.9	Credit fee:	OC: ** EPBA: FSO: N/A OC (SCF): **
	IDB (EPBA) <sup>1/</sup>	49.1		
	20% FSO 80% OC (SCF)	9.82 39.28		
	<b>Subtotal (2008)</b>	<b>100.0</b>	Currency:	OC: U.S. dollars from the Single Currency Facility EPBA: FSO: U.S. dollars OC (SCF): U.S. dollars
	<b>IDB (OC) (2009)</b>	<b>300.0</b>		
	<b>Additional subtotal</b>	<b>400.0</b>		
Reformulated loan	<b>Total</b>	<b>500.0</b>		
<sup>*/</sup> There is no change in the financial terms of the original loan. <sup>1/</sup> Blend of concessional resources from the Enhanced Performance-based Allocation (EPBA) System.				
Project at a glance				
<b>Purpose of the reformulation:</b> To amend the financing instrument and increase its amount, with a view to (i) providing the country with the funds to meet its social investment needs for the next three years, and (ii) updating the level of progress with the strategic actions (conditionalities) from the original proposal.				
<b>Objective:</b> The reformulated project maintains the objective of the original project, which is to help strengthen the social safety net for the very poor, and deepen the medium- and long-term vision of El Salvador's social policy for poverty reduction.				
<b>Special contractual conditions of the reformulated project:</b> The disbursement of funds under the tranches of the operation is subject to fulfillment of the policy reform measures or institutional changes agreed upon for the release of each tranche, as established in the Policy Action Matrix for the program (see Annex I).				
<b>Exceptions to Bank policies:</b> None.				

<b>Project consistent with country strategy:</b>	Yes [ X ]	No [ ]			
<b>Project qualifies as:</b>	SEQ [ X ]	PTI [ ]	Sector [ ]	Geographic [ ]	Headcount [ ]
<b>Verified by the CESI on:</b> The project concept document was examined at meeting 19-06 on 12 May 2006. No subsequent action was requested.					

<sup>\*\*</sup> The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

## **I. FRAME OF REFERENCE**

### **A. Background**

- 1.1 The Social Policy Support Program (ES-0140) was approved by the Bank on 21 September 2006 (1782/OC-ES), with the general objective of helping to strengthen the social safety net for the very poor and deepen the medium- and long-term vision of El Salvador's social policy for poverty reduction. More specifically, and taking the Solidarity Network model as a main point of reference, the operation was designed to support gradual progress in social policy to overcome extreme poverty through policy actions that ensure the systematization, strengthening, preservation, and consolidation of its targeting tools, its interagency and cross-sector mechanisms for coordinating the participating social sector ministries and institutions, its instruments and mechanisms for community participation, and its monitoring and evaluation systems and technical studies, with a view to creating, in the medium and long terms, an effective social safety net for the very poor.
- 1.2 A programmatic policy-based loan (PBL) was selected as the financing modality for the original program. It comprised three individual operations, each with a single-tranche disbursement, given the medium- to long-term horizon that the Government of El Salvador had set for the Solidarity Network as a policy to combat extreme poverty. This planning horizon was intended to allow flexibility for revising the scope of the program over time and to pursue construction of the vision of a State social policy. Each of the three individual operations under the programmatic PBL was to amount to US\$100 million. The first individual loan (1782/OC-ES) of the series was planned for disbursement over a 12-month period from the effective date of the loan contract.
- 1.3 Two years have elapsed since the program (ES-0140) was approved by the Bank's Board of Executive Directors. In the government's view, however, up until now the political circumstances have not been conducive to ratification of the loan contract (1782/OC-ES) by the Legislative Assembly. Because of this, the Salvadoran authorities requested extensions of the deadline for signature of the operation in the expectation that prospects for success in the Legislative Assembly will improve.
- 1.4 El Salvador will be going through a transition in 2009, with elections to the Legislative Assembly in January and presidential elections in March. The new President of the Republic will take office in June. With the approach of these elections there is now, for the first time in two years, a window of opportunity for the parties to engage in dialogue and for ratification of the program in the Legislative Assembly. On November 5, the plenary of the Legislative Assembly unanimously authorized the government to negotiate this operation with the Bank and sign the respective contract. Once the operation is approved by the Board of Executive Directors of the Bank and the contract is signed, it will require ratification by the Legislative Assembly.
- 1.5 A number of investment loans offered by the Bank and the World Bank, intended to strengthen the Solidarity Network program, failed to achieve ratification in the

Legislative Assembly from 2006 to 2008. However, using its own funds and donations from bilateral donors (including those of the European Union, Spain, and Luxembourg), the country has successfully moved forward with reforms to strengthen the Solidarity Network Program as the main instrument for reducing extreme poverty. In the face of sharply higher food and oil prices, which have a disproportionate impact on the poor, the government has in fact managed to expand that program more swiftly than originally planned. Nevertheless, both the government and the opposition are concerned about the country's debt profile and the need to devote increasing resources to social investments in a context of economic slowdown as a result of the international financial crisis. To help consolidate the Solidarity Network Program and establish it as a State program, and at the same time improve the country's debt profile, a reformulation of the operation (ES-0140) is proposed. This would involve changing the financial instrument from a programmatic PBL with three individual operations of US\$100 million each to a PBL with two tranches of US\$200 million and US\$300 million, respectively (see paragraph 2.22).

- 1.6 The purpose of the **reformulation** is to modify the financing instrument and increase its amount, with a view to (i) providing the country with the funds to meet its social investment needs for the next three years, and (ii) updating the level of progress with the strategic actions (conditionalities) from the original proposal.

**B. Rationale for increasing the loan amount**

- 1.7 The primary rationale for increasing the loan amount is the authorities' interest in improving the debt profile to provide more security and certainty to the market. Financing needs have increased significantly, initially in the wake of international food and oil price shocks in the first three quarters of the year and, more recently, because of the international financial crisis. Moreover, the authorities have expressed strong interest in continuing to reinforce the budgets of priority social programs. While GDP grew by 4.7% in 2007, this rate is expected to slow during 2008 and 2009, as a result of the world crisis. Inflation has risen sharply over the last two years, from an average of 4.4% between 2004 and 2007 to an annual rate of 8.7% at the end of September 2008. Rising food prices are the most important factor driving inflation, and the one that has the greatest impact on the poorest families.<sup>1</sup>
- 1.8 On the external front, the current account deficit for 2007 was 5.5% of GDP, reflecting the impact of the food and oil price shocks and a fall in maquila exports. The trade deficit reached 20% of GDP, and was financed in large part by family remittances, which represented 18% of GDP in 2007. Despite these important inflows, the current account balance was negative, and was financed primarily by foreign direct investment, which was unusually high as a result of the acquisition of

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<sup>1</sup> Morales, Hada Desireé, 2008, "La Economía Nacional y de los Hogares Salvadoreños: Impacto de los Precios de Commodities" [The national economy and the economy of Salvadoran households: Impact of commodity prices] *Tópicos Económicos*, Central Reserve Bank of El Salvador, Year 1, No. 14, July, 2008.



three major commercial banks. For 2008, the current account deficit is likely to exceed 6%, but it is expected to decline over the medium term. While these deficits are not high in comparison with other countries in the region, they reflect an economic vulnerability, particularly in the context of less favorable international financial markets.

- 1.9 In the face of these external shocks, the government has adopted an expansionary fiscal policy with a view to: (i) countering the unfavorable international setting sparked by the crisis in the United States, (ii) alleviating the high costs of oil and food and cushioning their impact on consumption, and (iii) reducing selected taxes and customs tariffs to offset increased production costs in agriculture and in the transportation sector. In the last few years, the government pursued a fairly restrictive fiscal policy that saw the primary deficit of 2.9% of GDP in 2001 replaced by a surplus of 0.6% in 2007. The primary balance is expected to be in equilibrium for 2008. More specifically, despite an expected increase in tax revenues for 2008, the fiscal situation is likely to deteriorate slightly with the rising cost of subsidies (for electricity, transportation, propane, and water), a wage increase and higher capital spending.
- 1.10 When it comes to financing sources, it is important to recall that a package of loans from the multilateral banks (World Bank, IDB, and the Central American Bank for Economic Integration, CABEI) failed to secure legislative approval in 2006, and the government therefore began to seek alternatives to international bond issues and multilateral bank loans in order to meet its financing needs for the 2007-2009 period. In 2006, it issued Eurobonds in the amount of US\$618 million, equivalent to 3.3% of GDP. In September 2006, the government established the Pension Obligations Trust Fund (FOP), which issues special bonds that are compulsorily sold to pension fund administrators, up to a maximum of 30% of their assets. With this reform, the government eliminated the need to seek annual parliamentary authorization for borrowing to cover pension payments. In addition, a Trust Fund for Investments in Education, Social Peace, and Citizen Security (FOSEDU) was created in 2007, which is authorized to issue certificates on the domestic market for up to US\$350 million between 2007 and 2009, to finance spending in the security and education areas.
- 1.11 In this context, financial requirements for 2008 are estimated at around 6% of GDP. The economic authorities expect to raise the equivalent of 2.5% of GDP through government securities (treasury bills or LETES), 1.5% of GDP from the FOP, 0.8% of GDP in external disbursements (from multilateral and bilateral sources), and 0.9% of GDP from certificates issued by FOSEDU. As international interest rates rise in 2008 and 2009 and the international market becomes less liquid, the government is expected to seek alternatives to issuing bonds in the markets. The Bank and World Bank operations will therefore help the central government face its liquidity challenges.
- 1.12 The nonfinancial public sector (NFPS) debt, including the pension debt, declined from 44.7% of GDP in 2006 to 43% at the end of 2007. This reduction came after a

sharp increase in recent years (amounting to about 10% of GDP since 2000), in particular after the 2001 earthquakes and the change in the pension system. Over the medium term, if the NFPS deficit can be reduced, financing needs are expected to drop gradually. A spike in financing needs is anticipated in 2011, however, when the Eurobonds issued in 2001 mature. The change in the financing structure proposed for the Bank and World Bank operations (see paragraph 1.20) would allow the government to reduce its cost of financing (in an environment of rising interest rates), and would also enhance the debt profile, given the longer amortization periods associated with multilateral bank loans. This operation is expected to produce average savings of 0.2% of GDP a year, for a total of US\$240 million, which would be used to increase social expenditure.

- 1.13 The government currently has no assistance program with the International Monetary Fund (IMF). The last IMF Article IV consultation report was approved by the Fund's Executive Board in late March 2008. The assessment noted that the central challenges remain those of sustaining economic growth over the medium term, enhancing the dollarized economy's resilience to external shocks, and reducing poverty. To continue along the path of economic and social progress, the report recommends additional measures to increase government revenues and reduce spending, improve banking supervision and regulation, and enhance the business climate and productivity so as to boost external competitiveness and sustain continued economic growth. The IMF concluded a new Article IV consultation mission in September 2008 and the consultation document is expected to be approved by the IMF's Executive Board in mid-November.
- 1.14 **Economic outlook.** Growth is expected to reach 3% in 2008, driven by continued expansion in the agriculture sector and the rise in nontraditional exports. Family remittances should continue to spur consumption and investment in El Salvador, although at a less accelerated pace. The economy is expected to slow even further in 2009, with growth of 2.5% as a result of the international financial crisis. Over the medium term, growth should return to annual rates of 4% to 4.5%, driven essentially by agricultural and nontraditional exports. At the same time, estimates put inflation at 8.5% by the end of the year, but it will slow over the medium term, assuming that the oil market returns to normal and the fiscal situation remains stable.
- 1.15 Over the medium term, a continued policy of fiscal consolidation is anticipated, with measures to achieve higher tax revenues and lower expenditures producing a primary surplus of 1.4% of GDP by 2012. Specifically, the authorities expect to raise the tax burden by 0.5 percentage points of GDP, through administrative measures and an ad valorem tax on alcoholic beverages that would replace the current fixed levy. Taken together, these measures are expected to raise the tax burden to 14.8% of GDP by 2012. However, total NFPS revenues and donations are projected to remain relatively constant over the medium term due to the decline in nontax income. On the expenditure side, subsidy costs are expected to be reduced with the elimination in 2009 of the electricity subsidy for medium and large users,

and closer targeting of the electricity and gas subsidies over the medium term. The wage bill is also projected to rise over the medium term, reflecting election promises to hire more teachers, doctors, nurses, and police officers. Lastly, the authorities hope to be able to boost investment spending from 2.3% to 2.7% of GDP between 2007 and 2012.

### **C. Rationale for changing the instrument**

- 1.16 The change in the instrument is based essentially on the substantial progress that has been made with reforms designed to strengthen the Solidarity Network Program as the main tool for reducing extreme poverty over the two years since the Bank's Board of Executive Directors approved the ES-0140 program. Because of that progress, the three tranches originally planned can be merged into two tranches, and greater certainty over the conditions of the second tranche makes the PBL instrument more appropriate than the original programmatic approach.
- 1.17 Progress has been particularly important in the following areas: (i) **Targeting.** To make targeting more efficient, the poverty map has been complemented by municipal censuses that enable the socioeconomic profiling of families, and by a “proxy means test” to classify and select them as beneficiaries when they do not live in municipios with severe extreme poverty; (ii) **Cross-sector efforts.** To ensure a comprehensive approach in interventions and to maximize the efficiency of cross-sector efforts, governing and executive bodies of the Solidarity Network have been formed, including the Solidarity Network's board of directors, its Intersector Committee, and its Municipal Coordination Committees. With respect to cross-sector efforts, the coverage of the conditional cash transfer (CCT) and health and education interventions has been expanded to cover more than half of the 100 poorest municipios, i.e. those where extreme poverty is classified as severe or high. In addition, specialized NGOs are beginning to offer services to promote community participation in these municipios; (iii) **Monitoring, follow up, and evaluation system.** To ensure that the processes and means used will effectively produce the outputs and goals expected by the Solidarity Network, a monitoring, follow up, and evaluation system has been designed and is now starting to be implemented. In particular, a methodological proposal for evaluating the Solidarity Network's impact has been designed, including qualitative instruments for measuring beneficiary satisfaction, and a baseline for evaluating the impact has been defined. Studies of Solidarity Network process evaluations have also been completed, and their findings are now being used to improve its design and implementation.
- 1.18 In addition to progress in these areas, which were established as triggers for the original first individual loan (1782/OC-ES) of the programmatic PBL series, and in some cases for the second loan, the government has decided to pursue reforms to improve the quality of life of vulnerable people in urban areas. Over the last year, an advisory council has been set up, and it is now designing an urban poverty strategy.

- 1.19 The reformulated program is a two-tranche PBL, in contrast to the original instrument, which was a programmatic PBL comprising three single-tranche operations. With the progress the government has made in implementing the Solidarity Network Program, and in defining clearly with the Bank the essential details for medium-term reforms in the sector, a multiple-tranche PBL is considered the appropriate financial instrument. The conditions for the second tranche have been designed to consolidate the Solidarity Network Program and its budget lines as an important and constant component of ongoing reforms to reduce poverty.
- 1.20 This operation was coordinated with the World Bank. That institution's Board of Executive Directors will be considering a development policy loan with deferred disbursement option (programmatic DPL-DDO) in the amount of US\$450 million. The authorities have presented these financing operations as an opportunity to restructure the country's debt in order to obtain better financial conditions, by easing the maturity structure, extending repayment terms, and reducing the financial cost of the debt. This will make it possible to reduce annual debt service payments or to channel those resources into priority social safety net programs.

#### **D. Reformulation strategy**

- 1.21 In preparing the reformulated program, the Bank team conducted an independent macroeconomic evaluation (IMA), which was updated to November 2008, and it also requested an assessment letter from the IMF. In addition, it reviewed progress with the reforms described in the Policy Action Matrix and made the following adjustments, based on the original matrix for the first individual loan operation (1782/OC-ES) of the programmatic PBL:
- a. The actions precedent to disbursement were updated, as were the means of verification for each component and each specific action, to reflect the progress made in various components since Bank's Board of Executive Directors' approval in September 2006.
  - b. In general, the intent was to combine the actions precedent to the original second and third disbursements and to reposition them, so that those actions already completed would be treated as precedent to the first tranche in the updated matrix, and the remaining actions would be left for the second tranche.
  - c. In addition, a new policy area was included to support development of an urban poverty strategy and preparation of a related intervention program. This new initiative is of high priority to the government, and will benefit a significant portion of the population that is currently excluded from most social protection programs. The program and the technical studies financed by the Bank and UNDP will be the technical foundation for future interventions in this area.
  - d. Lastly, further steps were taken to ensure budgetary protection in the social sectors involved in the extension of the Solidarity Network's coverage,

identifying the specific budget lines and the minimum levels of financing required.

- 1.22 The detailed technical rationale for these adjustments to the strategic actions is contained in Annex III.

**E. Country strategy in the sector**

- 1.23 The Solidarity Network represents the efforts of the Salvadoran government to design and implement a comprehensive strategy to assist families in extreme poverty, which seeks in the short term to improve the social indicators for education, health, and nutrition. This new approach combines the traditional role of social safety net and social assistance with social development, in that it simultaneously attacks the factors immediately contributing to poverty while promoting sustainable poverty reduction in the long term by improving family education and health. With this multiple-tranche PBL, the government intends to support these efforts with a series of policy actions in such areas as targeting tools, institutional arrangements and cross-sector efforts, mechanisms for community participation, information systems, and technical studies to improve quality in Solidarity Network implementation. At the same time, the reformulated program will support recent efforts to develop a comprehensive urban poverty strategy.
- 1.24 The World Bank operation, in turn, will support the government in three areas: (i) mobilizing resources through new legislation to increase tax collection, (ii) making public management more efficient and transparent and modernizing the government's financial management, and (iii) enhancing the supply of social services, with particular emphasis on secondary education.

**F. The Bank's strategy**

- 1.25 The main objective of the Bank's country strategy with El Salvador 2005-2009 is poverty reduction. To achieve this goal, it proposes two interrelated strategic objectives that are consistent with the government's "*País Seguro 2004-2009*" plan: (i) to promote sustainable economic growth by increasing competitiveness; and (ii) to strengthen human capital and improve opportunities for the poorest segments of the population, through better targeting and efficiency in social spending, focused on achieving the Millennium Development Goals (MDGs), while also improving the coverage and quality of social services. This operation will be directly related to the Bank's second strategic objective in El Salvador, since it will support the country in its strategic social development priority, to gradually overcome extreme poverty, achieve the MDGs, and strengthen the institutional framework, while providing a shield for its most important social protection program in an election year.

## **II. PROPOSED PROGRAM REFORMULATION**

### **A. Objective of the reformulated program**

- 2.1 The general objective of the operation is to help strengthen the social safety net system for the very poor and deepen the medium- and long-term vision of El Salvador's social policy poverty reduction. More specifically, and taking the Solidarity Network Program as a main point of reference, the operation will support gradual progress in social policy to overcome extreme poverty through policy actions that ensure the systematization, strengthening, preservation, and consolidation of its targeting tools, its interagency and cross-sector mechanisms for coordinating the participating social sector ministries and institutions, its instruments and mechanisms for community participation, and its monitoring and evaluation systems and technical studies, with a view to creating, in the medium and long terms, an effective social agenda for the very poor.

### **B. Structure of the reformulated program**

- 2.2 The reformulated program is a two-tranche PBL. In terms of its contents, the program will embrace three areas of action: (i) the macroeconomic environment, (ii) strategic actions in the social sectors, and (iii) budget protection for priority social programs. The Policy Action Matrix for the program, presented in Annex I, describes the specific actions precedent to disbursements of the multiple-tranche PBL. A more detailed description of the policy objectives and actions contemplated in the two tranches proposed for the reformulated operation follows below.

#### **1. Macroeconomic environment**

- 2.3 The objective of macroeconomic monitoring under the two tranches of the PBL is to help maintain sustained economic growth as the basis for the country's macroeconomic stability. From this standpoint, the disbursement condition for the first tranche is to maintain a macroeconomic environment that is consistent with the program's objectives and with the policy letter of October 2008. In view of its importance, this same condition will be monitored during the second tranche.

#### **2. Strategic actions (conditionalities)**

##### **a. Targeting tools**

- 2.4 The objective of this reform area is to consolidate the design, application, and extension of targeting tools aimed at giving priority to public investment in the poorest municipios and households. This objective is expected to be achieved through three basic actions relating to the design and use of a poverty map, household surveys, and the "proxy means test" (PMT). Actions precedent to disbursement of the first tranche will involve: (i) the design and application of the poverty map as a tool for geographical targeting at the municipal level; (ii) the design and application of municipal censuses as a tool for identifying families eligible for conditional cash transfers (CCTs); and (iii) the design of the proxy means test.

- 2.5 With respect to actions precedent to disbursement of the second tranche, in addition to updating the targeting tools of the rural Solidarity Network program, tools for future urban interventions will be updated (including a map for geographical targeting). Along those lines, the actions precedent to disbursement of the second tranche are: (i) update of the poverty map to make it pertinent to the characteristics of potential urban beneficiaries; (ii) application of the municipal censuses in 100% of the CCT program's priority municipios; and (iii) update of the Solidarity Network Program's targeting mechanism (reflected in the Operating Regulations), based on findings from the evaluation of the program's targeting.

**b. Coordination bodies and cross-sector efforts**

- 2.6 The objective of this reform area is to strengthen the performance of and expand the national and municipal forums that coordinate social policy to reduce extreme poverty, including their corresponding tools for budget coordination. This objective should be achieved through policy actions involving the formation and consolidation of Solidarity Network coordination bodies, and budget allocation and execution based on the resources required for priority social programs related to coverage of the Solidarity Network, in this and the coming year.
- 2.7 Consistent with this approach, the actions precedent to disbursement of the first tranche are: (i) the establishment and operation of of the Solidarity Network's board of directors, its intersector committee, and its municipal coordination committees; and (ii) the inclusion by the Ministry of Finance in the 2008 budget of a general line item to be transferred to finance the Solidarity Network Program, with its respective budget codes and tracking through the integrated financial management system (SAFI). The actions precedent to disbursement of the second tranche are: (i) periodic monitoring of the agreements reached in the Solidarity Network's board of directors, its intersector committee, and its municipal coordination committees, timely resolution of implementation problems in execution, and effective communication with decision makers; and (ii) issuance of guidelines and directives by the Ministry of Finance, instructing the ministries and public institutions involved in the Solidarity Network to program the funds from their budgets using the respective budget codes.

**c. Social protection**

- 2.8 The objective of this policy area is to help break the cycle of poverty by promoting incentives that will boost demand for improved education, health and nutrition levels for children living in extreme poverty. The objective is to be achieved through the design and implementation of conditional cash transfers (CCTs), the definition of an exit strategy for families benefiting from that program, and improvement of the process and mechanisms for delivering CCTs. The actions precedent to disbursement of the first tranche are: (i) design of the CCT intervention model, and its implementation in at least 47 of the 100 priority municipios where extreme poverty is severe or high, including verification of compliance by beneficiary families with the conditions established, and

(ii) formulation and approval of an exit strategy for the program's beneficiary families. The actions precedent to disbursement of the second tranche are: (i) extension of CCT coverage to at least another 30 of the 100 municipios with high or severe extreme poverty; and (ii) improvements to the CCT delivery process and mechanisms to make them transparent and efficient and to ensure compliance with the conditionalities.

#### **d. Education**

- 2.9 The objective of this reform area is to improve the supply of formal education to ensure timely school attendance (preschool and primary education) and raise enrollment levels, by organizing and operating "Effective School Networks" that will become models for intervention in isolated poor areas. The actions precedent to disbursement of the first tranche will involve: (i) design and implementation of the "Effective School Networks" model in at least 56 extremely poor municipios, in order to increase school attendance and retention rates for pupils in primary education; and (ii) design of a technical proposal for strengthening and expanding the Youth and Adult Literacy Program, which will be operating according to a curriculum, with learning modules and trained facilitators in place in at least 100 municipios with high or severe extreme poverty, so that beneficiaries can complete their primary schooling.
- 2.10 Actions precedent to disbursement of the second tranche will include: (i) modification of the Effective School Networks model to include management modalities and community participation forums as a means of ensuring school attendance and retention, and its implementation in accordance with pedagogical technical characteristics in at least 44 additional municipios of the Solidarity Network, plus organization of at least 117 networks in all 100 municipios with high or severe extreme poverty; (ii) extension of the Youth and Adult Literacy Program to at least 50 additional municipios, and an increase in the percentage of beneficiaries in the municipios with high or severe extreme poverty; (iii) the Youth and Adult Literacy Program has at least 50% of facilitators trained for the upper primary and secondary education levels; and (iv) design and implementation of a strategy to promote, organize, and execute the program, and design of a system for gradually evaluating and certifying the learning progress of beneficiaries.

#### **e. Health**

- 2.11 The objective of this subcomponent is to help ensure the delivery of a package of essential health and nutrition services for families living in extreme poverty. The actions precedent to disbursement of the first tranche are: (i) the design of a model for expanding the coverage of essential health and nutrition services as a mandatory standard for all public and non-public providers (NGOs) in extremely poor rural areas; and (ii) implementation of the model in at least 87 of the 100 municipios with high or severe extreme poverty. Actions precedent to disbursement of the second tranche include: (i) extension of the coverage expansion model to at least nine other municipios where extreme poverty is severe or high; (ii) review by the Ministry of



Public Health and Social Assistance (MSPAS) of the cost-effectiveness of the coverage expansion model; and (iii) steps to promote compliance with the same minimum levels of quality for NGOs and institutional teams contracted by the MSPAS to provide service in extremely poor rural areas.

**f. Comprehensive urban development**

- 2.12 The objective of this new policy reform area is to promote comprehensive urban development and help break the cycle of poverty and social exclusion in urban areas. The action precedent to disbursement of the first tranche therefore includes, as a minimum, the establishment of an advisory council to design an urban poverty strategy. The action precedent to disbursement of the second tranche will involve the design of a program of interventions in urban communities living in situations of poverty and social exclusion, based on the results of the preparatory studies defined by the urban poverty advisory council.

**g. Community participation mechanisms**

- 2.13 The objective of this intervention area is to promote the participation and empowerment of communities in resolving their problems and exercising social oversight over the Solidarity Network and other public programs. That objective is expected to be achieved through policy actions related to the delivery of services by specialized NGOs to promote community participation and support the beneficiary families, the design and operation of community participation mechanisms and their evaluation, and the exercise of social oversight functions by the community committees.
- 2.14 To this end, the actions precedent to disbursement of the first tranche are: (i) promotion of the services provided by specialized NGOs to promote community participation and support for beneficiary families initiated in at least 47 of the 100 municipios where extreme poverty is severe or high, in a regular and timely manner, using appropriate participatory methods; and (ii) design, operation, and evaluation of community participation mechanisms. The actions precedent to disbursement of the second tranche are: (i) introduction of specialized NGO services to promote community participation and support beneficiary families in at least another 30 municipios where extreme poverty is severe or high out of the 100 municipios in the Solidarity Network; (ii) launching of community participation mechanisms with at least the same degree of beneficiary participation, including social oversight, contributing in this way to the sustainability of interventions and encouraging real accountability; and (iii) exercise by the community committees of social oversight functions with respect to CCTs and education and health care services.

**h. Monitoring and evaluation systems.**

- 2.15 The objective of this reform area is to consolidate the design, implementation, and application of the monitoring, follow-up, and evaluation system for the Solidarity Network, promoting its replication in other social initiatives. The policy actions to

achieve this objective will involve the design of a CCT monitoring and follow-up system and an assessment of the system's effectiveness, an evaluation of the CCT program's process, and an evaluation of the program's impact, as well as dissemination of the monitoring and evaluation system's methodologies.

- 2.16 The actions precedent to disbursement of the first tranche include: (i) technical and operational design of the system for monitoring CCTs and other Solidarity Network interventions; (ii) performance of studies on the evaluation of Solidarity Network processes and use of their findings to improve their program design and implementation; (iii) design of a methodological proposal for evaluating the impact of the Solidarity Network, including qualitative instruments for measuring user satisfaction; and (iv) establishment of the baseline for evaluating the impact of the Solidarity Network and identification of the control groups. The actions precedent to disbursement of the second tranche include: (i) updating the design of the Solidarity Network Program (reflected in the Operating Regulations), based on the results of the program's interim impact evaluation and the evaluation of the effectiveness of the systems for monitoring the various Solidarity Network interventions; and (ii) disseminating the monitoring instruments and impact evaluation methodologies to national and local agencies, and making them available for other social initiatives.

**i. Technical strengthening.**

- 2.17 In this policy area, technical studies will be conducted to help consolidate the Solidarity Network as part of the "Opportunities" strategy for addressing poverty, and to deepen the medium- and long-term vision of poverty reduction social policy. To this end, policy actions precedent to disbursement of the first and second tranches of this last component will include: (i) the commissioning of technical studies to improve the process of implementing and consolidating the Solidarity Network; and (ii) qualitative improvement of the Solidarity Network implementation process as it moves towards consolidation of the "Opportunities" strategy, based on the findings of the technical studies.

**3. Budget protection and priority social programs**

- 2.18 Over the last four years, the Government of El Salvador has managed a year-on-year increase in the education and health care budgets and has introduced innovative programs such as the Solidarity Network. Nevertheless, there are still significant challenges that will be affected by current international conditions stemming from food and oil price shocks and, more recently, the international financial crisis. Under these circumstances, it is vital to provide budget protection for the priority programs related to Solidarity Network coverage in the areas of education, health care, and social protection. The CCTs and complementary programs to extend education and health care services are essential for providing comprehensive support to families living in extreme poverty.
- 2.19 Using this technical criterion, the following programs have been selected for budget protection in accordance with the amounts indicated in Annex II: (i) the Youth and

Adult Literacy Program; (ii) the Effective School Networks Program (preschool component); (iii) school nutrition in Solidarity Network municipios (school meals, including upper primary and secondary school); (iv) Health Services and Technical and Administrative Health Management in Solidarity Network regions; (v) the Solidarity Health Fund (FOSALUD); (vi) the hospital reconstruction and health services expansion program under World Bank loan 7084-ES; (vii) the CCT program; and (viii) centralized activities (investments related to the CCTs).

- 2.20 Disbursement of the first tranche of the operation is subject to presentation of evidence that (i) the 2008 budget has executed at least 65% of the required funds for priority programs related to Solidarity Network coverage in the areas of education, health and CCTs; and (ii) the draft general budget for 2009, as submitted to the Legislative Assembly, contains the funds required for those same priority programs. Disbursement of the second tranche will be subject to presentation of evidence that (i) the 2009 budget execution has provided the required funds for priority programs related to Solidarity Network coverage in the areas of education, health and CCTs; and (ii) the Cabinet approves the draft 2010 Budget Law, which will be submitted to the Legislative Assembly and contains the funds required for those same priority programs.

### **C. Cost and financing**

- 2.21 The reformulated operation presented here will have a total cost of US\$500 million, and will be financed through a PBL loan to be disbursed in two tranches. The amount of the first tranche will be up to US\$200 million, and the second up to US\$300 million. The financing of this single, reformulated operation would be structured as follows: (i) a loan of US\$100 million, which represents the loan already approved in 2006 (including US\$51.5 million from the Intermediate Financing Facility, or IFF), (ii) a further loan of US\$100 million drawn from the 2008 resources for PBLs (El Salvador is eligible for up to US\$49.1 million with an FSO/OC mix of 20/80%, and US\$50.9 million from the OC); and (iii) a loan of US\$300 million from the OC, the resolution for which would enter into force on 1 January 2009.

## **III. RISKS**

- 3.1 **Macroeconomic risks.** Although the macroeconomic situation is stable, there are some short- and long-term risks that need to be highlighted. In the short term, the liquidity crunch in international markets, together with the electoral climate, could lead to shrinkage in the lines of credit available to El Salvador, and could even spark capital flight. As a result, local liquidity would contract, leading to higher interest rates and a contraction in economic activity that would negatively impact long-term public debt trends. This risk would be mitigated to the extent that the IDB and World Bank loans will reduce the public and external financing requirements and will demonstrate a political determination to maintain a healthy macroeconomic framework regardless of who takes office in June 2009. Over the

medium term, the country's heavy dependency on international remittances, its vulnerability to oil price increases, and the tendency of the real effective exchange rate to appreciate all pose major competitiveness challenges that could affect both economic growth and current accounts results in view of international economic disturbances. In the face of these risks, efforts to sustain economic growth and to improve the fiscal situation by controlling expenditure and raising tax collection will be essential for ensuring a return to external account equilibrium and for continuing to reduce indebtedness.

- 3.2 **Political risks.** During the two years since the ES-0140 program was approved by the Bank's Board of Executive Directors, significant progress has been made with reforms to implement and evaluate the Solidarity Network Program. However, at a time of political transition there is always the risk that the new government will have different social priorities, and this could place fulfillment of the conditions attached to this PBL at risk. To mitigate this risk, the program will enhance the technical soundness of the Solidarity Network in terms of its targeting, coordination, monitoring and evaluation tools, community participation, and service delivery. In addition, changing the financing instrument to a PBL where conditions for the second tranche are fixed and priority budget items are protected will contribute to institutional consolidation of the country's most important poverty reduction program.

#### IV. RECOMMENDATION

- 4.1 Management recommends that the Board of Executive Directors (a) authorize a change in the financial instrument for the program from that originally planned to a PBL in two tranches, the first for up to US\$200 million and the second for up to US\$300 million, in accordance with the Conditionality Matrix for the operation (see Annex A); and (b) increase by US\$400 million the amount of financing originally planned, by approving the attached resolutions.

**SOCIAL POLICY SUPPORT PROGRAM (ES-0140)**  
**POLICY ACTION MATRIX**

Objectives	Conditions precedent to the first disbursement (2008)	Conditions precedent to the second disbursement (2009)
<b>I. MACROECONOMIC ENVIRONMENT</b>		
To help maintain sustained economic growth as the basis for the country's macroeconomic stability.	The macroeconomic environment is consistent with program objectives.	The macroeconomic environment is consistent with program objectives.
<b>II. STRATEGIC ACTIONS</b>		
<b>A. Targeting tools</b>		
To consolidate the design, application, and extension of targeting tools to give priority to public investments in the poorest municipios and households.	<p>The poverty map has been designed and applied as a geographical targeting tool at the municipal level.</p> <p>Municipal censuses have been designed and administered, consistent with progress of the conditional cash transfer (CCT) program, as a tool for identifying the families eligible for CCTs.</p> <p>The proxy means test (PMT) has been designed and used to classify and select households.</p>	<p>The poverty map has been updated to reflect the characteristics of potential urban beneficiaries.</p> <p>The municipal censuses have been applied in 100% of the CCT program's priority municipios.</p> <p>The CCT program targeting mechanism has been updated, based on the findings of the evaluation of the program's targeting.</p>
<b>B. Coordination forums and crosssector efforts</b>		
To consolidate the functioning and expansion of the national and municipal bodies that coordinate social policy for extreme poverty reduction, including tools for budget coordination.	<p>The Solidarity Network's board of directors, its intersector committee, and its municipal coordination committees have been established and are operating as coordination forums for the Solidarity Network.</p> <p>The Ministry of Finance has included in the 2008 budget a general line item to be transferred to finance the Solidarity Network Program, with its respective budget codes and tracking through the SAFI.</p>	<p>The Solidarity Network's board of directors, its intersector committee, and its municipal coordination committees are periodically monitoring their agreements, resolving execution problems expeditiously, and communicating their recommendations to decision makers.</p> <p>The Ministry of Finance has issued guidelines and directives instructing the ministries and public institutions involved in the Solidarity Network to program the funds from their budgets using the respective budget codes.</p>

Objectives	Conditions precedent to the first disbursement (2008)	Conditions precedent to the second disbursement (2009)
<b>C. Social protection</b>		
To help break the cycle of poverty by promoting incentives to boost demand for improved education, health, and nutrition levels for children living in extreme poverty	The CCT intervention model has been designed and implemented in at least 47 of the 100 municipios where extreme poverty is severe or high, and beneficiary families' compliance with the conditions has been verified.	CCT coverage has been extended to at least another 30 of the 100 municipios where extreme poverty is severe or high.
	Exit strategies for CCT beneficiary families have been formulated and approved.	The CCT process and delivery mechanisms have been improved to make them transparent and efficient and to ensure compliance with the conditionalities.
<b>D. Education</b>		
To improve the supply of formal education to ensure timely school attendance (preschool and primary education) and raise enrollment levels, by organizing and operating "Effective School Networks" that will become models for intervention in isolated poor areas.	<p>The "Effective School Networks" model has been designed and is being implemented in at least 56 extremely poor municipios, in order to increase school attendance and retention rates for pupils in primary education</p> <p>A technical proposal for strengthening and expanding the Youth and Adult Literacy Program has been designed, and the program is operating according to the revised curriculum, with learning modules and trained facilitators in place in at least 100 municipios where extreme poverty is severe or high, so that beneficiaries can complete their primary schooling.</p>	<p>The Effective School Networks model has been modified to include management modalities and community participation forums as a means of ensuring school attendance and retention, and is being implemented in accordance with pedagogical technical characteristics, in at least 44 additional municipios of the Solidarity Network. At least 117 networks have been organized in the 100 municipios where extreme poverty is severe or high.</p> <p>The Youth and Adult Literacy Program has been extended to at least 50 additional municipios, with an increase in the percentage of beneficiaries in the municipios where extreme poverty is severe or high.</p> <p>The Youth and Adult Literacy Program has at least 50% of facilitators trained for the upper primary and secondary education levels.</p> <p>A strategy for promoting, organizing, and executing the Youth And Adult Literacy Program has been designed and implemented, and a system for evaluating and certifying the learning progress of beneficiaries has been designed.</p>
<b>E. Health</b>		
To help ensure the delivery of a package of essential health and nutrition services for families living in extreme poverty.	The model for expanding the coverage of essential health and nutrition services has been designed and is mandatory for all public and non-public providers NGOs in extremely poor rural areas.	The coverage expansion model has been implemented in at least nine other municipios where extreme poverty is severe or high.

Objectives	Conditions precedent to the first disbursement (2008)	Conditions precedent to the second disbursement (2009)
	The model has been implemented in at least 87 of the 100 municipios where extreme poverty is severe or high.	The MSPAS has reviewed the cost-effectiveness of the coverage expansion model.  The MSPAS is promoting observance of the same minimum quality standards by NGOs and institutional teams contracted to provide services in extremely poor rural areas.
<b>F. Comprehensive urban development</b>		
To promote comprehensive urban development and help break the cycle of poverty and social exclusion in urban areas.	As a minimum, an advisory council has been established to design an urban poverty strategy.	A program of interventions in urban communities suffering from poverty and social exclusion has been designed, based on the results of the preparatory studies indicated by the Advisory Council on urban poverty.
<b>G. Community participation mechanisms</b>		
To promote the participation and empowerment of communities in resolving their problems and exercise social oversight over the Solidarity Network and other public programs.	Specialized NGOs have begun to offer services that promote community participation and to provide support for beneficiary families in at least 47 of the 100 municipios where extreme poverty is severe or high. The specialized NGOs provide these services in a regular and expeditious manner, using appropriate participatory methods.  Community participation mechanisms and their evaluation have been designed and are operating.	Specialized NGOs have begun to offer services that promote community participation and support beneficiary families in at least another 30 of the 100 municipios in the Solidarity Network where extreme poverty is severe or high.  Community participation mechanisms are operating with at least the same degree of beneficiary participation, including social oversight, contributing in this way to the sustainability of interventions and encouraging real accountability.  The community committees are exercising social oversight functions with respect to CCTs and education and health services.
<b>H. Monitoring and evaluation systems</b>		
To consolidate the design, implementation, and application of the monitoring, follow-up, and evaluation system for the Solidarity Network, promoting its replication in other social initiatives.	The systems for monitoring the CCTs and other Solidarity Network interventions have been designed in their technical and operational aspects  The evaluation studies of Solidarity Network processes have been completed and their results are being used to improve program design and implementation.	The design of the Solidarity Network Program has been updated based on the results of the program's interim impact evaluation and the evaluation of the effectiveness of the systems for monitoring the various Solidarity Network interventions.

Objectives	Conditions precedent to the first disbursement (2008)	Conditions precedent to the second disbursement (2009)
	<p>The methodological proposal for evaluating the impact of the Solidarity Network has been designed, including qualitative instruments for measuring user satisfaction.</p> <p>The baseline for evaluating the impact of the Solidarity Network has been calculated and the control groups identified.</p>	<p>The monitoring instruments and impact evaluation methodologies have been disseminated to national and local agencies, and are available for other social initiatives.</p>
<b>I. Technical and institutional strengthening</b>		
<p>To conduct technical studies to help consolidate the Solidarity Network as part of the "Opportunities" strategy for addressing poverty, and to deepen the medium- and long-term vision of poverty reduction social policy.</p>	<p>Terms of reference have been prepared for the priority studies to improve implementation and consolidation of the Solidarity Network, and the process of commissioning these studies has begun.</p> <p>Terms of reference have been prepared for the institutional analysis of the social area with a view to generating recommendations for institutional adjustments in the sector, and the process of commissioning this analysis has begun.</p>	<p>The Solidarity Network implementation process as it moves towards consolidation of the "Opportunities" strategy has improved, based on the findings of the technical studies.</p>
<b>III. BUDGET PROTECTION FOR PRIORITY SOCIAL PROGRAMS</b>		
<p>To protect the budgets of priority programs related to Solidarity Network coverage in the areas of education, health, and CCTs in order to ensure fulfillment of actions and coverage targets that propel the program.</p>	<p>The 2008 budget execution of at least 65% of the funds required for priority programs related to the Solidarity Network's coverage in the areas of education, health, and CCTs has been achieved.</p> <p>The draft general budget for 2009 has been submitted to the Legislative Assembly and contains the funds required for the priority programs related to Solidarity Network coverage in the areas of education, health, and CCTs (as calculated in Annex II).</p>	<p>The 2009 budget is being executed in accordance with the funds required for priority programs related to Solidarity Network coverage in the areas of education, health, and CCTs.</p> <p>The draft general budget law for 2010, which will be submitted to the Legislative Assembly, has been approved by the Cabinet and contains the funds required for those same priority programs (as calculated in Annex II).</p> <p>The Ministry of Finance has issued guidelines and directives, instructing the ministries and public institutions involved in the Solidarity Network to program the funds from their budgets using the respective budget codes.</p>



DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-\_\_\_/\_\_\_

El Salvador. Loan \_\_\_\_/BL-ES to the Republic of El Salvador  
Social Policy Support Program

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of El Salvador, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a social policy support program. Such financing will be for the amount of up to US\$9,820,000 from the resources of the Bank's Fund for Special Operations, corresponds to a parallel loan within the framework of the multilateral debt relief and concessional finance reform of the Bank, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on \_\_\_\_)

LEG/SGO/CID/IDBDOCS#1774034  
ES0140

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-\_\_\_/\_\_\_

El Salvador. Loan \_\_\_\_/OC-ES and \_\_\_\_/BL-ES to the Republic of El Salvador  
Social Policy Support Program

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of El Salvador, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a social policy support program.

2. The financing mentioned in paragraph 1 above will be for an amount of up to US\$90,180,000, and will be composed of:

- (a) A loan for the amount of up to US\$50,900,000 from the resources of the Single Currency Facility of the Bank's Ordinary Capital; and
- (b) A parallel loan within the framework of the multilateral debt relief and concessional finance reform of the Bank of up to the amount of US\$39,280,000, from the resources of the Single Currency Facility of the Bank's Ordinary Capital.

3. Such financing will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on \_\_\_\_)

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-\_\_\_/\_\_\_

El Salvador. Loan \_\_\_\_/OC-ES to the Republic of El Salvador  
Social Policy Support Program

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of El Salvador, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a social policy support program. Such financing will be for the amount of up to US\$300,000,000, from the resources of the Single Currency Facility of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Executive Summary of the Loan Proposal.

Conditional provision: This resolution will enter into force on January 1, 2009.

(Adopted on \_\_\_\_)

LEG/SGO/CID/IDBDOCS#1774017  
ES0140