

**REFORM PROGRAM FOR THE WATER SECTOR AND
THE POTABLE WATER AND SANITATION SUBSECTOR**

(ES-0068)

EXECUTIVE SUMMARY

**BORROWER AND
GUARANTOR:** Republic of El Salvador

EXECUTING AGENCY: Comisión Coordinadora para la Reforma Sectorial de los Recursos Hídricos [Coordinating Committee for Restructuring of the Water Resource Sector] (COSERHI) (see paragraphs 3.2 and 3.3); Administración Nacional de Acueductos y Alcantarillado (ANDA) [National Water and Sanitation Administration] (see paragraph 3.5); Ente Rector para la Administración de los Recursos Hídricos [Water Resources Authority (the Authority)] and Agencia de Regulación de los Servicios de Agua Potable y Alcantarillado (ARESA) [Water and Sanitation Regulatory Agency] (see paragraph 3.4).

AMOUNT AND SOURCE:

IDB Loan (OC):	US\$43.7 million
IDB nonreimbursable TC (FSO):	US\$ 1.5 million
MIF Donation:	US\$ 2.4 million
<u>Local counterpart:</u>	
To IDB (OC)	US\$11.3 million
To IDB TC (FSO)	US\$ 0.2 million
To MIF	US\$ 0.9 million
Total:	US\$60.0 million

**FINANCIAL
TERMS AND
CONDITIONS:**

Amortization period:	20 years
Disbursement period:	4 years
Interest rate:	variable
Inspection and supervision:	1% of the loan amount
Credit fee:	0.75%
Currency:	US\$ (Single Currency Facility)

OBJECTIVES:

The overall objective of the program is to foster and encourage structural reforms in the water resource sector, and the water and sanitation subsector, in order to: (i) promote conservation and more rational and efficient use of water resources; and (ii) create an institutional and business environment that will invite public and private investment in water and sanitation services.

The specific goal is to restructure management mechanisms in the sector and subsector by:

(i) creating a financially independent water authority responsible for oversight and policy-making to ensure proper development and preservation of the resource, with the necessary technical capacity, studies and instruments for integrated management of water resources and rational allocation of water rights; (ii) establishing a regulatory framework for the water and sanitation subsector, and an independent and financially autonomous regulatory agency equipped with the necessary instruments for enforcing regulations enacted to govern the provision of services; and facilitating and promoting competition and transparency at all levels among water and sanitation service providers; and (iii) supporting commercial restructuring in the sector, with the creation of more efficient and financially viable public, private, and semi-private operators of water and sanitation services, and programs to expand and improve the quality of services.

DESCRIPTION:

The program will have three components, in addition to support for Program execution and coordination: (i) restructuring of the water resource sector; (ii) establishment of the regulatory framework for the water and sanitation subsector; and (iii) commercial restructuring of the subsector under two subcomponents: support for management reorganization and related investments.

1. Component 1: Restructuring of the water resource sector (US\$6.8 million): Support for initial organization of the governing body in charge of water resources ("the Authority"), and development of the regulatory framework for the sector. This will include: (i) technical assistance and specialized consultancies; (ii) strategic studies in areas such as the water balance, the San Salvador aquifer, and the economic instruments for allocating water rights, as well as for a community participation project in a pilot catchment basin; (iii) support for the institutional structure and operations of the sector's governing body; and (iv) modernization of the hydrometeorology information system.

2. Component 2: Establishment of the regulatory framework for the water and sanitation subsector (US\$4.1 million): Support for formulating the subsector's legal and regulatory framework and legislation, and the organization and placement in operation of its regulatory agency (ARESA). This will include: (i) technical assistance and specialized consultancies to help formulate the

regulatory framework; (ii) strategic studies in areas such as tariff rates, subsidization policies and technical standards updating; and (iii) support for creation and start-up of ARESA.

3. Component 3: Commercial restructuring (US\$39.1 million): Support for planning and establishment of independent, commercially viable companies to provide water and sanitation services. This component is divided into two subcomponents: (a) organization of commercial operations (US\$4.1 million); and (b) related investments (US\$35 million).

Organization of commercial operations will include: (i) technical assistance and support for creation of the Unidad de Reforma Empresarial [Commercial Restructuring Unit] (URE); (ii) preparation of the restructuring plan to determine the most efficient operational structure for El Salvador's water and sanitation subsector, and formulation of a strategy for effective organization, separation and/or transfer of the various commercial operating units under a program of devolution and decentralization of services with private sector participation; and (iii) promotion of such private sector participation (PSP) using specialized consultants to give support and financial advice to the government towards the effective organization of PSP schemes.

The related investments are to be financed from a commercial restructuring support fund. Eligible investments will include: (i) those meeting the investment priorities criteria; (ii) those for rehabilitation and regularization of systems in the process of devolution and/or decentralization; (iii) investments in support of rural systems independently managed by local communities; (iv) activities in support of the formation and organization of companies providing organizational, training, commercial management, legal and other services; and (v) activities in support of worker training and retraining.

Preparation of the commercial restructuring plan and efforts to promote private sector participation will be financed by the MIF. In addition, part of the technical assistance for the URE, under the commercial restructuring component (Component 3), will be financed with local funds provided as counterpart to the MIF contribution. The MIF will also finance the technical assistance and priority studies for establishment of the regulatory framework (Component 2). The breakdown for this non-

reimbursable technical cooperation operation is included in Annex II of this document.

The nonreimbursable technical cooperation funds from the FSO will finance part of the activities involved in promoting and organizing rural investment schemes (Component 3). This operation is described in Annex III of this document.

**ENVIRONMENTAL/
SOCIAL REVIEW:**

Paragraphs 4.3 to 4.6 contain a summary of the environmental and social aspects of the operation. A specific review will be conducted as part of the assessment of compliance with program conditionality to verify that the environmental and social criteria have been incorporated in the regulatory frameworks developed for both the water resource sector as a whole, and the water and sanitation subsector. Implementation of the environmental management plan, whose conditions must be met by all investment activities under the program, will also be verified, including the adoption of participatory methods and support for the role of women in rural investment schemes.

RISKS:

This program faces the risks inherent in any reform process, namely:

1. A pre-election political climate and the difficulty of getting laws passed by the Legislative Assembly. The presidential election will take place in March 1999, and the new government will take office the following June. Nevertheless, there is clear political will on the part of the government to begin the process of restructuring and lay a solid foundation for the reforms. Authorities are likewise confident that the laws will be passed by mid-1998, and that the water sector authority and regulatory agency will have been created. By early next year the alternatives for commercial restructuring will have been developed as well, as part of the commercial restructuring plan to be financed by the MIF, and this will pave the way for agreements and commitments to start the reform process.

The COSERHI has already consulted with various political parties and civil society groups concerning the reforms and reports that they have been well received and that there is general consensus on their objectives and principles. There is also the precedent of successful reforms in the electricity and telecommunication sectors. While these encountered the difficulties hindering passage of any

law by a politically divided Assembly, there were no signs of opposition to the reform objectives – only to the process of implementation. The process must therefore be sufficiently flexible and fluid to accommodate different approaches, without compromising the objectives.

2. Institutional weaknesses within ANDA, the municipal governments, and the regulatory frameworks to be created. To deal with this unavoidable circumstance, the program will provide the necessary resources and technical assistance until the regulatory frameworks are consolidated and sufficient demand has been generated for decentralization and private sector participation.

3. Financial matters and rates. These are of crucial importance and it is vital that political pressure for the application of rate adjustments be reduced to a minimum. The formulation of an appropriate pricing policy and the implementation of economically and financially sound rate schedules are among the most important conditions for disbursement under the program. It will also be important to develop flexible mechanisms for private sector participation. The Bank's private sector window could play an important role in this area by facilitating implementation of the recommended PSP schemes.

4. Uncertainty concerning effective participation by the private sector and municipalities. This risk depends upon the country's political, economic, and social climate. The regulatory and promotional activities to be carried out under this program are intended to create a favorable legal and institutional framework, which will help to lower this risk. In addition, decentralization and private sector involvement have clearly taken on a momentum of their own in El Salvador.

BENEFITS:

This program will bring institutional order to the water sector and create a favorable environment for more efficient and modern management of the water resource sector as a whole, as well as the water and sanitation subsector. It will pave the way for private sector participation and decentralization, thereby opening up the sector, attracting higher levels of investment, and improving the coverage, quality, and efficiency of service throughout the country. The regulatory framework established will make it possible to monitor the quality standards to

be met by the service providers and for this information to be disseminated to the public to encourage the participation of consumers in the protection of their rights. Resolving the water supply problem will have a positive impact on public health, environmental, and quality-of-life indicators in El Salvador.

**THE BANK'S
COUNTRY AND
SECTOR STRATEGY:**

This program is consistent with the strategy adopted by El Salvador and the Bank for public service modernization and restructuring, encouraging private sector participation and decentralization in order to improve the coverage and quality of such services.

POVERTY-TARGETING:

The program does not specifically target low-income groups; rather, it aims to bring about sector reform at the national level. However, given the nature of El Salvador's water supply system, reaching the program targets should benefit the poorest population, which is most affected by the inadequate coverage and deficient quality of potable water services and sanitation. A positive impact is also anticipated for low income groups from the investments in support of commercial restructuring, which is directed toward medium-sized and small towns and rural areas (see paragraph 4.25).

**PROCUREMENT OF
GOODS AND
SERVICES:**

Bank procedures shall be used to procure the works, goods, and services under this program. Nonetheless, once the executing units have been sufficiently strengthened and trained, the implementation of ex post procedures for competitive bidding will be gradually tested. International competitive bidding will be required to procure goods worth US\$250,000 or more and works valued at US\$1 million or more. In the case of consulting services, international bidding is required for contracts valued at US\$200,000 or more. Competitive bidding for contracts below these thresholds will be conducted in accordance with the provisions of paragraph 3.33.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

Conditions precedent to the first disbursement of the loan:

1. Submission to the Legislative Assembly of the bill to establish the Authority ("the Water Resources Authority Act") (see paragraph 3.12).
2. Submission to the Legislative Assembly of the bill governing the regulatory framework of the potable water and sanitation subsector, and establishing the Water and Sanitation Regulatory Agency ("ARESA Act") (see paragraph 3.12).

3. Creation of the Commercial Restructuring Unit (URE) under the Office of the Chairman of ANDA, staffed with the specialized personnel needed to begin its activities (see paragraph 3.12).
4. Selection of a consulting firm to carry out the commercial restructuring study (with MIF financing), based on terms of reference previously agreed upon with the Bank (see paragraph 3.12).
5. Entry into force of the Operating Regulations, including specifications of the plan of operations and the environmental management plan, for the related investments under Component 3 (see paragraph 3.12).
6. Signature of an agreement for transfer from the the borrower to ANDA of the loan and local counterpart resources necessary to execute the commercial restructuring subcomponents under the responsibility of ANDA. The loan resources will be transferred under conditions similar to those established in the loan contract with the Bank, and the local counterpart resources will be transferred as a capital investment (see paragraph 3.28).
7. The executive decree expanding the authority and functions of COSERHI has entered into force, and the borrower has reported that this Commission has the legal capacity to execute the activities assigned to it under this Program (see paragraph 3.3)

Fulfillment of these conditions will allow access to all loan resources intended for: (i) support of the executing agency (COSERHI/UCM); (ii) Component 1; (iii) Component 2; and (iv) Component 3 in the following manner: up to US\$8 million for priority investments in accordance with investment plans agreed upon with the Bank; up to US\$1.6 million for investments in rural systems; and up to US\$1.5 million to support the organization and work of the URE (see paragraph 3.13). The studies to be financed by the MIF contribution will have begun earlier with the creation of the URE.

Conditions precedent to the first disbursement for investments in support of commercial restructuring under Component 3 (the remainder of the loan resources):

1. Entry into force of the Water Resources Authority Act and the regulatory framework for the water sector, including at a minimum that: (i) The Authority is operating in accordance with the provisions agreed to with the Bank and has the legal capacity to execute Component 1; (ii) regulations have been promulgated under the act; and (iii) the criteria for allocating water rights have been determined, including environmental requirements (see paragraphs 3.14, 3.15, 4.3 and 4.4).
2. Entry into force of the ARESA Act and the regulatory framework for the water and sanitation subsector, including at a minimum that: (i) ARESA is operating in accordance with the provisions agreed to with the Bank and has the legal capacity to execute Component 2; (ii) regulations have been promulgated under the ARESA Act and evidence is submitted showing that the law amending the act creating ANDA has also entered into force; (iii) the regulations governing contracts for provision of services, including the respective environmental considerations, have been approved; and (iv) a new rate schedule and policy for water and sanitation services has been implemented, along with the policy on subsector subsidies and development (see paragraphs 3.14-3.16, 4.3 and 4.4).
3. As previously agreed with the Bank, evidence that the tender calls for water and sanitation services under the private sector participation (PSP) modality have been published and a plan submitted for independent and decentralized operation of such services based on the commercial restructuring study (see paragraphs 3.14 and 1.32).

Other special conditions:

1. The following must be submitted during the first quarter of each calendar year during program execution: (i) a financial statement, together with a projection of ANDA's financial flows for the year to ensure that ANDA has sufficient funds to operate and meet its financial obligations

(see paragraph 4.12); and (ii) evidence that the costs of the investments made in commercial restructuring of the autonomous water and sanitation service providers are being recovered under financial conditions substantially similar, at a minimum, to those of the Bank's loan (see paragraph 3.30).

2. In addition to the usual conditions precedent to the first disbursement, the loan contract shall contain the rest of the Bank's standard conditions for this type of operation, as well as its conditions governing audits, reports, periodic meetings, inspections, maintenance, the procurement of goods and services, and the hire of consulting services.

**RECOGNITION OF
PRIOR EXPENSES:**

The Bank may recognize, as part of the financing and local counterpart, outlays for investment in designs, studies, and program activities. Expenses up to US\$1.2 million equivalent incurred during the 18-month period prior to the date of loan approval will be recognized as part of the local counterpart (see paragraph 3.34).

I. BACKGROUND

A. General context for public sector reform

- 1.1 In conjunction with its economic liberalization program begun in 1992, the government of El Salvador has made significant strides in modernizing and reforming the country's public sector. The macroeconomic results achieved through its stabilization and liberalization policies have been positive, as reflected in the respective country paper (1996). However, ensuring their continuation requires a modern and effective institutional structure in which the public sector plays the role of facilitator and promoter of private sector investment and growth. The slowdown in economic growth seen in 1996 and 1997, as well as the widening gap in income distribution and access to basic services, are due in part to institutional rigidities and inadequate public structures, which the government is endeavoring to correct.
- 1.2 The reform programs introduced by the government have redefined the concept of public service and are bringing about changes in areas where the government operated a centralized state monopoly. Already profound changes have been wrought in areas such as energy, telecommunications, transport, ports, and financial services, among others, limiting the state primarily to the role of regulator, policy maker, and promoter. To guide and direct this effort, the government moved to create the Presidential Commission for Modernization of the Public Sector (CPMSP) as a special body reporting to the Office of the President of the Republic. The CPMSP is headed by the Presidential Commissioner for State Modernization and made up of the Ministers of Finance and Economic Affairs. The Commission also has a Technical Unit (UTC) to coordinate its restructuring activities with the country's various agencies. This unit is executing the "Program for Modernization of the Public Sector" (1041/OC-ES), which was recently approved by the Bank.
- 1.3 The water sector, which is the object of this operation, is not immune to this process; indeed, its reorganization carries particular economic and social importance for the country. In the present document, a distinction is made between two separate levels in this area: (i) the water resource sector, which includes the many uses which are made of water as a natural resource; and (ii) the water and sanitation subsector which refers to this specific use of the resource, comparable to its use for farm irrigation and for hydroelectric power generation, for example.
- 1.4 The government's effort to reform both the water resource sector and the water and sanitation subsector began in February 1995 with the creation by executive decree of the Coordinating Committee for Restructuring of the Water Resource Sector (COSERHI). The objective of COSERHI is to coordinate studies and activities to

initiate the modernization process in the sector. It comprises the Presidential Commission, which acts as coordinator; the Office of the Chairman of the Board of Governors of the National Water and Sanitation Administration (ANDA), which serves as the executive body; and the Ministry of Agriculture. The COSERHI, through its technical arm, called the Coordinating Unit on Modernization (UCM), and with special support from the Office of the Chairman of ANDA, has been conducting a number of studies and activities aimed at formulating a program of reforms for the water resource sector and the water and sanitation subsector, and it is these which form the basis for the present operation.

B. Diagnostic of problems in the water resource sector and water and sanitation subsector

1. Water resources management

- 1.5 El Salvador is the most densely populated country in the Americas (280 inhabitants per square kilometer), with a population of 5.8 million and a land mass of some 20,935 km². Its primary source of water, the Lempa River, is used to generate electric power, irrigate farmland and supply drinking water. It is estimated that 63% of the country's available water resources come from the Lempa River basin, while the other 37% is drawn from other surface and subsurface water sources.
- 1.6 The principal user of water resources, although not the main consumer of the resource, is the electricity sector since over 60% of El Salvador's electric power comes from hydrogenerating plants. Irrigation accounts for the largest proportion of water consumption, distributing the resource over some 46,000 hectares of farmland. Human consumption is relatively low, averaging 120 liters/inhabitant/day in San Salvador and less in the smaller municipalities owing to reduced production capacity.
- 1.7 The dumping of untreated wastewater into bodies of water has seriously compromised water quality. Various studies indicate that some 90% of the country's surface waters are contaminated and unsafe for human consumption without treatment. Meanwhile, they also report that the major aquifers providing potable water are probably reaching levels that risk overburdening the water supply.
- 1.8 There are water shortages in some areas, yet El Salvador does not have an agency responsible for overall management of water resources. What is seen instead is the disjointed and unsustainable use of the resource within each sector. There is no mechanism for allocating water rights, and the communities, municipalities and national agencies all compete for the utilization and ownership of the country's water - to the point where this competition has led to social conflict in many areas. The lack of institutional, legal and/or market instruments embodying such rights has created an expectation of "free" water

rights and unregulated access to the resource, resulting in the current critical situation with respect to the quality, quantity, distribution, and conservation of water resources in El Salvador.

- 1.9 The problems confronting the use of water resources in El Salvador can be traced to: (i) the absence of a well-thought-out legal framework; (ii) the weakness and lack of coordination among its institutions; and (iii) the nearly total lack of information on the quantity and quality of its water resources.
- 1.10 El Salvador lacks a clean water act, and its environmental law has only now been passed by the Legislative Assembly. Instead, it has a series of uncoordinated and sometimes contradictory legal instruments that touch upon water resources. Among the institutions responsible for this sector there is no formal structure in place for the management and allocation of water resources; rather, the country possesses a patchwork of institutions each pursuing its highly segmented and, in some case, overlapping duties. Moreover, for the last 20 years only isolated and partial information has been available on the quality and volume of the country's water resources. El Salvador's last water balance was drawn up in 1979.
- 1.11 The existence of an institutional framework for integrated management of water resources is a necessary precondition for the proper organization of subsector entities, which depend upon, and compete for the use of, the same resources. The privatization of electric power companies in El Salvador, for example, creates an urgent need for determining the form in which water rights are to be allocated, since this is a key factor under the laws governing the electricity sector. Any attempt to deal with the issue in isolation from other sectors could be highly disruptive. Not having an adequate legal framework for managing the resource weakens the reform process. Before the private sector will participate, for example, clear rules of the game are required concerning the rights and obligations surrounding water use, in order to avoid and/or resolve disputes and make long-term investment plans.

2. The water and sanitation subsector

- 1.12 It is estimated that only 56.7% of El Salvador's total population has access to clean water: 78.3% in urban areas and 25.5% in rural sectors. This is the lowest figure for overall water coverage in Central America. In addition, the indicators of quality of service for those who do have access to water show a great deal of fluctuation. These factors have a direct impact on the serious public health and environmental sanitation problems that confront the country. In the area of sanitation, some 60% of those living in urban areas have access to sewerage systems, while less than 2% of the resultant sewage receives any kind of treatment before being discharged into the country's waterways.

1.13 The problems of the subsector can be traced primarily to its management structure. Under its organic act of 1961, the National Water and Sanitation Administration (ANDA) is responsible for providing service throughout the country, having been created as an autonomous public service agency reporting to the Ministry of Public Works. Under that act, ANDA is the only institution in El Salvador authorized to regulate, standardize, plan, set tariff rates, and operate water and sanitation services. The structure for provision of water and sanitation services can thus be described as a centralized public monopoly, paralleled by a growing number of private, informal operators not subject to regulation of any kind, as well as various independent water system programs for rural communities, supported by external lending

1.14 This management model has been plagued with problems, due in part to conflicting and contradictory mandates, which include the development, operation, and regulation of these services, plus strong political sensitivity. The sector's administration is excessively centralized, with top-down decision making and a heavy concentration of power in ANDA's Office of the Chairman. The resulting structure is cumbersome and slow to respond to the large demands of the subsector, with little internal coordination among its weak technical and operational units. The accounting and management systems designed for centralized public administrations are not suitable for service companies and do not permit the monitoring of systems efficiency or sustainability indicators. This hinders decentralization and efficient systems management.

ANDA is administered by a board of governors made up of six directors. Five are appointed from the Ministries of Public Works, the Interior, Public Health and Economic Affairs, and the National Construction Association, while the sixth acts as Chairman of ANDA and is appointed by the President of the Republic.

The Administration operates 150 water and sanitation systems in 178 of El Salvador's 262 municipalities, ranging from the country's largest — the Greater Metropolitan Area of San Salvador with 300,000 connections — to some of its smallest with less than 200 connections. There are 71 municipalities that operate their own systems under de facto arrangements. These are generally in the smallest municipalities, operate on a shoestring and occasionally receive support from ANDA and El Salvador's Municipal Development Institute (ISDEM). Finally, there are 13 municipalities that have no water and sanitation system whatever.

ANDA is organized in four regions: the Greater Metropolitan Area of San Salvador (AMSS) and the central, eastern and western regions. However, operations are in fact centralized in the AMSS which generates 70% of the Administration's income, absorbs probably more than 70% of its costs, and employs 72% of its work force. At the national level, the AMSS accounts for 56% of all connections and 62% of the nation's urban population with access to water and sanitation services. The regions have little autonomy and limited budgets, basically acting as extensions of management offices located in the AMSS.

ANDA has had a very limited role in rural areas, primarily operating the systems transferred to it in 1996 by PLANABAR, a program formerly managed by the Ministry of Health under a loan from the Bank. To handle these systems, ANDA created a rural management office within its organizational structure.

1.15 ANDA's current management took over a company in 1994 staffed by fixed-term employees and with minimum performance capacity. Since then, the Office of the Chairman has introduced institutional reforms which have produced positive results. For example, the new management has succeeded in reducing the labor force from 12.58 employees per

thousand connections in 1994, to 6.56 in 1996. The reduction in personnel was accompanied by job retraining to help staff find work in the private sector. ANDA now contracts a number of its services out to the private sector, such as the installation and reading of meters, delivery of invoices and collections, repairs, and new service installations. In 1995 ANDA submitted – and the executive branch duly approved – a draft decree setting more sensible tariff rates than those prevailing at the time.

- 1.16 Under this decree, the general consumer subsidy for water and sanitation services was reduced by limiting it to the first 20 cubic meters per month for residential consumption. Although this decree was seen as only the first step in the movement toward economically efficient pricing of these services, there have been no further reviews or adjustments in tariff rates since it came into effect.
- 1.17 Despite the achievements of the current administration, the people of El Salvador are still left with the perception of low levels of coverage and uneven service quality, including unscheduled interruptions, lack of response to complaints, areas that remain without service for long periods even though payments are up to date, and neglect of systems in municipalities outside the San Salvador area. The people have no institutions to defend their rights and are forced (particularly the low-income segments of the population) to pay much higher prices to alternative suppliers – for example, to sellers of water by the jug or barrel in an increasingly buoyant retail water market. Meanwhile, the services provided by ANDA in rural areas are both extremely limited and deficient. All of this is the result of a structure which is not designed for a service company whose primary responsibility is to its consumers.
- 1.18 There is an obvious need for new investment in the subsector. However, in order to reach this goal it will be necessary above all to reorganize water and sanitation services to introduce a framework of modern policies, regulations, and standards which either do not exist at present in the subsector, or are found to operate in imperfect form within individual firms only. For this reason, the government and the Office of the Chairman of ANDA, acting through COSERHI, have proposed a comprehensive program of institutional reforms consistent with two sweeping global trends: (i) the broad shift in political and social support within the country for decentralizing state-run activities and giving greater autonomy to local governments and communities; and (ii) the need to make the private sector participate in the provision of services in order to improve quality, efficiency and innovation in the sector, and increase the level of investment at a time when the public sector can no longer afford to do so.

C. Conceptual design and principles of the restructuring program

- 1.19 In order to get at the root of the management problems involved in its administration of water resources and provision of water and sanitation services, the government of El Salvador has drawn up a restructuring plan which will receive support under the present operation. The reforms to be carried out under this plan include: (i) the creation of an institutional and regulatory framework for integrated development of water resources; (ii) the creation of an independent institutional and regulatory framework for the water and sanitation subsector; (iii) clear definition of the authority responsible for subsector development policy; and (iv) the introduction of a management restructuring program aimed at promoting the establishment of viable public, municipal, private and or semi-private companies for the provision of services in the subsector. The authority for these reforms will rest upon two key pieces of legislation to be drafted by the COSERHI. The first is an act creating the Water Resources Authority ("the Authority"), and the second consists of a law establishing the regulatory framework and regulatory agency (ARESA) for the water and sanitation subsector.

1. Basis for restructuring the water resource sector

- 1.20 The process of restructuring the water resource sector will begin with passage of the act creating the Water Resources Authority, which will act as administrator of the country's water resources and the sole authority empowered to grant water concessions. The Authority will maintain a data bank and users' roster, and will make use of information provided by other government and private sector organizations. The Authority will not be empowered to carry out projects or works itself, or to compile permanent hydrometeorological or environmental records.
- 1.21 This regulatory framework will provide incentives for participation by the private sector and local communities, and promote development of economic instruments and means of consensus such as markets for water rights, watershed authorities, etc., all with the minimum restrictions necessary to avoid monopolies, safeguard the rights of low-income groups and protect the environment. This legislation will specifically revoke all existing legal provisions that empower any other organization to unilaterally grant water concessions for any purpose whatever. The Authority will prepare the preliminary draft of a Clean Water Act in cooperation with the Ministry of the Environment and Natural Resources (MARN).
- 1.22 The Authority will be constituted as a public law corporation with its own capitalization and independent legal status, and self-financed through concession fees. The Authority will have the minimum structure necessary to facilitate its administration of the country's water resources.

2. Basis for restructuring the water and sanitation subsector

- 1.23 (i) **The regulatory framework.** The law establishing the regulatory framework for the water and sanitation subsector also created the Water and Sanitation Regulatory Agency (ARESA) as an independent public agency with its own capitalization and corporate status and having complete technical, operational, administrative, and financial autonomy. The proposed act is a modern framework law which mandates the ARESA to: (i) establish clear and transparent rules for service providers and consumers; (ii) set the stage for turning services over to independent operators and permitting orderly private sector participation; (iii) promote competition through comparison of operations, and raise efficiency among service providers; (iv) defend consumer rights against monopolistic abuses and poor quality service; (v) determine tariff rates based on principles of economic and financial efficiency, and transparency with respect to the inclusion of subsidies; (vi) oversee the decreeing of tariff rates; (vii) approve tariff rates submitted by operators on the basis of rules and methods established by the agency; and (viii) regulate service contracts in accordance with the law.
- 1.24 ARESA will act as an independent and self-sufficient agency, financing its operations through fees paid to it by the operators. It will have a trim organizational structure headed by a three-member governing council appointed to a six-year term by the President of the Republic following open competitive examinations. Whereas the role of ARESA will be strictly limited to that of a regulatory agency, the operation of water and sanitation systems themselves will remain in the hands of operating companies, including ANDA, whose organic law will be duly amended for this purpose.
- 1.25 (ii) **Policy-making duties.** The proposed law makes the Ministry of Economic Affairs responsible for approving the policies, plans and strategies to be adopted for provision and expansion water supply and sanitation services. Part of the proposed restructuring seeks to create mechanisms within the executive branch for development and subsidization.
- 1.26 (iii) **Commercial restructuring.** The third pillar of the subsector reform program is commercial restructuring. This strategy envisages transforming El Salvador's water and sanitation systems from highly centralized operations under ANDA, into a system in which various commercial units with public, private, or semi-private management would coexist, all operating in accordance with rules set by the regulatory agency. The management restructuring process will depend upon the existence of a suitable regulatory framework and an independent regulatory institution. Certain restrictions inherent in the transition of a socially sensitive sector such as this must be taken into account, and the process

must enjoy political support while remaining sufficiently flexible and adaptable to the rapid changes sure to follow decentralization of water and sanitation systems and the opening up of opportunities for private sector participation.

- 1.27 The question of how to transform ANDA within this process has led to discussion of various options. The two most noteworthy alternatives are: (i) de facto transfer of all systems under ANDA to the municipalities (devolution plan); and (ii) immediate separation of the system in the Greater Metropolitan Area of San Salvador (AMSS) in preparation for the concessions to private sector operators, accompanied by the gradual transfer of other systems to municipalities and decentralization of management in those systems which cannot be transferred and are to remain under ANDA. The first option has the disadvantage that local government in El Salvador, with its 262 municipalities, is still weak, so that this alternative could lead to a high degree of fragmentation and simply multiply the problems of inefficiency in public management. In any case, El Salvador does not have any municipal statutes empowering these governments to administer water systems. And the second alternative, although it meets the criterion of flexibility, presupposes selection of the private sector participation (PSP) solution and could undermine efforts to find other decentralization methods that may optimize the division of territorial coverage between public and private operators from the commercial standpoint, minimizing the existence of "residual" areas that must be managed in subsidized form indefinitely.
- 1.28 Reorganization of the subsector will be guided by a comprehensive restructuring plan factoring in the pertinent political, institutional, financial, and social restrictions. This plan will determine the optimal strategy for attracting private investment, and the scale of viable decentralization schemes most likely to promote economic efficiency. In this context economic efficiency is understood as making use of economies of scale in production, operations, administration, and financing; determining the minimum size for efficient operations while ensuring proper management capacity; promoting competition through open and competitive contracting; encouraging commercial competition through comparison of service areas; and reducing the risk of market domination or monopolistic practices.
- 1.29 The restructuring process will be carried out on two levels: (i) through the Commercial Restructuring Unit (URE) to be created under the Office of the Chairman of ANDA, which launched and is acting as the lead agency in the reform program; and (ii) through the COSERHI, whose coordination is being handled by the CPMSP in which the Ministers of Finance and Economic Affairs play a leading role.
- 1.30 The URE, in cooperation with COSERHI, will carry out the restructuring plan, concentrating on reorganization of ANDA and

implementation of decentralization efforts. Meanwhile, COSERHI, through its Coordinating Unit on Modernization (UCM), will be responsible for promoting the private sector partition (PSP) schemes. The restructuring plan will set specific targets and deadlines for completion of the reforms, and identify possible configurations for commercial units deemed viable from an institutional, financial, geographic, demographic, political, and economic point of view. Each of the commercial units detached from ANDA will be regulated by ARESA and must comply with *service concession contracts* prescribed by law. The latter are management contracts establishing the terms and conditions for provision of the services, including delimitation of the areas served, periods and deadlines, tariff rates and commitments with respect to investments in the system, and quality requirements and targets. The contracting authority under the law is ARESA.

- 1.31 A highly specialized consulting firm with international experience will be hired to help COSERHI stimulate private sector participation. It will be the task of this firm to promote private sector participation in the management of water and sanitation systems by seeking terms and conditions that are acceptable to private investors while at the same time satisfying El Salvador's need to ensure access for the greatest number of persons and expand services at the national level.
- 1.32 For its part, the URE will promote devolution and decentralization schemes according to the strategy and goals set out in the restructuring plan. For the purposes of this program, devolution means a water and sanitation system administered by ANDA, but with control delegated to the regional level where systems operate independently, with their own personnel, budgets, accounts, invoicing, financial planning and revenue-generating capabilities. Decentralization means full transfer from ANDA to a fully autonomous public or private sector operating company.
- 1.33 Various municipalities have voiced the desire to manage their water and sanitation systems independently. ANDA has already launched a pilot project with six municipalities that have formed a semi-private company (Tetralogía). This effort looks promising and provides a concrete example of decentralization based on the concept of commercial units, the formation of which will be made easier by the proposed changes to the ARESA Act. The URE's mandate is not only to transfer systems, but also to provide them with a full range of consulting services, promotional activities, and advice on business organization, in order to produce systems with viable physical and institutional infrastructures.
- 1.34 Using proven participatory methods, a locally managed or community-level investment program will be developed for water services in rural areas to take advantage of the creation of Rural Water Associations (ARAs). Much valuable experience has been accumulated by the US Agency for International Development (USAID) and NGOs

under programs in which communities have been allowed to choose and manage the level of service they are prepared to pay for. Working directly with the ARAs, the URE will take care to ensure that rural systems managed by ANDA are transferred to local communities in an appropriate manner, making use of those participatory methods that have proven successful in El Salvador.

D. The Bank's support for restructuring

- 1.35 It is important to recognize that the proposed restructuring program is a politically sensitive and long-term institutional process. Consequently, Bank support for the present operation must be guided in the right direction by setting realistic targets, providing the instruments and flexibility needed to ensure that commitments to change are fulfilled. Accordingly, it was decided that a program defined by restructuring stages or targets, accompanied by direct funding and support for reform activities, would be the most effective means of balancing commitments and incentives, and hence of achieving concrete results. This makes it possible to arrange the steps of the restructuring process in a logical sequence, and to reinforce the achievement of results over time. An investment component is included in this process to directly support efforts to promote viable, fully-autonomous systems, as well as to provide funding for high-priority projects that the country urgently requires.
- 1.36 The Bank has been working closely with the government of El Salvador in developing the basic concepts of the restructuring process, primarily by assisting in the preparation of the necessary legislation. Thus, by the time the operation described in the following chapter is completed, it will have produced: (i) a financially independent water authority carrying out its duties as the governing and policy-making body and ensuring proper utilization and conservation of water resources, with the technical capacity, studies, and instruments necessary for integrated management of the resource and rational allocation of water rights; (ii) a functioning regulatory framework for the water and sanitation subsector, along with an independent and financially autonomous regulatory agency equipped with appropriate instruments for enforcement of the regulations governing water and sanitation service delivery, facilitating and promoting competition and transparency at all levels; and (iii) a management restructuring process with the creation of more efficient and financially viable public, private, and semi-private water and sanitation service operators, meeting their goals for expansion, improved service, and greater access for disadvantaged groups.

E. Activities of other donors

- 1.37 Various other donors are involved in the water and sanitation sector in El Salvador, including the European Community and the Governments of Japan, Germany, and the United States - the latter

through USAID. All of these parties are funding specific projects, primarily under systems operated by small municipalities and in rural areas. Particularly noteworthy is the experience gained by USAID in financing rural water and sanitation projects, and in its new approach to bilateral cooperation. The USAID projects are confined to certain regions and concentrate strictly on small municipalities. The activities to be carried out by the Bank under this operation will enhance the work of the other donors, by establishing the legal and regulatory mechanisms needed to create fully autonomous water and sanitation services. At present, each of the municipal programs belongs in essence to ANDA and is subject to its supervision and approval. The same is true of the Social Investment Fund and Local Development (FISDL) project being financed by the Bank, which includes a number of small investments in water and sanitation systems at the municipal level.

F. The Bank's strategy and experience in the sector

- 1.38 The Bank has had a significant presence in the sector since 1961, having approved more than 12 loans for investment in this area. Although the physical goals were achieved in each case, the sustainability of these investment projects has been unsatisfactory owing to ANDA's inability to allocate adequate resources for preventive maintenance. The most recent project (898/SF-ES - National Reconstruction Plan: Program for Rehabilitation of Water and Sanitation Systems), to be completed in 1998, has been the seed for the present program through its institutional strengthening component. The diagnostic studies carried out under that program enabled the Bank and the government to establish a dialogue on reform, which in turn gave rise to the investment proposal leading to the present operation. This program is thus consistent with the country's and the Bank's strategy of promoting the modernization and reorganization of public services, fostering private sector participation and decentralization as a means of increasing access and improving service.

II. THE PROGRAM

A. Objectives

- 2.1 The objective of the program is to foster and encourage structural reforms in the water resource sector, and the water and sanitation subsector, in order to: (i) promote conservation and more rational and efficient use of water resources; and (ii) create an institutional and business environment that will invite public and private investment in water and sanitation services. The goals of the program are those listed in paragraph 1.36 of chapter I above.

B. General description of the program

- 2.2 In addition to overall support for execution and coordination of the program, this operation will have three components: (i) restructuring of the water resource sector; (ii) establishment of the regulatory framework for the water and sanitation subsector; and (iii) commercial restructuring of the subsector under two subcomponents: support for management reorganization and investments in support of the restructuring process. Implementation of the program is subject to conditions precedent to disbursement, allowing access to program resources only insofar as the restructuring targets have been met. The stages in this process are described in chapter III. Following is a general description of each component and its activities.

1. Execution and coordination of the program (US\$1.7 million)

- 2.3 Support for the preparation, implementation, and coordination of the program during its four-year execution period. This will include the placement in operation and financing of the COSERHI budget, as well as technical assistance.

2. Component 1: Restructuring of the water resource sector (US\$6.8 million)

- 2.4 Support for initial organization of the governing body in charge of water resources (the Authority), as well as planning of the regulatory framework for the sector. This will include the following activities:
- 2.5 (i) **Technical assistance** (US\$500,000). Specialized consulting services to help the Authority draft regulations for the allocation of water rights, the supervision of studies, the design and implementation of the data bank on water right concessions and allocations, and creation of the users' roster. This component will also include assistance with the preparation of policies governing allocation of water rights, methods of coordinating

efforts with local communities, drafting of operating manuals and training programs.

- 2.6 (ii) **Strategic studies** (US\$2.90 million). *Water balance and updating of the master plan for water resources.* The objective under this component is to aid in the operation of the Authority by supplying the elements needed to evaluate applications and allocate water rights based on water zoning. In addition, hydrological aspects will be further studied and detailed characteristics of watershed areas will be collected.
- 2.7 *Study of the San Salvador aquifer.* The object is to evaluate the aquifer and investigate its behavior to determine the measures required to restore, protect, and manage it and provide the Authority with suitable criteria for regulating its use. This study is crucial to controlling water consumption for human and industrial use in the AMSS.
- 2.8 *Economic instruments for allocating water rights.* Designed to investigate the relative value of the resource and establish the economic criteria for evaluating and allocating water rights, and regulating the market.
- 2.9 *Community participation project in a pilot catchment basin.* Study on the management and allocation of water rights under a community participation project in a pilot catchment basin.
- 2.10 (iii) **Support for institutional organization** (US\$2.2 million). This will include funding to upgrade the facilities and purchase furniture, office equipment, and material for the documentation center (data bank on users and water concession holders). Resources will also be provided to support initial operation of the Authority by financing its operating budget for the first two years. Beginning in the third year, the Authority must be financially self-supporting, primarily through fees for the allocation of water and dumping charges.
- 2.11 (iv) **Modernization of the hydrometeorology information system** (US\$1.2 million). Essential in order to obtain the basic information required to update the country's water-budget.
3. Component 2: Establishment of the regulatory framework for the water and sanitation subsector (US\$4.2 million)
 - 2.12 Support for formulating the subsector's legal and regulatory framework and its legislation, and the organization and placement in operation of its regulatory agency (ARESA). This will include the following activities:
 - 2.13 (i) Technical assistance (US\$500,000). Specialized consultancy to help formulate the regulatory framework, preparing regulations

needed to implement the law and drafting supplemental regulations and manuals of operations and procedures. Support will also be provided for basic regulatory training for the Authority's personnel (includes partial financing from the MIF).

- 2.14 (ii) **Strategic studies** (US\$300,000). This includes a study of tariff rates for use in establishing the new tariff schedule, to be issued by decree under the law establishing the regulatory framework for the water and sanitation subsector. It also includes updating technical standards to establish minimum requirements for all operators to guarantee the quality of the service. Along with the study on tariff rates, support will be provided through a study and/or specialized consultancy (with MIF financing) to help the government define its policy on subsidies and assistance.
- 2.15 (iii) **Support for institutional organization** (US\$3.4 million). Covers the allocation of physical premises, furniture, equipment, recruitment and appointment of ARESA personnel, and its operating budget for the first two years. Beginning in the third year the regulatory agency must be financially self-supporting, primarily through the charging of fees to operators of water and sanitation services. A portion of these resources would also be used to support the institutional establishment of the entity assuming responsibility for subsector policies and development.

4. Component 3: Commercial restructuring (US\$39.1 million)

- 2.16 Support will be provided for the promotion and establishment of independent, commercially viable companies to provide water and sanitation services. This component is divided into two subcomponents: (a) related investments; and (b) organization of commercial operations.

a. Related investments (US\$35 million)

- 2.17 These investments are designed to help reach the targets set under the restructuring plan (see paragraph 2.24). Distribution of investment resources will be governed by the Operating Regulations and will be activated only when restructuring targets agreed upon with the government are reached. These will include:
- 2.18 **Priority investments** (US\$10 million). These projects are designed to help ANDA maintain minimum levels of service and enable it to meet the need for rehabilitation and regularization of services in cases requiring immediate attention. Projects identified as high-priority investments in existing master plans and diagnostic studies will be eligible under this component, as well as those meeting emergency criteria.
- 2.19 (ii) **Investments in support of the restructuring program** (US\$20 million). The objective of these projects is to facilitate

operations and ensure the economic viability of independent commercial service providers. The investments are intended to provide support for systems in process of devolution and/or decentralization, according to criteria set out in the Operating Regulations. The support provided must be sufficiently flexible to adjust to the specific needs of each operating unit. Eligible projects will include investments in organizing commercial operations, job training and *regularization and rehabilitation of systems*. Regularization projects are intended to ready systems for autonomous operation by updating the technical register and users' roster, clearing up irregular connections, improving user metering, organizing the distribution network for the systems, improving system metering, and preparing manuals for efficient operations and maintenance. Rehabilitation projects will focus on systems which have been transferred and/or decentralized, and for which a service contract has been signed and a plan for maximizing operating efficiency has been drawn up. Included as well are: the repair of pumping stations; clean-up or replacement of wells; repair of pipelines, distribution tanks, and tubing; and works and/or activities to expand systems, provided they help to make the independently managed operation commercially viable.

- 2.20 In addition, support will be provided for business development at the local and municipal level in the areas of organizational structure, commercial management and legal affairs, etc., up to the amount of US\$2 million. This activity is a form of technical assistance for systems not covered by PSP schemes with private international investment. Support in this category will be guided by the strategy defined in the restructuring plan, to be supplemented by additional support for creating packages to make feasible the formation of companies that will act as service providers under independent municipal, semi-private, or decentralized management. Job retraining activities may also be included under this component.

- 2.21 (iii) **Rehabilitation and construction of rural systems** (US\$5 million). There are over 450 water and sanitation systems serving rural communities, most of which are in need of rehabilitation before being transferred to the communities. The program will finance a diagnostic study and the preparation and implementation of project activities aimed at improving systems that provide inadequate service. As a prerequisite for receiving this support, the community must organize its own water administration under the ARA system in order to guarantee its sustainability. Support will also be provided for the promotion, design, and implementation of new systems for providing water and sanitation services to selected rural populations. These projects will be carried out using participatory models of proven effectiveness in El Salvador, and are expected to give access to approximately 30,000 individuals living in the poorest rural areas. The program will target rural areas that have the lowest ratio of

hook-ups to the water supply system, and that are not being considered for the assistance offered by other donor institutions (includes partial financing under the FSO nonreimbursable TC).

b. Organization of commercial operations (US\$4.1 million)

- 2.22 Support in this area will include the following activities:
- 2.23 (i) **Creation of the Commercial Restructuring Unit (URE)** (US\$2.1 million). Support will be provided for the placement in operation of the URE and the financing of its budget, including specialized technical assistance during execution of the program. The URE will serve as a temporary body to be disbanded upon completion of the restructuring plan financed under the program, although it could be absorbed into the executive as a policy-setting unit for the subsector (includes partial financing from the MIF).
- 2.24 (ii) **Preparation of the restructuring plan** (US\$1 million). This plan will determine the most efficient operational structure for El Salvador's water and sanitation subsector by identifying commercial operating units and efficient forms of management for water supply, sewerage, and wastewater treatment services. These operating units will be identified on the basis of technical, economic, financial, institutional, and legal criteria, in order to create commercially viable systems or groups of systems (MIF financing).
- 2.25 The formulation of this plan will begin with strategic studies to include: *cost accounting and financial systems; supply and inventories study; and valuation of assets* in order to guarantee commercially viable operating units. Finally, the plan will devise a strategy for effective creation, separation, and/or transfer of the different commercial operating units, and establishment of a program for devolution and decentralization of services with private sector participation, including implementation targets during the program's execution period. This process allows for different participation arrangements, such as semipublic enterprises, municipal enterprises, NGOs, and specialized private companies.
- 2.26 (iii) **Promotion of private sector participation** (US\$1 million). In addition to the restructuring plan, consultants will be hired to provide the government with support and specialized financial advice to ensure effective organization and promotion of private sector participation (PSP) schemes. The work under this component will include: (i) evaluation of viable options, financial feasibility and selection of optimum alternatives; (ii) support for preparation of bid packages to be used in letting contracts for private sector participation; and (iii) promotion. The progress of these activities will be coordinated with the Bank's private sector

window to introduce a possible financing option and to encourage and facilitate viable PSP schemes (MIF financing).

C. Scale of the program

- 2.27 The scale of components 1 and 2 was determined on the basis of the basic need to establish and place in effect the institutional and regulatory framework for the the Authority and ARESA, bearing in mind the functions assigned to them under their respective organic acts.
- 2.28 The institutional support for management restructuring under component 3 likewise reflects the basic need for reorganization into small operating units supported with technical assistance, studies, and activities deemed essential for successful transformation of the sector.
- 2.29 The highest-priority projects have budgeted sufficient resources to meet the most pressing and/or urgent requirements in order to maintain a basic level of water and sanitation services. The scale of these projects is based on the master plans for San Miguel, Santa Ana, and Sonsonate, along with the diagnostic studies carried out for the Greater Metropolitan Area of San Salvador, which identify the highest-priority activities for the rehabilitation and regularization of systems. The US\$10 million allotted for this component represents a fraction of the amount required for the rehabilitation of these systems.
- 2.30 The projects in support of restructuring are of sufficient scope to aid in the formation of companies in accordance with the commercial restructuring plan to be created. Based on a sample of small and medium-sized cities, the approximate cost per connection for rehabilitation and regularization of services was worked out, resulting in a very conservative estimate of over US\$50 million for the nation as a whole. The amounts allocated under the present program are thus designed to serve as a catalyst to launch the first stage of the restructuring process.
- 2.31 The US\$5 million allotted for rural investments was deemed adequate for purposes of transferring the rural systems currently managed by ANDA to the respective communities, expanding coverage under the pilot project and acting in concert with the bilateral and multilateral support being provided in this area.

D. Cost of the program and sources of financing

- 2.32 The total cost of the program is US\$60 million, including financial costs, which breaks down as follows (see the cost summary table at the end of this chapter).

- 2.33 *MIF technical cooperation (US\$2.4 million)*, which will be utilized for: (i) carrying out strategic studies on commercial restructuring, promoting private investment, and providing specialized technical assistance; and (ii) financing studies to support establishment of the regulatory framework, once the regulatory agency itself has been created. (Annex II)
- 2.34 *FSO nonreimbursable technical cooperation (US\$1.5 million)*, which will finance promotional and organization activities in support of rural water and sanitation systems. (Annex III)
- 2.35 *IDB loan (US\$43.7 million)*, which will finance creation and organization of the governing bodies, regulatory agencies, and executing units, as well as establishment of an investment fund to support restructuring, which is to be accessible against evidence that targets and reform conditionalities defined under the program have been met.
- 2.36 The IDB loan will be financed with resources from the Ordinary Capital (OC), subject to the following terms and conditions of financing:
- | | |
|-----------------------------|---|
| Amortization period: | 20 years |
| Interest rate: | variable |
| Grace period: | 6 months following the last applicable disbursement |
| Credit fee: | 0.75% |
| Inspection and supervision: | 1% of the loan amount |
- 2.37 The Bank's loan will be in United States dollars, drawn on the Single Currency Facility from the Bank's ordinary capital. Interest charges during the execution period will be financed from the loan.
- 2.38 *Local counterpart*: The local funds provided as counterpart to the loan will total US\$11.3 million over the four-year period, including US\$600,000 in finance charges and US\$500,000 for contingencies and indexing of costs. In addition, the counterpart to the MIF technical cooperation will total US\$900,000, of which US\$200,000 is for the (FSO) nonreimbursable technical cooperation.

SUMMARY OF COSTS (in US\$ millions)									
COMPONENTS	IDB				COUNTERPART				TOTAL
					GOVERNMENT			SUB-TOTAL	
Description	OC	MIF	FSO	SUB-TOTAL	OC	MIF	FSO		SUB-TOTAL
Program execution and coordination	1.2	0.2		1.4	0.3			0.3	1.7
Restructuring of the water resource sector	2.1			2.1	4.7			4.7	6.8
a. Technical assistance	0.4			0.4	0.1			0.1	0.5
b. Strategic studies					2.9			2.9	2.9
c. Institutional organization	1.7			1.7	0.5			0.5	2.2
d. Modernization of the hydrometeorology information network					1.2			1.2	1.2
Regulatory framework of the water subsector	2.9	0.5		3.4	0.5	0.3		0.8	4.2
a. Technical assistance		0.2		0.2		0.3		0.3	0.5
b. Strategic studies		0.3		0.3					0.3
c. Institutional organization	2.9			2.9	0.5			0.5	3.4
Support for commercial restructuring	30.6	1.6	1.5	33.7	4.7	0.5	0.2	5.4	39.1
Additional investments	29.1		1.5	30.6	4.2		0.2	4.4	35.0
a. Priority investments	8.0			8.0	2.0			2.0	10.0
b. Investments in support of commercial restructuring, decentralization, and devolution	19.5			19.5	0.5			0.5	20.0
c. Rural systems	1.6		1.5	3.1	1.7		0.2	1.9	5.0
Organization for commercial restructuring	1.5	1.6		3.1	0.5	0.5		1.0	4.1
a. Commercial Restructuring Unit (URE)	1.5			1.5	0.5	0.1		0.6	2.1
b. Restructuring plan		0.6		0.6		0.4		0.4	1.0
c. Promotion of private sector participation		1.0		1.0					1.0
Subtotal	36.8	2.3	1.5	40.6	10.2	0.8	0.2	11.2	51.8
Unallocated	1.9	0.1		2.0	0.5	0.1		0.6	2.6
Contingencies	1.1	0.1		1.2	0.2	0.1		0.3	1.5
Indexing of costs	0.8			0.8	0.3			0.3	1.1
Financial charges	5.0			5.0	0.6			0.6	5.6
Interest	4.6			4.6					4.6
Credit fee					0.6			0.6	0.6
Inspection and supervision	0.4			0.4					0.4
TOTAL	43.7	2.4	1.5	47.6	11.3	0.9	0.2	12.4	60.0

III. THE BORROWER, EXECUTING AGENCY AND PROGRAM EXECUTION

A. The borrower and executing agencies

- 3.1 The borrower and guarantor for the operation is the Government of El Salvador. The borrower, through the General Department for Investment and Public Credit of the Ministry of Finance, will be responsible for general coordination of the program in terms of monitoring compliance with conditionalities, consolidating the information, and preparing various reports as required by the Bank. The executing agencies for the program and their duties are described below.
- 3.2 **The Coordinating Committee for Restructuring of the Water Resource Sector (COSERHI).** The COSERHI, through its Coordinating Unit on Modernization (UCM), will participate in program execution and coordination. Its specific functions will include: (i) carrying out initial preparations for program execution, with a view to promoting passage of the laws creating the Authority and ARESA; (ii) assist these bodies through their initial formation and commission planning studies where warranted; (iii) assist ANDA in carrying out the restructuring plan, and conduct the activities under component 3 to promote private sector participation. COSERHI is due to be disbanded at the conclusion of the program.
- 3.3 COSERHI will carry out these activities with the assistance of the Presidential Commission for Modernization of the Public Sector (CPMSP), which will authorize the use of its Integrated Financial Unit for purposes of administering program resources. As part of the conditions for the first disbursement, the decree law expanding the authority and functions of COSERHI must have entered into force and the borrower must have reported that this commission has the legal capacity to execute the activities indicated in paragraph 3.2.
- 3.4 Once the Authority and ARESA have been created, these institutions will be responsible for carrying out components 1 and 2, respectively, to reinforce their institutional capabilities (see paragraphs 1.19-1.24).
- 3.5 **The National Water and Sanitation Administration (ANDA).** ANDA, acting through the Commercial Restructuring Unit (URE) (see paragraphs 1.29 and 1.30), will be responsible for carrying out component 3, in coordination with COSERHI. Like the above-mentioned UCM, the URE will have a small but highly qualified staff, headed by trained professionals with expertise in business administration. This unit will have the additional support of international consultants specialized in restructuring, decentralization, and promoting private sector participation.

- 3.6 Based on the management restructuring study which will determine the optimal type of commercial operation and the most viable combination of public, private, and semi-private management, the URE will provide support and coordinate the formation of fully autonomous or decentralized companies. (Meanwhile, COSERHI/UCM will be promoting implementation of private sector management schemes.) To help it achieve its objectives, the URE may utilize program resources for investments in accordance with the Operating Regulations approved by the Bank (Technical Annex).
- 3.7 To carry out these investments, and to provide technical assistance in the field, the URE may obtain support from part of the personnel of the existing executing agency under loan 898/SF (PEU), which is now in the final stage of its execution. And for activities in rural areas, the URE may request the support of ANDA's Rural Water Systems Administration (GSR), as well as hiring NGOs with proven expertise in the promotion and implementation of water projects in rural environments. The duties of the URE will cease at the conclusion of the program.

B. Stages in the execution of the program

- 3.8 Implementation of this program will be subject to two sets of conditions precedent to disbursement, allowing access to program resources only insofar as the restructuring targets have been met. Table 1 at the end of this chapter provides an outline of the conditions, targets, and activities required for disbursement eligibility.
- 3.9 In the first stage, access to the resources of the first disbursement will be subject to the basic conditions of execution, namely the strengthening of COSERHI/UCM and ANDA/URE, provision of specialized technical assistance and preparation of the restructuring plan. Efforts will also be made to promote passage of the laws creating the Authority and ARESA, develop their respective regulatory frameworks, and strengthen the two entities. Based on the studies of the restructuring process, the government and the Bank will reach agreements on the process for creating commercial organizations to provide water and sanitation services, including viable PSP schemes. Investment projects at this stage are limited to emergency or high-priority measures and the rural investments.
- 3.10 The point of departure for the second stage is the entry into force of the above-mentioned laws, regulatory frameworks, tariff rates, and policies. In other words, the establishment of clear rules of the game governing operations in the sector and subsector. Only when these conditions have been met to the Bank's satisfaction will the resources for activities in support of the restructuring process be authorized. All operators of public services, including public agencies and private or semi-private companies, will be subject to the rules laid down by the regulatory agency.

- 3.11 There is no fixed schedule or specified number of months for these two stages; rather, each will commence with the decision that the specified conditions have been met, which may require longer or shorter periods depending on the social and political backing that the process enjoys.

C. Eligibility conditions for disbursements

- 3.12 Conditions precedent to the first disbursement of the loan are as follows: (i) submission to the Legislative Assembly of the draft laws creating the Authority ("the Water Resources Authority Act") and the regulatory framework for the water and sanitation subsector, establishing the Water and Sanitation Regulatory Agency ("ARESA Act"); (ii) creation of the Commercial Restructuring Unit (URE) under the Office of the ANDA Chairman, including staffing with the specialized personnel needed to begin activities; (iii) selection of a consulting firm to carry out the commercial restructuring study, based on terms of reference previously agreed upon with the Bank; and (iv) entry into force of the Operating Regulations for the related investments under Component 3.
- 3.13 When these conditions are fulfilled, the borrower will have access to all loan resources allocated for: (i) support of the program executing agency (COSERHI); (ii) component 1; (iii) component 2; and (iv) component 3 in the following manner: up to US\$8 million for priority investments in accordance with investment plans agreed upon with the Bank, up to US\$2.5 million for investments in rural systems, and up to US\$1.5 million to support the organization and work of the URE.
- 3.14 The conditions precedent for disbursement of the remaining loan resources (to finance projects in support of restructuring under component 3) are as follows: (i) entry into force of the Water Resources Authority Act and the regulatory framework for the water sector; (ii) entry into effect of the ARESA Act and the regulatory framework for the water and sanitation subsector; and (iii) as previously agreed with the Bank, evidence that the tender calls have been published for awarding water and sanitation services in the private sector participation (PSP) modality, and submission of a plan for independent and decentralized operation of such services on the basis of the commercial restructuring study.
- 3.15 Entry into force of the regulatory framework for the water sector means: (a) that the Authority is operating in accordance with the provisions agreed to with the Bank; (b) that regulations have been promulgated under the act; and (c) that the criteria for allocating water rights have been determined.
- 3.16 The entry into force of the regulatory framework for the water and sanitation subsector means: (a) that ARESA is operating in accordance with the provisions agreed to with the Bank; (b) that regulations have been promulgated under the ARESA Act and evidence

is submitted showing that the law amending the act creating ANDA has also entered into effect; (c) that the regulations governing contracts for provision of services have been approved; (d) that a new tariff schedule and policy for water and sanitation services has been implemented; and (e) the subsector subsidies and development policy has been put in place.

- 3.17 The implementation of a new subsidies and development policy should help to coordinate and improve the allocation of all the support resources provided by different donors which at the current time flow to the small towns and rural areas, requiring ANDA to intervene in a less than satisfactory manner.

D. Operating Regulations governing utilization of the investment fund

- 3.18 The investment resources will be allocated under three headings: (i) high priority investments; (ii) investments in support of restructuring; and (iii) rural investments as described in chapter II (paragraphs 2.21-2.25). These resources will be administered by ANDA/URE under the Operating Regulations. Following is a summary of the essential aspects of these regulations, which can be found in draft form in the technical files of RE2.
- 3.19 **High priority investments.** Eligible under this heading are investments identified as essential to avoid possible depletion of the water supply in the respective system, and/or those designated as priority investments in the diagnostic studies and existing master plans. Activities involving the rehabilitation of pumping stations under this component must take into account environmental considerations and be accompanied by a plan for optimization of operations, or must be justified as an emergency resulting from equipment breakdown. Because of their emergency status and relatively small scale, these investments may be carried out under the systems as currently constituted prior to restructuring.
- 3.20 **Investments in support of restructuring.** Only those systems identified and designated as priority projects in the commercial restructuring plan and not otherwise included under a PSP scheme supported by international operators and investors will be eligible for program resources under this heading, which shall therefore include private sector participation activities in its own right.
- 3.21 These resources may be used to: (i) regularize systems in order to ready them for decentralization; (ii) rehabilitate systems in commercial units targeted for devolution and/or decentralization, and for which an operating plan and service contract have been issued by the regulator; (iii) supply technical assistance to aid in the formation of the companies that will operate water and sanitation services; and (iv) provide job training.

- 3.22 Those systems or groups of systems identified in the restructuring plan that express formal interest in constituting themselves as independent or decentralized service providers will be eligible for technical assistance to help them form companies. Up to US\$2 million will be available for technical assistance with the relevant legal and commercial aspects and for submission of applications and preparation of projects, as well as for environmental support.
- 3.23 In order to be eligible for financing with program resources, proposals to create commercial enterprises must be accompanied by a specific diagnostic study on service provision, and must be an integral part of a well-defined project and backed by an operating plan for the corresponding system. The operating plan will serve as the basis for determining the activities and costs to be covered, and must include detailed information on at least the following aspects: (i) supply and demand; (ii) population served and quality of service; (iii) condition of infrastructure; (iv) operation and maintenance; (v) organization and administration; (vi) commercial management; (vii) short- and medium-term investments required; (viii) analysis of financial viability; (ix) environmental aspects; and (x) authorization of water sources and waste disposal from the water authority.
- 3.24 All applications will be evaluated and arranged in order of priority by the URE, with resources allocated on the basis of demonstrated technical, financial, economic, environmental, and social feasibility. Assuming that environmental requirements are met, the principal evaluation criteria will be social acceptability and financial and institutional sustainability as a guarantee that the systems can operate independently.
- 3.25 Each operating company will be subject to the general provisions governing service providers under the ARESA Act and other requirements deriving from this act and its regulations. Contracts for provision of services must be let by means of a well-publicized public selection process ensuring transparency, nondiscrimination, and open competition.
- 3.26 Rural investments. Rural projects will be developed in six stages using participatory methods: (i) identification and selection of communities; (ii) development and specification of projects with community participation; (iii) identification of water sources and disposal sites for raw or treated sewage; (iv) Community training in the operation and maintenance of the system, protection of water sources and receiving bodies, financial administration, gender issues, organization of water committees and management personnel in the municipalities, and basic public health; (v) rehabilitation and building of systems in accordance with environmental standards and the community's needs and ability to pay; and (vi) follow-up with technical assistance and monitoring of the rural systems that are transferred and/or managed by local communities.

- 3.27 Each year the URE and ANDA's Rural Water Systems Administration (GSR) will determine the highest priority communities using criteria set out in the Operating Regulations. Beneficiary communities must assume responsibility for system operation and maintenance by creating a Rural Water Association (ARA) following rules established by the GSR during the initial stage of promotional activities and program definition. The ARA must undertake to contribute resources (in money or in labor) equivalent to at least 20% of the total investment for the project, as well as to set a tariff rate that will cover the operation and maintenance of the system and provide a fund for its rehabilitation.

E. Disbursement and flow of resources

- 3.28 The resources under this loan will be transferred from the Central Bank into two separate accounts, one in the name of the Financial Unit (UFI) Program under the Presidential Commission for Modernization of the Public Sector, to be used in components 1 and 2, and the other in the name of ANDA for component 3, according the established categories. For the latter transaction, the respective funds transfer agreement between the borrower and ANDA must be drawn up. UCM/COSERHI will effect all of the disbursements required for the initial studies in progress through the UFI and, once the Authority and ARESA have been created, the resources will be transferred directly to them for execution and monitoring of the respective components and for their operation.
- 3.29 Resources will be transferred from ANDA to systems due to be turned over to autonomous operators in the following manner: (i) promotional activities, support for the formation of companies, regularization works and the readying of systems for independent operation will all receive direct support on a nonreimbursable basis; (ii) funding for projects to rehabilitate systems for decentralized operation (under the ANDA umbrella) according to the guidelines contained in the restructuring plan will be repaid directly to the central government by ANDA. Resources provided for rehabilitation projects that result in decentralization and the effective separation of systems from ANDA (by means of an operating plan established under the restructuring plan) will be recovered from the new service providers directly by the Ministry of Finance, under the same conditions that applied when ANDA received the funds from the government. In such cases, ANDA will be released from its repayment obligation and the recovery risk is transferred to the Ministry of Finance.
- 3.30 As a special condition, the borrower must submit evidence that it is recovering the costs incurred for projects in support of restructuring from water and sanitation service providers, under financial conditions similar to those of the Bank loan.
- 3.31 The resources of the loan will be used solely to finance activities in which the resulting service is to be provided by a water and

sanitation company – whether municipal, private, or semi-private – but not under the direct management of a municipality, in accordance with the provisions of the ARESA Act and the service contracts.

F. Disbursement of funds and disbursement schedule

- 3.32 The program execution period is four years. The preliminary disbursement schedule for direct costs, including those of the technical cooperation projects, is as follows:

(US\$ millions)	Year 1	Year 2	Year 3	Year 4	Total
Execution	0.50	0.50	0.40	0.40	1.80
Reforming the water sector	1.20	3.40	1.10	1.10	6.80
Regulatory framework (subsector)	0.50	0.20	2.30	1.10	4.10
Management restructuring	7.20	11.10	10.70	10.10	39.10
Total	9.40	15.20	14.50	12.70	51.80

G. Procurement of goods and services

- 3.33 Contracts for works, goods, and services under this program will be in accordance with the Bank's procurement procedures. International competitive bidding will be required for procurements in excess of US\$250,000 for goods, US\$1 million for works, and US\$200,000 for consulting services. Following the standard procedures, bidding on contracts below these thresholds will be in accordance with the procurement procedures contained in the technical files of RE2/EN2, and the following provisions:

- (a) Unrestricted national competitive bidding for: goods valued between US\$150,000 and US\$249,999; works valued between US\$250,000 and US\$999,999; and consulting contracts valued between US\$100,000 and US\$200,000. Under this procedure, tender calls will be published either twice in a single newspaper, or once only in two newspapers, of wide national circulation. Contracts will be awarded by a technical committee to the lowest evaluated proposal, and a report on the proposed award of contract will be forwarded to the Bank for its approval.
- (b) Private bidding for goods worth less than US\$150,000; works less than US\$250,000; and consulting contracts less than US\$100,000. In applying this procedure, the executing agency will invite proposals from no fewer than five bidders, with a bidding deadline that allows for open competition. Once the contract award has been decided, and prior to notification of

the winning bidder, the tendering authority must obtain the Bank's nonobjection.

H. Recognition of expenses and project preparation advance

- 3.34 The Bank may recognize, as part of the financing and local counterpart, outlays for investment in designs, studies, and program activities. Expenses up to US\$1.2 million equivalent incurred during the 18-month period prior to the date of loan approval will be recognized as part of the local counterpart.

I. Evaluation and monitoring

- 3.35 Given the characteristics of the reforms contemplated, the primary means of monitoring the program will be through direct participation by the Bank's technical team in dialogues with the government in its decision-making stages. These stages will include: evaluation of the commercial restructuring plan and agreements with the government for its implementation; and the formulation of proposed legal and regulatory frameworks and tariff rates, all of which are conditions precedent to the disbursements.
- 3.36 In addition to the Bank's administration missions, each year during the execution period a meeting will be held between the Bank, COSERHI, URE, the Authority and ARESA to assess performance under the operation, the degree to which program objectives have been accomplished, and the need to correct or alter certain aspects of the program. The technical and monitoring reports by the regulatory agency will be evaluated to check on the performance of the independent operators. In addition, at least two surveys or public consultations will be conducted to determine the level of public acceptance of the new service delivery structure.
- 3.37 COSERHI and URE/ANDA, through the General Department of Investment and Public Credit, will be responsible for submitting the following reports to the Bank at intervals during the execution of this program: (i) semi-annual progress reports, including the scheduling of activities, evaluation of projects carried out, and assessment of goals and objectives; (ii) annual financial reports and a final financial report audited by an independent firm of accountants approved by the Bank (the financial reports must be submitted within 60 days following the close of each fiscal year, and the final report is due within three months of the last disbursement; (iii) annual plan of action showing the utilization of resources allocated for additional investments under the program. The first such plan must be submitted within 60 days following the date of eligibility for the first disbursement. Subsequent plans are required at one year intervals reckoned from that date.

PROGRAM FOR REFORM OF THE WATER RESOURCE SECTOR AND THE POTABLE WATER AND SANITATION SUBSECTOR (ES-0068)

ELEGIBILITY CONDITIONS, VERIFICATION MILESTONES, AND ACTIVITIES

ELEGIBILITY CONDITIONS

DISBURSEMENT

WATER RESOURCES

Submission of the bill to the Water Resources Law to the Assembly

REGULATORY FRAME- WORK FOR THE SUBSECTOR

Submission of the draft law on creating the regulatory framework for the water sector to the Assembly

COMMERCIAL RESTRUCTURING

Submission of the URE restructuring plan for commercial restructuring studies

ACTIVITIES

- UCM Tech. Assist.
- Water budget
- Hydromet. network

MILESTONES

Passage of the legislation

YES

ACTIVITIES

- Instit. support
- Tech. Assist.
- Studies

Passage of the ARESA and ANDA legislation

YES

- Instit. support
- Tech. Assist.
- Studies

Comm. restr. agreement

YES

- PSP Prom.
- Prom. of descent.

ELEGIBILITY CONDITIONS

SECOND DISBURSEMENT

WATER RESOURCES

- Definition of the standards and regulatory framework, and criteria for the allocation of water use rights

REGULATORY FRAME- WORK FOR THE SUBSECTOR

- Implementing regulations for the Act and definition of the regulatory framework
- Approval of the contract and transfer regulations
- New rates policy and structure and subsidies and promotion policy

COMMERCIAL RESTRUCTURING

- Evidence that bidding invitations have been published for the PSP schemes (private sector participation)
- Decentralization and devolution plan

ACTIVITIES

Monitoring activities

Monitoring activities

Comm. R. Investme

IV. FEASIBILITY OF PROGRAM EXECUTION

A. Technical feasibility

- 4.1 The preparation of this program has been based on research and diagnostic studies begun by COSERHI over two years ago, during which time there has been ample consultation within the government and with other groups in society. The proposed modernization and reform program is both supportive of and consistent with the modernization process introduced by the government in other sectors. In addition, efforts were made during the design of this operation to ensure discussion of the proposed reforms at both the national and international level, the latter in order to profit from the experience of other countries. Hence the laws which form the heart of the reform are the result of work which has benefitted from consultation with local and foreign experts, including individuals from Great Britain, France, Spain, Chile, Argentina and Mexico, as well as from the World Bank and ECLAC. These laws meet minimum technical requirements with adjustments for particular circumstances in El Salvador. They are based on sound modernization principles acceptable to the government from a political and social perspective. Moreover, the guiding principles of the proposed reforms are consistent with the Bank's policy on public services (OP-708), as well as with the principles embodied in the Water Resources Strategy paper recently presented to the Policy Committee of the Bank's Board of Executive Directors.
- 4.2 The technical assistance, studies, and institutional strengthening called for in components 1 and 2 all represent necessary activities for effective implementation of reforms, and the establishment of properly functioning regulatory frameworks. At the same time, the technical feasibility of investments in urban systems is guaranteed by the project selection criteria included in the Operating Regulations. In general, the type of investment eligible under this program is based on detailed studies of the problems facing El Salvador's water supply and sanitation systems. The model proposed for rural systems allows the identification of the most appropriate technical solutions, depending on the community's preferences and willingness to pay, while ensuring that the minimum criteria for safety and water quality are maintained. The NGOs that will carry out this component have proven experience with these processes in El Salvador.

B. Environmental and social feasibility

- 4.3 The underlying theme of this program is environmental sustainability, for which reason integrated management of the country's water resources forms the basic frame of reference for the process of restructuring the water and sanitation subsector. The environmental and social repercussions of this program are both

positive and profound, and are designed to reinforce environmental management and water conservation for the benefit of all sectors of the country's population. The water Authority to be created under this program has a specific mandate to control the allocation of water rights and enforce environmental policy affecting water resources as promulgated by the Ministry of the Environment. The Act Establishing the Authority has been drafted in a way that guarantees its consistency with the Environmental Act. Moreover, the mechanisms for allocating water rights promote efficient use of this resource in order to prevent monopolistic practices and guarantee environmental protection and equal access for the poor.

- 4.4 The law creating the regulatory framework for the subsector specifies that service contracts are to contain a provision requiring service providers to comply with environmental standards issued by competent authorities. Part of the evaluation of compliance with program conditionalities will consist of verifying that environmental criteria have been incorporated into the regulatory framework of both the water resource sector and the water and sanitation subsector.
- 4.5 Environmental management is being strengthened in El Salvador and this effort has been redoubled with the recent creation of the Ministry of Environment and Natural Resources (MARN). The Bank is assisting in this process through environmental operations already under way (loan 886/OC-ES and technical cooperations ATN/SF-5025-ES and ATN/SF-4336-ES) or currently in preparation (ES-0074). The operations in progress are strengthening MARN and the environmental management system, including ANDA's Environmental Unit (UA). This unit will assist the URE in complying with the environmental provisions of the Operating Regulations, which require each operator and service provider wishing to apply for project resources to draw up a plan of operations, which in turn includes an environmental management plan.
- 4.6 The environmental management plan must specify preventive activities and measures for conservation, management, and monitoring of the environment. For rural and smaller systems, the selection criteria promote community participation, public consultation, inclusion of women, and environmental conservation. The environmental criteria for investment projects in urban and rural areas alike are based on a sampling of systems analyzed during preparation for this program. Specifically, the analysis covered the restoration of services at the urban level for new systems in the Greater Metropolitan Area of San Salvador (AMSS), three departmental capitals and 20 small water supply systems.

C. Institutional and financial feasibility

- 4.7 (a) Component 1. Water resources. From an institutional point of view, the establishment of a water resources authority (the Authority) and its regulatory framework is an acknowledged need

which has the support of the government. The Authority is a small entity with well-defined functions. Its annual operating costs are estimated at 13.3 million colones. According to its organic law, the Authority must become financially self-supporting after its second year of operation. It has been estimated that a fee on water usage, hydroelectric power and irrigation rights in the range of 0.01 colones to 0.02 colones per cubic meter would generate around 27 million colones/year, based on current levels of usage. A tax on this order would result in a rise of approximately 1% in current water fees and the cost per Kwh of electricity. Revenues generated in this way could be used for the protection of basins and water sources, and the Authority's own budget expenditures and operations. These numbers are for illustration purposes only: the final figures will be determined once the Authority has been created and the technical studies for its regulatory framework have been carried out.

- 4.8 (b) Component 2. Regulatory framework for the water and sanitation subsector. The proposed restructuring process would not be feasible without at the same time establishing a suitable regulatory framework. The regulatory agency (ARESA) to be created is a small entity, strictly limited to regulatory duties and promoting competition and efficiency in the provision of these services. After its second year of funding under the program, ARESA will finance its operations via a percentage fee applied either to the total operating costs of water service providers, or as a surcharge on the tariff rates charged by the latter. In principle, the operating costs of the regulatory agency are estimated at 13.6 million colones per year, which would require a surcharge of 0.07 colones per cubic meter to be paid by service providers.
- 4.9 (c) Component 3. Commercial restructuring. Despite the best efforts of El Salvador's authorities, ANDA has yet to become financially self-supporting. ANDA's marketing efficiency is low and the organization is characterized by a lack of information and inadequate management of what data it possesses. Virtually no registers are maintained, either in technical areas or customer accounts. The ratio of residential meters is 70% in the AMSS, but a large percentage of the installed meters are in fact out of service. Invoicing is based largely on estimates with little actual reading of meters. Furthermore, the invoicing system is such that the organization has no billing history beyond one year.
- 4.10 In 1995 a tariff rate increase was decreed as a first step in reorganizing the country's water rates. The tariff schedule approved at that time is based on the total cost per cubic meter of water invoiced (basic tariff rate). The first block of residential consumption (less than 20m³/month) is subsidized and is billed at 50% of the basic tariff rate. Blocks consuming between 20 and 40m³/month and above 40m³/month pay a surcharge (1.1, and 2.75, respectively). Outside the AMSS, the rate is 0.8 of the base rate.

Under this system, the surcharges offset the subsidies for the first block and the regional users.

- 4.11 This decree boosted tariff rates and helped generate nominal profits for ANDA. However, these rates have remained unchanged since 1995 (at 1.83 colones/m³) despite rising costs – especially energy costs and depreciation adjustments. ANDA's current financial position is precarious. According to projected income and expenditures, including a modest increase in efficiency, it is estimated that the basic tariff rate would have to rise to more than 3 colones/m³ in order for ANDA to absorb all of its costs, including repayment of its debts in 1998.
- 4.12 Based on ANDA's projected financial flows, ANDA's position is weak, and unless it raises rates and improves efficiency it cannot meet its financial obligations. Although the government has decided against raising rates for the moment, the Ministry of Finance is making arrangements to provide ANDA with sufficient support to continue operating until such time as the new tariff rate policy can be introduced and a management restructuring plan, as set forth in this program, can be put in place. Accordingly, as a special condition of the loan, the borrower will submit a financial statement during the first quarter of each calendar year throughout the execution period, along with ANDA's projected financial flows for the respective year, to ensure that it has sufficient financial resources to continue operating and meet its financial obligations.
- 4.13 Reform commitments under this program will promote greater financial self-sufficiency and the right incentives and financial signals by: (i) implementing the new tariff rate policy; and (ii) promoting private sector participation and decentralization to improve the indicators of commercial and technical efficiency.
- 4.14 (i) **Implementation of the new tariff rate policy.** In creating the new regulatory framework and launching the management restructuring process, one of the conditions for disbursements under the program requires the implementation of a tariff rate system which will guarantee financial self-sufficiency and economic efficiency. The methods and tariff rate formula will be established by the regulatory agency ARESA, and will be determined for each service contract. Also, insofar as possible, the use of transparent subsidies will be encouraged under an assistance policy which the executive branch will determine for the subsector.
- 4.15 (ii) **Promotion of private sector participation and decentralization.** One of the goals of commercial restructuring is to identify commercially viable organizational structures and support their implementation. The utilization of service contracts, which every public or private service provider will be required to sign, will provide a framework for promoting efficiency and financial solvency among operators, and an essential instrument

for defining the regulatory framework, the borrower's rights and obligations, and the mechanisms for verifying fulfillment of managerial investment and coverage goals. Prior to the approval of devolution or decentralization plans, the financial viability of the new operators must be established.

- 4.16 (d) Financial viability of rural systems. The rural water development program will maintain financial viability by covering its own systems operating and maintenance costs. One of the steps being taken with the Rural Water Associations (ARAs) in developing the systems is the determination of willingness to pay among the beneficiary population and type of service expected by the community. This allows the system to be designed accordingly. Evidence from the sample communities analyzed and interviewed suggests that rural systems will cover the cost of their operations and generate surpluses for repairing and replacing equipment and hence be financially viable. The surpluses are generated by incorporating depreciation into the tariff rates charged consumers. USAID has financed the development of over 130 systems designed by this method, which are operating properly.

D. Economic feasibility

- 4.17 (a) Economic rationale and benefits of reforming the water resource sector. There is evidence that integrated management of water resources, where entire basin areas are involved and participatory mechanisms and incentives (e.g. markets) are used, can result in major savings. The program seeks to begin introducing institutional and participatory instruments incorporating economic incentives to optimize water use. The main benefit is a more economic and environmentally efficient use of the resource, although, admittedly, it is a long-term process and the sector is far from a perfect competitive market.
- 4.18 The Authority will prepare a study of economic instruments for the allocation of water rights which incorporates the environmental externalities associated with the use of the resource. This study will take into account the relative marginal productivity of the different uses and seek to design practical mechanisms that facilitate trade in water rights. Pilot initiatives will be conducted for this purpose as information and experience is gained, and the population becomes educated in this area.
- 4.19 (b) Economic rationale and benefits of reforming the water and sanitation subsector. The proposed restructuring is a necessary condition for a series of actions aimed at solving problems facing the sector: lack of access, poor quality of service, and inefficient allocation of investment resources - problems which have a direct impact on public health and quality of life in El Salvador.

- 4.20 To guarantee the benefits sought in this reform program, the regulatory principles will be to: (i) minimize political influence on the regulator and avoid over-regulation; (ii) promote competition based on comparison and the prevention of monopolistic practices; (iii) endorse legal instruments protecting the consumer; (iv) introduce provisions in service contracts which spell out clear rules describing the rights and obligations of service providers; (v) provide incentives for expanding access and improving the quality of service; (vi) propose a tariff rate system which makes financial and economic sense; and (vii) create an environment favorable to private capital. Finally, the management restructuring process will endeavor to create commercial units based on modern economic principles of economies of scale and market size.
- 4.21 (c) Economic rationale for and benefits of investment in commercial restructuring. The investment funds included in the program are there as a support and reinforcement to help achieve the goals of the reforms and reflect the significant benefits of the program, the quantification of which is not possible with the information available. Utilization of the fund is to be governed by the Operating Regulations, which include economic criteria for the allocation of resources. By way of illustration, an indicative sample of systems has been analyzed to evaluate the potential benefits of regularizing and rehabilitating systems.
- 4.22 In the case of investments in the regularization of services, these projects permit the reallocation and transfer of water resources from high consumption, low social value segments of the market, to other market segments where the social value is much greater, as demonstrated by the marginal markets to which consumers must resort due to deficiencies in the regular service. In El Salvador, this is particularly true in low-income areas where, because of water shortages and service interruptions, people pay between 5 colones and 8 colones per barrel of water (equivalent to between 25 colones/m³ and 40 colones/m³), depending on the area, versus ANDA's charge of 2 colones/m³. ANDA itself sells water by the barrel to private distributors at a price of 8 colones/m³. In an indicative sampling of four cities (Usulután, Zacatecoluca, Sonsonate and La Unión), it was estimated that regularizing their systems would cost between US\$24.3 and US\$33 per household, while the annual benefits to be expected (net gain to the consumer) would total between US\$24 and US\$41 per household, as a result of a 5% redistribution in water consumption. This indicates that a high economic return can be expected from regularization of the service.
- 4.23 Similarly, the benefits of rehabilitating systems in these cities have the effect of increasing the water supply, resulting in an internal rate of return (IRR) of between 18% and 64%. Yet the marginal cost fluctuates between 2.75 colones/m³ and 4.41 colones/m³, which is greater than the current tariff rate

charged by ANDA but much lower than the minimum price of water in the marginal market (25 colones/m³).

- 4.24 Based on the evaluation of earlier operations and experiences in El Salvador, together with the social and economic surveys carried out in planning this program, it was decided that it is essential for all rural investments to be based on community consultation and participation in order for local residents to have a hand in defining the level and type of service they are willing and able to pay for. It is recommended that rural projects be financed on the basis of minimum investment cost per person (selection criterion). To the extent possible, the Rural Water Associations (ARAs) should establish collection and savings mechanisms to cover repairs and maintenance. In addition, priority will be given to projects that target areas in greatest need and relative poverty, where there is a desire on the part of the community to participate, where health problems associated with lack of water are greatest, and where potential beneficiaries are most numerous.

E. Targeting low-income groups

- 4.25 The restructuring program does not specifically target low-income groups, given its sectoral approach and national scope. However, owing to the particular characteristics of El Salvador's water supply system, reaching the program targets should benefit the poorest population, which is most affected by the inadequate coverage and deficient quality of potable water services and sanitation. A positive impact is also anticipated for low income groups from the investments in support of commercial restructuring, which is directed toward medium-sized and small towns and rural areas.

F. Risks under the program

- 4.26 This program faces the risks inherent in any reform process, namely:
- 4.27 1. **A pre-election political climate and the difficulty in getting laws passed by the Legislative Assembly.** The presidential election will take place in March 1999, and the new government will take office the following June. Nevertheless, there is clear political will on the part of the government to begin the process of restructuring and to ensure that a solid foundation is laid for the reforms. Authorities are likewise confident that the laws will be passed by mid-1998, and that the water sector authority and regulatory agency will have been created. By early next year the alternatives for commercial restructuring will have been developed as well, as part of the commercial restructuring plan to be financed by the MIF, and this will pave the way for the signing of agreements and undertakings for the start-up of the reform process.

- 4.28 COSERHI has already consulted with various political parties and civil society groups concerning the reforms, and reports that they have been well received and that there is general consensus on their objectives and principles. There is also the precedent of successful reforms carried out in the electricity and telecommunication sectors. While these encountered the difficulties hindering passage of any law by a politically divided assembly, there were no signs of opposition to the objectives of the reforms - only to the form in which they were to be implemented. It is for this reason that the process of change must be sufficiently flexible and fluid in order to accommodate differences in the route taken, without compromising the objectives at which it aims.
- 4.29 **2. Institutional weaknesses within ANDA, the municipal governments, and the regulatory frameworks to be created.** To deal with this unavoidable circumstance, the program will accompany the restructuring process with the necessary technical assistance for institutions until the regulatory frameworks are consolidated and sufficient demand has been generated for turning services over to independent authorities and private sector participation.
- 4.30 **3. Financial aspects and tariff rates.** These are of crucial importance and it is vital that political pressure for the application of rate adjustments be reduced to a minimum. The formulation of an adequate pricing policy and the implementation of tariff schedules and levels that make economic and financial sense constitute one of the most important conditions for disbursements under the program. It will also be important to develop flexible mechanisms for private participation in the financing of water and sanitation services. The Bank's private sector window could play an important role in this area by facilitating implementation of the PSP schemes recommended under the program.
- 4.31 **4. Uncertainty concerning effective participation by the private sector and municipalities.** This risk depends upon the country's political, economic and social atmosphere. The regulatory and promotional activities to be carried out under this program are intended to create a legal and institutional framework which will help to lower this risk. In addition, turning these services over to independent authorities and opening them up to the private sector has taken on a momentum of its own in El Salvador.

LOGICAL FRAMEWORK (SUMMARY)
REFORM PROGRAM FOR THE WATER SECTOR AND THE POTABLE WATER AND SANITATION SUBSECTOR
(ES-0068)

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>more rational use and water resources and improve quality of water and sanitation benefit of all Salvadorans.</p>	<ul style="list-style-type: none"> - Improvement in indicators of quality and quantity of water in comparison to 1998 data. - Improvement in public health indicators in comparison to 1998 data. 	<ul style="list-style-type: none"> - Annual environmental evaluations (MARN/ANDA/UA). - Socioeconomic evaluations. - Statistics on quality of life and health (Ministry of Health). 	
<p>the management mechanisms of water and sanitation subsector, and efficiency in the services.</p>	<ul style="list-style-type: none"> - Water use rights assigned and registered by the Water Resources Authority, through a modern and transparent allocation and registration process. Favorable public acceptance of work performed by the Water Resources Authority. - Quality of service improved relative to that currently provided by ANDA in each of the decentralized and devolved systems and/or private service delivery. A 70% or higher favorable public acceptance level is confirmed, reflecting: (i) elimination or substantial decrease in the number of unjustified service cutoffs without warning; (ii) customer satisfaction with potable water pressure and quality; (iii) customer satisfaction with public attention, complaints, and billing services; - Coverage of decentralized and privately administered systems expanded in accordance with the expansion plans agreed upon by the regulatory agency and the systems operators, under the terms and within the time frame established in each service contract. <p>Satisfactory indicators of technical and financial efficiency for each decentralized, devolved, or privately managed operator in accordance with the technical and efficiency standards established by the regulatory agency in the service contracts.</p>	<ul style="list-style-type: none"> - Survey and public consultation to evaluate the operations of the Water Resources Authority. - Representative survey of service users to be prepared for the program. - Reports on complaints and administrative performance provided by ARESA in accordance with its responsibilities under the law. - Service contract and evaluation report by ARESA. - Technical and financial monitoring reports ARESA. 	<ul style="list-style-type: none"> - Commitments undertaken by the regulatory agency and ARESA have been fulfilled. - ARESA is strengthened and is operating independently. - A strictly business-oriented structure has been developed at the service-user level. - Tariff rate and development policy have been established to promote economic and financial efficiency in the drinking water services.

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p><u>Water sector</u></p> <p>Authority to promote the use of water resources.</p> <p>Regulations for use in establishing regulatory framework for the water</p> <p>technically, environmentally, economically rational criteria for allocation.</p>	<ul style="list-style-type: none"> - The Authority and ARESA established and operating. - Regulations in place for the regulatory framework. - Water rights being allocated and registered. 	<ul style="list-style-type: none"> - Staff and budget. - Registry of concessions. - Issued provisions. - Water budget. - Performance evaluation. 	<ul style="list-style-type: none"> - All of the activities of the program have been completed. - Reforms receive political backing. - Social acceptance.
<p><u>Regulatory framework and sanitation subsector</u></p> <p>regulatory agency to govern provision of water and sanitation</p> <p>the sector's regulatory framework and issue regulations to the act creating the regulatory agency.</p>	<ul style="list-style-type: none"> - The regulatory agency has been created and in operation. - The regulations under the act have been issued and the regulatory framework is in place. - Regulations governing service contracts approved. - New tariff rate schedule based on financially and economically rational criteria approved. - Policy governing assistance and allocation of subsidies approved. 	<ul style="list-style-type: none"> - Budget and personnel assigned. - Regulations published. - Provisions issued. 	<ul style="list-style-type: none"> - All of the activities of the program have been completed. - Reforms receive political backing. - There is social acceptance.

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>management restructuring in the water and subsector</p> <p>management restructuring the creation of public, private and private water and sanitation operators.</p>	<ul style="list-style-type: none"> - The country's main water and sanitation system is operating under the PSP modality. - Public and private municipal companies have been formed and are operating independently according to the management restructuring plan. - The ANDA is operating those systems not turned over to independent operators, or that are not under PSP management after decentralization. - The size of the ANDA in terms of total connections at the national level has been reduced by 50%. - Over 50% of rural water and sanitation systems currently under the ANDA are being managed by communities. 	<ul style="list-style-type: none"> - Service contracts specifying quality and access goals. - Transfer contracts duly executed. 	<ul style="list-style-type: none"> - All of the activities of the program have been completed. - Reforms receive political backing. - There is social acceptance. - There is interest among the private sector and at the municipal level in managing systems.

**REGULATORY FRAMEWORK AND MANAGEMENT RESTRUCTURING IN THE
WATER AND SANITATION SUBSECTOR**

**MIF TECHNICAL COOPERATION
(TC-98-01-42-5)**

EXECUTIVE SUMMARY

EXECUTING AGENCY: Comisión Coordinadora para la Reforma Sectorial de los Recursos Hídricos (COSERHI); Administración Nacional de Acueductos y Alcantarillado (ANDA), acting through the Unidad de Reforma Empresarial (URE); and Agencia de Regulación de los Servicios de Agua Potable y Alcantarillado, hereinafter called the "Regulatory Agency" or "ARESA".

BENEFICIARY: Republic of El Salvador.

OBJECTIVES: The objective of the Technical Cooperation is to support and enhance the program for restructuring of the water and sanitation subsector under operation ES-0068, which seeks to promote comprehensive reform of the water sector and the water and sanitation subsector at the national level. Specifically, this Technical Cooperation will provide support for establishment of the regulatory framework governing provision of water and sanitation services, and for the formulation of high priority activities to aid the restructuring process and promote private sector participation.

DESCRIPTION: This Technical Cooperation will have two components: (i) support for management restructuring; and (ii) establishment of the regulatory framework for the water and sanitation subsector. The first component includes activities to provide the executing agencies with technical advice on decentralization, privatization and management restructuring in general. This component will also include formulating the commercial restructuring plan, which will provide the basis for the formation of fully autonomous and decentralized companies; determining the optimal types of management to employ (public, private, semi-private); and actually promoting private sector participation. The second component is designed to provide support for formulation of the subsector's regulatory framework, including strategic studies and technical assistance for the regulatory agency (ARESA) to be created under operation ES-0068.

ENVIRONMENTAL AND SOCIAL REVIEW: At its meeting on March 20, 1998, CESI approved the environmental and social report on program ES-0068.

FINANCING: Type: donation
MIF: US\$2,400,000.00
Local counterpart funding: US\$ 900,000.00
Total: US\$3,300,000.00

RECRUITMENT OF CONSULTING SERVICES: The Bank's standard procedures will be used for recruitment of consulting services, which must be from countries participating in the MIF. For consulting services valued at US\$200,000 or less, ad hoc recruitment procedures agreed between the Bank and the country will be used. Under these procedures, national public bidding will be held for consulting contracts valued between US\$100,000 and US\$200,000 and national private bidding for those below US\$100,000.

The conditions precedent to the first disbursement will be the standard Bank conditions for this type of operation. In addition, the beneficiary will be required to present evidence that the executive decree expanding the authority and functions of COSERHI has entered into force and that this Commission has the legal capacity to execute the technical assistance activities under its responsibility and to promote private sector participation, both under the commercial restructuring component. The other conditions precedent, by component, will be as follows:

SPECIAL CONTRACTUAL CONDITIONS: (a) for component 1: evidence must be submitted to the Bank indicating that the Commercial Restructuring Unit (URE) has been created.

(b) for component 2: evidence must be submitted to the Bank showing that the Act creating ARESA has entered into force.

OPERATING BUDGET

CATEGORIES	MIF	LOCAL	TOTAL
1. Commercial Restructuring	1,812,000	568,000	2,380,000
(i) Technical assistance	200,000	168,000	368,000
– Consultancy on business and commercial topic to aid the URE in setting up autonomous/decentralized systems		168,000	168,000
– Consultancy to assist the COSERHI with promotion, participation and negotiation with the private sector	200,000		200,000
(ii) Preparation of restructuring plan	612,000	400,000	1,012,000
– Basic strategic studies (cost accounting and financial systems, supply and inventories studies, and regulations for commercial restructuring)	260,000	400,000	660,000
– Commercial restructuring plan and strategy for its implementation	352,000		352,000
(iii) Promoting private sector participation	1,000,000		1,000,000
2. Establishment of the regulatory framework for the water and sanitation subsector	480,000	270,000	750,000
(i) Technical assistance	210,000	270,000	480,000
– Consultancies for drafting of the regulations for the law creating the regulatory agency, manual of procedures, basic information studies for supervision of operators, information awareness and promotion of activities of the regulatory agency.	160,000	200,000	350,000
– Training of regulatory agency staff, including training grants to visit other countries with successful regulatory systems.	50,000	70,000	120,000
(ii) Strategic studies	270,000		270,000
– Tariff rates and subsidies	100,000		100,000
– Updating of technical standards	70,000		70,000
– Policy mechanisms			
Financing and technical assistance	100,000		100,000
Subtotal	2,292,000	838,000	3,130,000
Contingencies	108,000	62,000	170,000
TOTAL	2,400,000	900,000	3,300,000

SUPPORT FOR INVESTMENTS IN WATER AND SANITATION SYSTEMS IN RURAL AREAS

NONREIMBURSABLE IDB TECHNICAL COOPERATION (FSO)
TC-97-10-50-1

I. BACKGROUND

A. Rural water and sanitation systems

- 1.1 Rural El Salvador has a total population of around 2.4 million and may be divided into two distinct types of area depending on number of inhabitants: more populated versus less populated rural areas. One of their principal common features is that both types of area lack access to one or more urban services such as telephone, electricity, health units, access roads, etc. The more populated rural areas characteristically have some 29 households/km with connection to piped water, or population centers with more than 150 and less than 2,000 inhabitants. The less populated rural areas have communities with less than 150 inhabitants each.

B. Current institutional status of the rural sector

- 1.2 The Ministry of Public Health and Welfare has been responsible for providing water and sanitation services in rural areas since the 1960s under the National Basic Rural Sanitation Plan (PLANSABAR).
- 1.3 As part of the state modernization process begun in 1994, the Government of El Salvador transferred responsibility for provision of these services in rural areas to ANDA beginning in January 1996, including the 308 water and sanitation systems built and operated by PLANSABAR. However, ANDA did not have the necessary policies in place and lacked the financial and human resources to meet the water and sanitation needs of the rural population.
- 1.4 There are as well large numbers of public entities, NGOs, and bilateral organizations in rural areas that have taken an active role in the field of water and sanitation, but whose actions and strategies lack an adequate level of coordination. This situation has led to conflicts between stakeholders over ways to meet the water and sanitation needs of the rural population.
- 1.5 Consequently, of the major institutional problems obstructing efforts to provide water and sanitation services in the rural sector, the following are perhaps the most important:
- a. Lack of a regulatory body for the sector to control, promote, and coordinate national planning, with adequate laws governing

the design, construction, operation, utilization, and participation in such systems, as well as training programs.

- b. Absence of a body responsible for planning, management, coordination, and control of resources in the water and sanitation sector.
 - c. Absence of a permanent fund to guarantee resources on an annual basis for new investment and ensure the continuity of water and sanitation programs.
 - d. Lack of national policies and strategies for directing community participation and contributions to water and sanitation projects in rural areas, leading at times to competition among the various lending agencies.
 - e. The managers of community-run water and sanitation systems are generally not supported with training or advisory services.
- 1.6 Given the serious problems confronting water supply and sanitation systems in rural areas, ANDA is attempting to carry out an action plan aimed at providing self-sufficient, decentralized services to be operated under the responsibility of the Rural Water Associations (ARAs), with ANDA providing supervision, technical assistance and training. In addition, ANDA is preparing a manual of technical standards for the design of rural water and sanitation systems, the importance of which lies in the fact that the various institutions involved in financing rural water systems use different technical standards.
- C. Access to water services in the rural sector
- 1.7 The rural sector has a population of around 2.4 million, of which only 700,000 have access to clean water.
- 1.8 Even for these 700,000 inhabitants, the quality of the water and services is less than adequate with frequent interruptions and unreliable systems. In addition, a significant number of systems are in need of rehabilitation and expansion.
- 1.9 ANDA manages virtually all of the country's rural water and sanitation systems, which total around 700 (308 from PLANSABAR and 400 under FIS). According to the results of a survey conducted among the systems managed by ANDA, there is strong interest on the part of communities in managing their own systems.
- 1.10 The primary critical factors concerning the current operation of systems are as follows: (i) lack of a coordinating body; (ii) institutions that act in an uncoordinated manner; (iii) general deficiencies in financial management and operation of the institutions; (iv) inadequate technical assistance for existing

systems; (v) low efficiency and effectiveness; (vi) low levels of coverage; (vii) deficiencies in the quality of the water supplied; (viii) low health standards; and (ix) environmental degradation.

D. The need for investment and foreign assistance

- 1.11 The needed investment to provide access to the 60% of the rural population that is not connected to the water supply system (1.4 million inhabitants) is approximately US\$140 million. By contrast, the actual level of international support anticipated over the next four years is estimated at scarcely US\$80 million.
- 1.12 According to various sources of financing, the cost for sustainable water and sanitation systems in the rural sector is some US\$200.00 per capita. This cost includes the physical works; promotion and organization of the community; monitoring; technical, operational, administrative and social assistance; basic public health training; and environmental measures to protect sources of water. In other words, this figure represents the total cost for a system operated and maintained by the community in a sustainable manner. The cost per inhabitant is higher for communities with low population density.
- 1.13 The need for concessional funding for investment in water and sanitation systems in the rural sector is due primarily to three aspects: (1) low coverage at present and the adverse impact this has on health and the environment; (2) the fact that these systems are not likely to produce sufficient returns to interest service providers under privatization schemes; and (3) low-income groups living in extreme poverty make up the biggest part of the rural population.

E. Successful projects with rural communities and participation by women

- 1.14 Successful projects have been carried out in El Salvador through AID programs to build rural water and sanitation systems which are operated by NGOs such as CARE and CREA, and which in the last few years have provided some 50,000 inhabitants with these services at a cost of US\$10 million.
- 1.15 The main concepts of the AID programs have been as follows: participatory planning based on demand from users; reliance on appropriate technology; careful follow-up after construction; protection for water resources; training in the operation, maintenance, administration and proper use of sanitation infrastructure; and training in gender issues. Under this participatory approach, the users choose the level of service and the type of administration they want and pay for the service in accordance with the economic conditions in their community and the type of administration they choose. In order to ensure

sustainability, the social, technical, and financial feasibility of projects are analyzed. Based on the results of this analysis, plans are then drawn up for construction of latrines; public health training; the building of water works; training in the organization, operation, maintenance, and administration of the system; and follow-up.

- 1.16 What distinguishes the CARE operations from other programs is the focus on gender and the emphasis in its programs on promotional work and organization of the community, educational messages and protection of natural resources, tailoring programs to the communities expectations, training and monitoring activities.
- 1.17 The results obtained by CARE have demonstrated how to tap the following potential characteristics in providing water and sanitation systems for rural areas: (i) users wish to choose the level of water and sanitation service for their community; (ii) they are interested in administering their own water services; (iii) they want to choose the management model for administering their water service; (iv) local communities have the capacity to pay for the operation, maintenance and administration of water services; (v) local capacity exists for operating, maintaining and administering water projects; (vi) some communities have the capacity to pay a proportion of the cost for constructing a water and sanitation system; (vii) administrators of water systems demand monitoring services in order to maintain highly efficient operations; (viii) projects whose components are implemented in integrated fashion obtain better results; (ix) well-executed social components represent a significant cost (between 25% and 30% of the total cost of a project) but produce long-term economies; and (x) the ability of communities to provide counterpart funding is generally limited to between 15% and 30% of total project cost, with roughly half of this in the form of labor (especially at the high, 30% end) and the other half in cash.
- 1.18 It is important to note that carrying out this type of rural water and sanitation program affords an excellent opportunity to introduce local governments to the participatory process. Those communities that have earned the attention and support of their respective local government have achieved greater security in the administration of the systems.
- 1.19 At the community level, water supply systems are particularly beneficial to women since in homes that are not connected to services, the task of fetching water usually falls to the women aided by her children. In several cases it is the women in a community who have taken charge of managing the local water project, primarily by collecting funds, preparing meals, and sitting on committees.

II. OBJECTIVES AND GOALS

A. Overall objective

- 2.1 The present operation will have as its object to provide support in the form of technical assistance, physical investment in rehabilitation and expansion of rural water and sanitation systems. This technical cooperation is an integral part and is designed to enhance the activities and investments in the rural environment that are included under loan ES-0068. Consequently, this technical cooperation will be subject to: (a) the same conditions precedent to the first disbursement as specified in the abovementioned loan; (b) the same Operating Regulations; and (c) the same procedures for hiring consultants as are set out in the loan.

B. Specific objectives

- 2.2 Following are the specific objectives of this operation:
- a. To provide technical assistance for promotional work, organization and training in gender issues in communities participating in the program.
 - b. To design and determine the costs for rehabilitation and/or expansion of water and sanitation systems in rural areas, in accordance with the community's desired level of service and ability to pay. Acting in conjunction with the community, to select the model for administration of the system.
 - c. To carry out a training program for communities participating in the program which focusses on gender issues and topics relating to the management, administration, operation and maintenance of systems, the protection of water sources, and public health.
 - d. To monitor and supervise water and sanitation systems in rural areas, with regard to the technical, operational and organizational aspects of the chosen model of administration.

III. DESCRIPTION OF THE PROJECT

A. Benefits and beneficiaries

- 3.1 The primary benefit of this operation, in addition to investments in physical works in the rehabilitation and expansion of rural water and sanitation systems, is the implementation of sustainable systems with respect to their environmental, financial and social

aspects. As well, the proposed participatory approach will help to develop local capacity, skills, and responsibility. From the point of view of health, improvements in the quality of water and sanitation systems are expected to reduce the incidence of waterborne diseases.

- 3.2 Based on the experience of El Salvador and studies carried out by CARE, the resources of this technical cooperation and those of loan ES-0068 will cover between 25,000 and 30,000 beneficiaries in the rural sector, most of whom will be from low-income groups. At the community level, having clean water has meant a huge improvement in quality of life for families, since housework has been simplified and the time that women previously spent fetching water can be dedicated to the care and education of children.

B. Activities

- 3.3 The planned activities which are to be carried out over a period of four years are organized into four components corresponding to the specific objectives listed above. These activities form part of the participatory methods to be implemented in support of the investments planned under loan ES-0068. The activities will be carried out using this participatory approach and with attention given to women's issues, and this approach will be required at all levels and stages of the process. In particular, during the implementation of the technical assistance it is necessary for the potential beneficiaries to participate in all stages of the project, from planning to eventual maintenance. This will lead to the development of a sense of ownership and responsibility, and contribute to the development of skills and local capacity.
- 3.4 The activities included here form part of an action program that the NGOs and/or consulting firms will carry out as part of the application of the participatory method. This includes: community promotion and organization, the design and selection of administration models by the community itself, training and technical assistance, and follow-up and monitoring. These activities form part of a comprehensive package to be carried out within the same community.

1. Community promotion and organization

- 3.5 The initial activities will be to hold meetings with traditional community representation (local leaders), elected municipal representatives and the general public in order to assess their socioeconomic characteristics, needs and preferences with respect to water and sanitation services, and to determine their desire to participate in the program under the established guidelines.
- 3.6 Based on these initial meetings, and if the community expresses interest in participating in the program, the following actions

will be carried out: survey of the area; contacts and meetings with local institutions and leaders; formation of a local organization to assist in planning the work, promotional activities, conducting of diagnostic studies and surveys, educational process in public health, etc.; estimation of the community's willingness and capacity to pay; and signing of agreements expressing these commitments.

- 3.7 At this stage, the users – with the help of a consultant or NGO to be hired for carrying out the technical cooperation – must choose the level of water and sanitation services for which the community is prepared to pay all operating costs plus a percentage of the initial investment.

2. Design and selection of the administration model for water and sanitation systems

- 3.8 The actions and activities required for design and planning of the physical works for the water and sanitation system, the plan for protection of water sources, and the administrative model will be conducted.
- 3.9 The abovementioned plans will be designed to meet both social and least-cost criteria. The principal activities will include: identification of appropriate sources and the feasibility of various models of latrine; projections of the volume and availability of water; estimates of the investment and operating costs for certain alternatives. Based on these preliminary studies, the lowest-cost alternative which offers the level of service desired by the community will be identified.
- 3.10 Since women and children make the heaviest use of water and sanitation services, their preferences and views are extremely important to the design of the infrastructure and policies surrounding their use. Their participation is particularly important at times of: decision making regarding the tariff rates for water, hours of service, approval of the regulations, and the locations for latrines, sinks or household service connections.
- 3.11 Once the social and technical feasibility has been determined, it will be possible to analyze jointly with the community the various administrative options such as municipal administration, local administration under a community association or water committee, or mixed (municipal/community) administration.
- 3.12 The community, with the support of the consultant or NGO, must choose the administration model that it is most confident will be able to provide continuity in its service.

3. Community training

- 3.13 This activity includes a combination of classroom and practical training in operation and maintenance, administration, leadership, conflict resolution and local development, as well as public health topics relating to the proper use of water and sanitation facilities. The most important public health issues to be covered will include proper use of latrines and water, personal and household hygiene, disposal of household waste and garbage. All training activities must be conducted with the use of participative methods and practices, especially with groups of women and school-age children. Trainers providing health instruction, along with Ministry of Health personnel, will be responsible for training community health volunteers. These local individuals will, in turn, be responsible for passing on the training they receive, to ensure that the instruction reaches everyone in the community.
- 3.14 The other major topics for training programs will include: inventory management, planning, repairs, protection of water sources, gender issues and establishing tariff rates. Formal training in these topics will be reinforced through normal activities carried out in the course of the projects.
- 3.15 Training in planning will also be aimed at municipal authorities, and the training in protection of water sources must be offered as well to persons living outside the service area but within the watershed or critical area for the local water source.
- 3.16 In order to ensure that the program takes account of women's issues, it is important to develop training programs on this topic for the members of the water committees and municipal management staff.

4. Monitoring and follow-up

- 3.17 As part of its duties, and in coordination with the commercial restructuring unit of ANDA and GSR, the consultant must carry out monitoring and follow-up activities primarily in the following areas:
- a. Operation, maintenance and administration of the water project, including training for operational and administrative personnel, updating of tariff rates, technical assistance and review of the administrative model selected.
 - b. Protection of water sources.
 - c. Proper use of water systems and latrines, including hygiene and environmental health, and rational use of water resources, among other topics.

C. Budget

- 3.18 The total cost of the technical cooperation is estimated as equivalent to US\$1,700,000. The Bank's contribution would be US\$1,5 million to be drawn from the resources of the Fund for Special Operations. The government's counterpart contribution would be US\$200,000. The contribution will be provided in Salvadoran colones. The consolidated budget is presented below:

CONSOLIDATED BUDGET (US\$)			
COMPONENT	IDB	ANDA COUNTERPART	TOTAL
1. Community promotion and organization	300,000	50,000	350,000
2. Design of the water and sanitation system	300,000	50,000	350,000
3. Community training	450,000	50,000	500,000
4. Monitoring and follow-up	250,000	50,000	300,000
TOTAL	1,500,000	200,000	1,700,000

D. Execution

- 3.19 The beneficiary under this operation will be the Republic of el Salvador. ANDA will be responsible for the execution of this operation, acting through its commercial restructuring unit, in coordination with its Rural Water Systems Administration and in accordance with the guidelines set out in the Operating Regulations for loan ES-0068. In carrying out the activities described here, the executing agency will require the services of a consultant with ample and proven experience in the implementation of rural water and sanitation systems with community participation, who must also have ample experience in community organization and monitoring and follow-up activities.

IV. PARTICIPATION BY WOMEN

- 4.1 The ultimate objective of a rural water and sanitation project including a gender perspective or focus is to provide women and men in the community with access to resources, while at the same time enhancing the role of women, promoting their self-esteem and achieving equity. Where the needs of women have been recognized and efforts made to achieve a balance in the participation of men and women, this has been demonstrated to lead to greater equity and additional benefits for the community.

- 4.2 It must be recognized that in order to facilitate a gender approach during execution of the project, aspects such as those listed below must be taken into account:
- a. Employ appropriate channels of communication and media to keep women informed and encourage their participation in the project.
 - b. Promote and support participation by women in community activities and meetings.
 - c. Arrange meetings, workshops and gatherings at times and in locations which facilitate attendance by women.
 - d. Organize separate meetings with men and women, the contributions from which will permit feedback for traditional gatherings.
 - e. Review the process used for elections and assignment of duties on water committees in order to make them more participative and representative of men and women.
 - f. Promote training for women enabling them to assume responsibilities and take decision on the water committee and in support of the project.
- 4.3 Following are a number of issues that should be considered among the first steps in adopting a gender approach:
- a. Raise awareness among administrative and operational personnel of the importance of working with a gender focus.
 - b. Establish a data base broken down by gender in order to acquire an understanding of the practical needs of women and identify ways of providing them with support or helping them to meet these needs.
 - c. Consult with women concerning existing barriers to their participation in local entities and their economic, social and political productivity.
 - d. Include female participation in the project from the beginning.
 - e. Create training programs aimed at women to ensure that men and women alike have the tools needed to construct, operate, administer, use and maintain the new water and sanitation services. To this end, it is important to provide technical training for women in the administration, construction, operation and maintenance of basic infrastructure works.

- f. Provide leadership training in order to encourage more active participation by women in the water committees.

V. REPORTS

1. Consultant Reports

- 5.1 Through the intermediary of ANDA's Rural Water Systems Administration, the consultants shall submit the following reports:
 - a. An initial report describing the work plan, to be submitted within 30 days after signatures of the service contract. This plan must include *inter alia*: (i) project schedule; (ii) revised terms of reference; (iii) implementation plan; and (iv) methods to be used.
 - b. Semi-annual progress reports on the advances achieved in the preceding six-month period and detailed comparison of activities in that period vis-à-vis the project schedule. These reports will contain an evaluation of the activities carried out with respect to their degree of compliance with the overall and specific objectives of the operation, and a projection of tasks to be carried out over the next six-month period, with recommendations of the courses of action to be taken and other pertinent measures.
 - c. A final report 30 days after completion of the operation. This report must be approved by ANDA, through its Rural Water Systems Administration, as well as by the Bank, in order for the final disbursement to be made.

2. Reports from the beneficiary

- 5.2 During the execution of this project, ANDA, through its Rural Water Systems Administration, must submit the following reports for the Bank's approval:
 - a. Semi-annual reports containing comments on the progress reports prepared by the consultants, and on the performance of local consultants.
 - b. A final evaluation report indicating the degree to which the consulting firm and local consultants have complied with their objectives. This report must be submitted to the Bank within 30 days following submission of the firm's submission of its final report to ANDA.

3. Promotion and dissemination of results

- 5.3 In order to promote the accomplishments of successful projects under the program so that these may be incorporated in other areas in El Salvador, the executing agency will prepare events for the purpose of disseminating information at the field level, encouraging the communities to demonstrate the success of their operations to others.

4. Financial reports

- 5.4 ANDA, acting through its Rural Water Systems Administration, will present an annual financial report for the Bank's approval, as well as a final financial report, to be audited by an independent firm approved by the Bank.
- 5.5 The annual financial reports must be submitted within 60 days following the close of each fiscal year, and the final financial report must be presented within three months after the last disbursement.

RGII-ES130P
ES-0068
Original: Spanish

PROPOSED RESOLUTION

EL SALVADOR. LOAN ___/OC-ES TO THE REPUBLICA DE EL SALVADOR
Reform Program of the Water Sector and the Potable Water and Sanitation Sub-Sector

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 República de El Salvador, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Reform Program of the Water Sector and the Potable Water and Sanitation Sub-Sector. Such financing will be for the amount of up to US\$43,700,000, from the resources of the Single Currency Facility of the Bank's Ordinary Capital, and will be subject to the "Terms and Financial Conditions" and to the "Special Contractual Conditions" of the Executive Summary of the Loan Proposal.

PROPOSED RESOLUTION

**EL SALVADOR. NON-REIMBURSABLE TECHNICAL COOPERATION
FOR A PROGRAM TO SUPPORT INVESTMENTS IN POTABLE WATER AND
SANITATION IN THE RURAL AREA
(REFORM PROGRAM OF THE WATER SECTOR AND THE POTABLE WATER AND
SANITATION SUB-SECTOR)**

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 agreements as may be necessary with the República de El Salvador and to adopt such measures as may be pertinent for the execution of the plan of operations which is part of Document PR-_____, with respect to a nonreimbursable technical cooperation for a Program to Support Investments in Potable Water and Sanitation in the Rural Area, which is part of the Reform Program of the Water Sector and the Potable Water and Sanitation Sub-Sector, referred to in the same document PR-_____.
2. That up to the equivalent of US\$1,500,000, in salvadorean colones, is authorized for the purposes of this resolution, chargeable to the net income of the Fund for Special Operations.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.