

**HARMONIZATION AND INTEGRATION OF THE HYDROCARBONS MARKET
IN THE CENTRAL AMERICAN ISTHMUS**

(TC-97-07-095)

EXECUTIVE SUMMARY

- BENEFICIARIES:** Six countries of the Central American Isthmus comprising Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama, acting through their representatives on the inter-governmental Comité de Cooperación de Hidrocarburos para América Central (CCHAC).
- EXECUTING AGENCY:** Economic Commission for Latin America and the Caribbean (ECLAC).
- MIF FACILITY:** The Program comprises two three-year projects, of which the first would be supported by the MIF's Technical Cooperation Facility (Facility I) and the second by German technical cooperation through the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) [*German Technical Cooperation Agency*].
- OBJECTIVES:** The overall objective of the Program is to promote the sustainable development of the hydrocarbons subsector (oil and gas) in the Isthmus. The specific objective of the first project, with MIF financing, is to promote conditions conducive to a more efficient and competitive regional hydrocarbons market. This is expected to attract new investments by established and new private sector enterprises, as well as promote mixed public/private investments. The specific objective of the ECLAC/GTZ project will be to promote a more sustainable utilization of hydrocarbons in selected areas, by increasing efficiency in their use and mitigating the environmental impact of their use and management.
- DESCRIPTION:** The MIF Project will support decisions to be made in four areas: (i) an action plan to facilitate the harmonization and integration of the regional hydrocarbons market, based on a diagnostic study of the subsector; (ii) draft harmonized hydrocarbons laws and regulations, and the harmonization of technical and environmental standards; (iii) a study of the convergence of hydrocarbons pricing, fiscal and customs policies; and (iv) proposals for eliminating obstacles so as to promote regional-scale hydrocarbons projects, identifying those of highest

priority. The Project will be closely coordinated with those of other donors as appropriate, to ensure that it is executed with synergism and without duplication.

FINANCING:	Modality:	Grant
	MIF:	US\$1,100,000
	GTZ:	US\$ 600,000
	ECLAC:	US\$ 350,000
	Beneficiaries:	US\$ 900,000
	Total:	US\$2,950,000

BANK AND MIF STRATEGY: The overall Program forms an integral component of the package of high-priority regional economic integration activities that the Bank is supporting through the Regional Consultative Group for Technical Cooperation for Central America (GCR-CA). The MIF Project dovetails with other Bank technical cooperations that support subsector reforms underway in Guatemala, Nicaragua (Bank/MIF) and Honduras. The Bank is supporting two other initiatives for infrastructure integration in the Isthmus: electrical interconnection (SIEPAC project) and transportation.

PROJECT EXECUTION: To ensure compliance with MIF Project undertakings and to take steps as necessary for achievement of the project objectives, and to carry out the steps necessary for achievement of its objectives, a Memorandum of Understanding was presented to the Bank, signed at ministerial level by the President of the CCHAC as well by the subsector officials from each participating country. It is proposed that the action plan be ratified by the ministers responsible for the subsector during the first year of the Project, at a meeting to be called by the Bank. The approval of the action plan is a precondition for proceeding to the other studies mentioned below.

The Project's overall direction will be entrusted to a Steering Committee comprising the Director Generals of Hydrocarbons (DGH) or their equivalent, who constitute the CCHAC. The Bank and ECLAC will participate in the Steering Committee as advisors. GTZ will participate in the Committee as observer when and as appropriate. ECLAC-Mexico will act as executing agency for the MIF Project, as in the case of the ECLAC/GTZ project. The Steering Committee will make decisions relating to the Project by consensus among the countries, including decisions on the use of project funds. Execution will be the

responsibility of ECLAC. The Agreement will be with ECLAC for the benefit of the six countries and will be acknowledged by their representatives in the CCHAC. Further, to assist in compliance with Project commitments and achievement of its objectives, the Bank will select in consultation with the countries and the Executing Agency an advisory panel comprising three independent experts, who will be contracted by the Executing Agency.

**ENVIRONMENTAL
AND SOCIAL ISSUES:**

The MIF Profile was approved by the Technical Review Group of the Committee on Environment and Social Impact at its meeting of November 17, 1997, with no further environmental assessments or actions required. Of note is the recent elimination of leaded gasoline in the Isthmus countries except Panama, where it will be phased out by 2002.

**BENEFITS AND
RISKS:**

The major benefit expected from the MIF Project is to bring about a more efficient and competitive hydrocarbons market and supply in countries of the Isthmus. Two major risks to accomplishment of the Project's objectives are: (i) failure by the Isthmus countries to continue their commitment to the Program and the overall process of regional economic integration; and (ii) lack of coordination with the ECLAC/GTZ project. To mitigate these risks, the Project will be monitored on an ongoing basis and reviewed with the countries in depth at periodic meetings; and the Steering Committee and Executing Agency will ensure coordination between both projects.

**EXCEPTIONS TO BANK
POLICY:**

See section on procurement directly below.

**PROCUREMENT OF
GOODS, WORKS AND
CONSULTING
SERVICES**

As an exception to the required procedure of selection by open competition, the direct hiring of ECLAC is recommended. This agency will carry out any procurement, contracting of consultants or other required activities, observing the procedures of the Bank applicable to MIF financing. Direct hiring is in accordance with Chapter GS-403 of the Procurement Manual.

I. COUNTRY ELIGIBILITY

- 1.1 The Donors' Committee has approved the eligibility of the six Central American Isthmus countries for all financing modalities from the Multilateral Investment Fund (MIF): viz. Costa Rica and El Salvador on December 3, 1993; Guatemala on March 30, 1995; Honduras on December 14, 1993; Nicaragua on June 7, 1994; and Panama on February 9, 1995.

II. THE PROJECT

A. Frame of reference

1. The hydrocarbons subsector

- 2.1 Market growth. The region is dependent on imports for its petroleum supplies, US\$1.8 billion CIF in 1996, equivalent to 9.1% of foreign exchange generated by exports of goods and services. Except for limited production in Guatemala, the region does not have proven oil or gas reserves or promising prospects for major discoveries in the medium term. Although petroleum products form the main commercial energy source in the six Isthmus countries, markets are relatively small. However, they grew vigorously at 11% p.a. during the five years 1990-95 and, after declining in 1996, rose by 4% in 1997. This growth during the 1990s resulted not only from the economic recovery but also from the dramatic increase in the use of oil fuels for power generation, in part due to the droughts of 1991 and 1994, but also because most of the power generation additions have been thermal plants. Even after excluding the use of fuels in power generation, final consumption rose by 7.6% p.a. during the five years 1990-95 and more moderately by 2.7% in 1996 and 2.8% in 1997. With such market growth, significant investments are being made and are expected in future in the construction and expansion of terminals, internal transportation, storage, gasoline stations and other facilities in the supply chain.

- 2.2 Supply system. While the market differs in each of the countries, three multinational companies dominate the importation, refining and wholesale distribution of hydrocarbons, except for Costa Rica where RECOPE exercises the state monopoly in these functions, and the LPG trade which is dominated by two Mexican groups. The main import terminals belong to the established companies or are leased by governments to them, except for Costa Rica where RECOPE is the sole importer of crude oil and its main products. The entry of new investors has recently been gathering momentum and, in some countries, fuels are now imported by private and public power generation companies. Private carriers haul the refined products by road from the import terminals and refineries to the wholesalers

and major consumers and, except for Costa Rica, the countries lack pipeline systems for the movement of refined products. However, such systems are being considered for El Salvador, Guatemala and Nicaragua. Companies typically supply the national market of each country with little regional-scale trade. The program described in this document will seek to promote conditions to facilitate the economies of scale from investments based on a regional approach.

- 2.3 A refinery is located in each country to supply the national market. Except in Panama, each refinery is small and of simple design, and typically imports and processes not only crude oil but also reconstituted petroleum (a blend of products and light crudes). This is done to overcome technical constraints in meeting the growing demand for light and intermediate products and to reduce the high cost of products compared to large modern refineries in Venezuela, the Caribbean and the United States. The processing of reconstituted petroleum was reinforced by the San José Accord of 1980, ^{1/} which until 1995 did not include imports of refined products but did cover blends of crudes and products. Market requirements are increasingly met by direct imports of refined products, as is the case in Honduras where the refinery has been closed since 1992.
- 2.4 National reform programs. For many years the system of petroleum imports, domestic prices and marketing margins had been under State control; and typically the State held the monopoly to import crude oil, the refinery operated with guaranteed profits, and the distributors, transporters and retailers had fixed margins and prices. Starting in 1992, several Isthmus countries have made progress in reforms of the legal framework, supply liberalization and reduced role of the State, seeking to promote more efficient and competitive supply. The reforms in Guatemala, Honduras and Nicaragua have been supported by IDB sector loans and technical cooperation (IDB/MIF in Nicaragua). The nature of these reforms is given in project reports and a diagnostic study prepared by the Bank in 1997, in consultation with the six countries and ECLAC, which is available in the project technical files (TF-1).
- 2.5 Market structures still do not satisfy conditions of efficiency and competition, due to small fragmented markets, infrastructure constraints, and weak regulatory and institutional frameworks. National programs cannot achieve their objectives unless policies of market harmonization and integration are introduced that will

^{1/} The San José Accord consists of a joint and unilateral declaration of the presidents of Venezuela and Mexico dated August 3, 1980, on a program of energy cooperation for the Central American and Caribbean countries which has been renewed annually to date. A percentage of the oil bills paid to Mexico and Venezuela is set aside to finance certain types of projects in the beneficiary countries on favorable terms.

facilitate the movement of hydrocarbons between the Isthmus countries, attract regional-scale investment by established and new private sector enterprises, and promote efficiency and competition.

2. Natural gas

- 2.6 During the 1990s, the electricity and hydrocarbons subsectors have become increasingly interlinked as a result of the increased use of liquid fuels in power generation. They will be further linked if natural gas is imported by pipeline from Mexico or Colombia for power generation and other use, as is under consideration by governments and private enterprises. Most recently, ECLAC completed a prefeasibility study for a natural gas pipeline from Mexico, within a joint project with GTZ and the Organización Latinoamericana de Energía (OLADE) financed by the Federal Republic of Germany, and presented its findings to the six countries, Mexico, multilateral and bilateral agencies, and private sector firms at a meeting in Mexico City on February 3-4, 1998. The study concluded that the concept looks sufficiently attractive to justify examining it in greater detail.
- 2.7 The six countries have accordingly formed an ad-hoc committee to initiate discussions and promote a feasibility study, to be financed by a multilateral agency or the private sector. The requisite activities and studies to address normative, regulatory and legal issues, as well as linkages with the power subsector, were reviewed by the countries with multilateral and bilateral agencies on March 30, 1998 in Managua, Nicaragua; and the present Program provides for some of these activities.

3. Institutional framework

- 2.8 Since 1986, the six countries have been addressing regional hydrocarbons issues with moderate resources through a technical cooperation project that Germany has provided to the region through GTZ and ECLAC as executing agency. They have participated actively in defining project priorities and activities, doing so through two regional committees established in 1991: the Foro Regional Energético para América Central (FREAC), comprising energy ministers, and the Comité de Cooperación de Hidrocarburos para América Central (CCHAC), comprising officials responsible for the hydrocarbons subsector.
- 2.9 The CCHAC is a committee without formal constitution which has functioned positively and successfully since its creation with a mandate to coordinate efforts aimed at regional integration in the hydrocarbons subsector. Initially, the government department responsible for the subsector in Panama was designated as secretariat *pro tempore* for two years, followed by Costa Rica and, since October 1996, Nicaragua. Having no staff or budget, the CCHAC has relied on support from the ECLAC/GTZ project. For their part, the six countries contribute their costs of participation in

CCHAC annual meetings to coordinate the program; the secretariat *pro tempore* contributes the requisite administrative and secretarial expenses; and the country hosting annual and technical meetings contributes local costs incurred in their organization. Within the framework of that project, officials responsible for the subsector have recently defined and begun some special studies with national experts; and the CCHAC, acting through its secretariat, has launched its first activity which is the establishment and monthly updating of a system of monitoring and comparing petroleum prices in the six countries.

- 2.10 With a view to ensuring the sustainability of its efforts, at the Fourth CCHAC meeting held on October 29, 1996 in Costa Rica, a process was initiated for approval by the national authorities of a constitutive agreement that would give CCHAC legal status. This process is superseded by the decision taken by the Central American Presidents at their XIX Summit, held on July 12, 1997 in Panama, to restructure the overall institutional framework for Central American integration. The permanent secretariats that currently service the various regional committees are to be unified into a new general secretariat to be based in El Salvador. The restructuring is under preparation, with Bank support, and is due to be implemented in late 1998. The CCHAC will continue as a decision-making committee and will have access to the new secretariat for services to be defined. The responsibilities of the executing agency for the present project will be reviewed and conformed as appropriate.
- 2.11 At their XIX Summit, the Presidents also urged the six countries to ensure that the process of regional integration and institutional reform take place with sufficient flexibility to permit the eventual joining of Belize and the Dominican Republic; and the latter has been an observer at CCHAC meetings since 1997.

4. The proposed Program

- 2.12 An evaluation mission in April 1997 found the ECLAC/GTZ project to be highly successful. The project, now in its sixth phase, has been extended to the end of 1998 to facilitate the transition to a new three-year phase, which is expected to start in January 1999 as an integral part of the new Program. The ensuing project offer is in process of submission by GTZ to the responsible ministry of the German government, Bundesministerium für Wirtschaftliche Zusammenarbeit (BMZ) [*Federal Ministry of Economic Cooperation*], with a view to approval by the third quarter of 1998. Details are available in the project technical files (TF-2).
- 2.13 It is essential to continue and deepen the reform process at regional level in a structured and organized fashion. The governments' vision, as reflected in a Central American fuels strategy approved in 1996, is to implement the harmonization and integration of the hydrocarbons market. The Bank's diagnostic

study (mentioned in paragraph 2.4), prepared in consultation with the countries and ECLAC, proposed a program that would enable the objectives of that strategy to be achieved. The countries have demonstrated strong interest to move ahead with the program but are justifiably taken up with day-to-day problems at national level and need external support to implement it.

- 2.14 The program forms part of the significant, albeit partial, advance in the process of Central American economic integration that is crucial for the subregion's effective participation in regional, hemispheric and global markets. As such, it formed an integral component of the package of high-priority economic integration activities that the Bank presented, at the request of the six countries' economic ministers, to the Second Meeting of the Regional Consultative Group for Technical Cooperation for Central America (GCR-CA) held on October 23, 1997 in Brussels. The program comprises two projects, of which the first will be financed by the MIF and be administered by the Bank and the other by Germany in the context of the ECLAC/GTZ project. The request for MIF financing was made on November 13, 1997 by the Secretary *pro tempore* of the CCHAC on behalf of member countries; and at the Brussels meeting Germany announced that it was prepared to consider the new phase of its ongoing project.
- 2.15 The project profile was approved by the Bank's Programming Committee on October 22, 1997, and the environmental and social aspects by the Technical Review Group of the Committee on Environment and Social Impact on November 17, 1997. Project details were prepared in 1998 by Bank missions with country officials responsible for the subsector on February 6 in Mexico City, March 31 in Managua, and May 13 in College Station, Texas.
- 2.16 To ensure the parties' commitment to the program's objectives, a Memorandum of Understanding was presented to the Bank, setting out in concrete terms the program's objectives, signed at ministerial level by the President of the CCHAC (currently the Minister-Director, Instituto Nicaragüense de Energía, Nicaragua) as well as by officials responsible for the subsector in the countries participating in the CCHAC. The Memorandum of Understanding is available in the project technical files (TF-3). It is further proposed that the action plan referred to in paragraph 2.21 be ratified by the ministers responsible for the subsector, during the first year of the project at a meeting to be called by the Bank. Approval of the action plan is a pre-condition for proceeding to the other studies mentioned below.

B. Objective of the program

- 2.17 The program's overall objective is to promote sustainable development of the hydrocarbons subsector in the Isthmus. The specific objective of the MIF project is to establish favorable conditions for a more efficient and competitive regional

hydrocarbons market. The specific objective of the ECLAC/GTZ project's new phase is to promote a more sustainable utilization of hydrocarbons in selected areas by increasing efficiency in their use and mitigating the environmental impact of their use and management.

C. Components and activities

1. The MIF project

- 2.18 The Project will support decisions to be made in four areas: an action plan to facilitate the harmonization and integration of the regional hydrocarbons market, based on a diagnostic study of the subsector; draft harmonized hydrocarbons laws and regulations and the harmonization of technical and environmental standards; analysis of the convergence of hydrocarbons pricing, fiscal and customs duty policies; and proposals for eliminating obstacles so as to promote regional-scale hydrocarbons projects, identifying those of highest priority.

a. Result 1: Action plan to facilitate market harmonization and integration

- 2.19 An action plan will be prepared and initiated to facilitate the harmonization and integration of the regional hydrocarbons market, based on a diagnostic study of the subsector.
- 2.20 The diagnostic study will analyze the following issues: infrastructure of the whole chain (storage, refining, ports, highways, service stations, etc); technical and environmental standards and specifications in effect in each country for all liquid and gas fuels (fuel quality, infrastructure, etc); economic issues (number of actors in each segment of the industry, pricing, tax and customs duty systems, obstacles to entry of new actors, etc); international trade in hydrocarbons (import and export procedures, obstacles to entry of new actors, existing trade treaties between countries of the region, etc); legal issues (existing and/or proposed hydrocarbon laws and regulations, commercial, anti-monopoly and consumer protection laws, obstacles to entry of new investments, etc); and institutional aspects (regulatory agencies, capacity, relations with other ministries, entry of natural gas, etc).
- 2.21 Thereafter the action plan will be prepared; the diagnostic study and draft action plan will be discussed at a workshop in each country, and the action plan will be further reviewed at a regional technical meeting. The purpose of the national workshops is to discuss the project's main results at national level with ministries and/or the private sector (according to the issue). An overview, rather than a sector focus will thereby be acquired at a technical level. The action plan will be finalized for approval of the officials responsible for the subsector and for ratification at

ministerial level within the first year of the project, at a meeting to be called by the Bank.

b. Result 2: Harmonization of laws, regulations, and technical and environmental standards

- 2.22 The legal reforms in the subsector recently enacted in Guatemala and Nicaragua and drafted in Honduras with Bank support, are designed to set limits on State intervention and to define private sector rights and obligations without discriminating against or favoring enterprises already established. They have the components necessary for promoting competition and motivating investments without distinction between national and foreign or existing and new enterprises, and for eliminating bureaucratic, legal and tax barriers that restrict petroleum trade. Regionally, the harmonization of legal frameworks has been started as part of the ECLAC/GTZ project, and the authorities of the six countries are agreed to strengthen these efforts.
- 2.23 The Project includes activities in support of the process of harmonization of the national hydrocarbon laws and regulations. The following activities will be carried out: update a comparative analysis of existing and proposed laws and regulations; identify interrelations with general laws (commercial, anti-monopoly and consumer protection laws, foreign investment, etc); propose changes to national laws and regulations for their regional harmonization, with a view to promoting a competitive regional market; and prepare a draft regional regulatory framework for natural gas.
- 2.24 With regard to the technical and environmental standards and special regulations pertaining to the new hydrocarbons legislation, their regional harmonization has already begun under the existing ECLAC/GTZ project. As a result, the countries have agreed on common product specifications and a program for future adjustments that accord with environmental criteria, and have developed technical standards for handling liquefied petroleum gas (LPG). It should be mentioned that, at a national level, the Bank is supporting efforts in Guatemala, Honduras and Nicaragua.
- 2.25 Nonetheless, additional efforts are needed regionally to continue the harmonization of technical and environmental standards and specifications for marketing hydrocarbons, so that the companies can move products between countries without hindrance. The Project will include activities to accelerate and expand this harmonization in two areas: (i) updating existing harmonized specifications (technical and environmental) of all fuels, based on the new products available in the market, propose short-term harmonized targets for fuel specifications, and analyze the impact of such harmonization on petroleum infrastructure and interregional trade; and (ii) defining harmonized technical and environmental standards for the construction and operation of infrastructure, transport and distribution facilities for liquid petroleum products, as well as

for the transport, handling and use of natural gas, based on the adaptation of international standards.

- 2.26 Plans call for organizing: (i) a workshop in each country to discuss standards and specifications for marketing hydrocarbons; (ii) a regional technical meeting to discuss legal issues and fuel and marketing specifications; (iii) a regional training seminar for hydrocarbon regulatory agencies on infrastructure standards; and (iv) a regional technical meeting to discuss the proposed regulatory framework for natural gas.
- 2.27 As far as possible, such activities will be coordinated with general reforms of trade legislation, notably antimonopoly regulations, consumer protection, measures and standards, commercial arbitration, and liberalization of the insurance market.

c. Result 3: Convergence of pricing policies

- 2.28 The creation of a regional hydrocarbons market will necessitate the convergence of national pricing policies, so as to prevent distortions at the regional level. It is also vital to harmonize tax and customs policies for petroleum products, so as to ensure neutral treatment for both crude oil and products, prevent hidden subsidies for local refineries, and ensure that solid, liquid and gaseous fuels used in the generation and regional trade of electricity receive similar treatment in each country.
- 2.29 Accordingly, a study will be prepared on promoting the convergence of pricing policies and a seminar-workshop will be organized to consider it. The study will cover the following issues: hydrocarbon pricing structures; taxes, duties and other charges applied to imports and exports of crude oil and products; impact of taxes, duties and other charges on the fiscal income of these governments; import and export administrative procedures, both within and outside the region; progress in the treatment applied to fuels for power generation; coherence in the pricing policies of petroleum products prior to the entry of natural gas and other new fuels (coal, orimulsion, etc); and preparation of recommendations on promoting the convergence of pricing policies for hydrocarbons.
- 2.30 Thereafter, a workshop will be organized in each country to discuss the study, as well as a regional technical meeting. In the second year of the project, the final study will be presented to officials responsible for the subsector in each country, and the study and their recommendations will be submitted to their respective ministers for consideration.

d. Result 4: Promotion of regional projects

- 2.31 In order to improve supply efficiency and increase competition in domestic markets, proposals will be prepared for eliminating obstacles to the promotion of regional infrastructure projects,

identifying the most important projects. The following activities are anticipated: propose changes to existing legal, economic and institutional conditions so as to encourage the entry of new investment; conduct a preliminary evaluation of high-priority regional infrastructure projects; draw up project profiles and prepare a promotion campaign; organize a technical meeting to discuss the proposed changes to existing conditions; and organize a project briefing seminar for private investors.

2. The ECLAC/GTZ project

- 2.32 It is anticipated that the new phase of the ECLAC/GTZ project will support activities for rational hydrocarbons use and strengthened environmental protection in the subsector; see details in the project technical files (TF-2).

D. Organization and execution of the Project

1. Overall direction of the Project

- 2.33 Ownership of the Project is that of the six countries, as represented by the CCHAC. The Project's overall direction will be entrusted to a steering committee comprising the Director Generals of Hydrocarbons (DGH) or equivalent, who constitute the CCHAC. The Bank and ECLAC will participate in the Committee as advisors. GTZ will participate in the Steering Committee as observer when and as appropriate. This Steering Committee will agree the decisions related to the Project by consensus between the countries, including decisions on the use of Project funds, whose administration will be ECLAC's responsibility. The Steering Committee will meet at least once a year at joint annual meetings of the Project, and on other occasions when and as necessary, and will agree the work plans to be carried out by ECLAC.
- 2.34 Overall supervision of the Project by the Bank will be the responsibility of the project team, which will keep the country offices in the six beneficiary countries informed of project progress; and regular contact with ECLAC on administrative matters will be conducted through the country office in Mexico.

2. Executing agency

- 2.35 It is recommended that ECLAC-Mexico be hired directly as Executing Agency for the Project, which constitutes an exception to the required procedure of selecting consultants through open competition. This reflects a letter of request to that effect dated November 13, 1997, forwarded by the Secretary *pro tempore* of the CCHAC on behalf of the six member countries. ECLAC has diligently responded to their interests during its twelve years as executing agency of the GTZ project, the earlier years of which were very exacting as the first steps were taken towards deregulating national markets. It is trusted and respected by them

as impartial and knowledgeable about the politically sensitive issues related to the Program, and has the technical skills to manage the Project at a reasonable cost. Acting for both projects, it will be coordinate and monitor their execution and carry out overlapping tasks with synergism and, being familiar with the issues, will be effective as executing agency of the MIF project from the outset. The Bank has found it to be a satisfactory executing agency in recent technical cooperation projects, as for example the study of restructuring the institutional framework for Central American integration. Details of CEPAL's responsibilities are available in the project technical files (TF-4). It will carry out any procurement, contracting of consultants or other required activities, observing the Bank's procedures applicable to MIF financing. Direct hiring is in accordance with Chapter GS-403 of the Procurement Manual.

- 2.36 The Agreement will be concluded with ECLAC for the benefit of the six countries and will be acknowledged through their representatives on the CCHAC. Approval of annual work programs and decisions on the use of funds will be subject to resolutions by subsector officials in the six countries; such resolutions will normally be prepared and signed during annual project meetings. CCHAC, as an entity involved in hydrocarbons issues and in process of formation, will also be part of the Agreement.
- 2.37 To assist in compliance with Project commitments and achievement of its objectives, the Bank will select, in consultation with the countries and the Executing Agency, an advisory panel comprising three independent experts, who will be contracted by the Executing Agency. The panel will act as project advisor on substantive issues and will support both institutions by reviewing reports of consultants and experts; participating in project Annual Meetings and other meetings as required; and reviewing the terms of reference and proposing consultants and experts to be selected for specific issues (one panel member according to the specialty of the consultant to be hired). The scope of work is available in the technical files (TF-5).
- 2.38 In consultation with the countries under a rapid procedure, the executing agency will prepare the terms of reference for all consultants and experts and the short list of candidates with recommendation, for the Bank's non-objection; and will contract the services of these experts in accordance with Bank procedures (applicable to MIF funds), as set forth in the Project Agreement between the Bank and the executing agency.

E. Cost and financing

- 2.39 The total cost of the Program is estimated at about US\$2,950,000, of which the MIF will contribute a grant of about US\$1,100,000, Germany a grant of about \$600,000, ECLAC its costs equivalent to about US\$350,000, and the six beneficiary countries a counterpart

contribution equivalent to about US\$900,000. The cost items to be financed by the MIF, Germany, ECLAC and beneficiary countries are set forth in the project technical files (TF-6). The program budget is summarized in Table II-1 below, and an itemized breakdown is available in the project technical files (TF-7).

TABLE II-1: PROGRAM BUDGET (US\$ '000s)					
	MIF	Germany	ECLAC	Counter-part	Total
TOTAL PROGRAM	1,104	600	350	880	2,934
Consulting services	683	359	-	-	1,042
Technical meetings	121	60	-	92	273
Other	62	12	-	-	74
Program management and coordination	161	169	350	727	1,407
Contingencies @ 7.5%	77	-	-	61	138

- 2.40 The activities to be financed from MIF resources are shown in Table II-2 below.

TABLE II-2: PROJECT BUDGET (US\$ '000s)						
Outputs	1	2	3	4	Other 1/	Total
Components	215	388	187	214	100	1,104
Consultants	115	170	98	118	36	538
Technical meetings	17	63	18	23	-	121
Other 2/	3	53	3	3	-	62
Advisory panel	28	27	28	28	35	146
Project management and coordination 3/	37	48	27	27	22	161
Contingencies @ 7.5%	15	27	13	15	7	77

1. Consulting services and missions not attributable to specific outputs.
2. Acquisition of normative documents, communications and publication of reports.
3. Executing agency missions and overhead.

F. Disbursements

- 2.41 The technical cooperation funds will be disbursed over a period of about 36 months, in accordance with Bank procedures.
- 2.42 The Project activities schedule and related disbursements show that the latter will reach \$400.000 in the fifth quarter of the Project.

G. Project monitoring and evaluation

- 2.43 The Project will be monitored and adjusted to current requirements by means of semiannual reporting and annual meetings. Annex II-1

presents the expected project outputs and benchmark indicators for reporting and monitoring project progress against objectives. The Project will be coordinated with those of other donors where and as appropriate, to ensure that it is executed with synergy and without duplication.

- 2.44 The executing agency will produce a semiannual report to examine project progress, within one month after each June 30 and December 31 as from the eligibility date of the Project. The Bank will examine objectives, targets and performance benchmarks attained, seek agreement on any corrective measures needed, and consider any additional work that may be required within the budget. As well, at least once per year, the Bank will meet with the countries and executing agency for project planning, monitoring and coordination. It reserves the right to conduct an evaluation of all or part of the Project at any time through its own staff or an independent expert.
- 2.45 The beneficiaries have not requested an ex-post evaluation of the Project, as it will be monitored and performance of its objectives evaluated on an ongoing basis as described above.

H. Viability and risks

- 2.46 The major benefit expected from the Project is to bring about a more efficient and competitive hydrocarbons market and supply in countries of the Isthmus. By promoting conditions conducive to harmonization and integration of the market, the Project is expected to attract new investments by established and new private sector enterprises, as well as promote mixed public/private investments.
- 2.47 Two major risks to accomplishment of the Project's objectives are: (i) failure by the Isthmus countries to continue their commitment to the Program and the overall process of regional economic integration; and (ii) lack of coordination with the ECLAC/GTZ project. To mitigate these risks, the Project will be monitored on an ongoing basis and reviewed with the countries in depth at periodic meetings, and the steering committee and executing agency will ensure coordination between both projects. Although the Program has a three year horizon, some additional Bank support may be required thereafter to promote continuity of governmental efforts in harmonizing and integrating the regional market.

III. FULFILLMENT OF PROJECT ELIGIBILITY CRITERIA

A. General criteria

- 3.1 The technical cooperation, designed to further efforts to facilitate private investment as well as promote mixed public and private investments in the subsector, is fully consonant with the MIF's general objective, which is to strengthen investment and expand the private sector as a means of accelerating economic growth and social development within each country.

B. Criteria under Technical Cooperation Facility

- 3.2 The objective is fully compatible with MIF's overall objective of strengthening private investment and its expansion as a basis for accelerating economic growth and social development of countries of the region. It is also consistent with eligibility criteria for the Technical Cooperation Facility, Article III (2.a and 2.b), which include the financing of programs to reform private investment policies and legal frameworks.

IV. CONCORDANCE WITH THE BANK'S STRATEGY

- 4.1 As stated in paragraph 2.14, the Program forms an integral component of the package of high-priority economic integration activities that the Bank is supporting through the GCR-CA. The Bank is similarly supporting two other initiatives for infrastructure integration in the Isthmus: electrical interconnection (SIEPAC project) and transportation.
- 4.2 The Project dovetails with Bank operations under execution that contain support for hydrocarbons subsector reform in three Isthmus countries. Specifically, in Guatemala, the infrastructure and investment sector reform program is supported by loan 1014/OC-GU and technical cooperation loan 1015/OC-GU. In Honduras, the energy sector reform program is supported by non-reimbursable technical cooperation ATN/SF-4737-HO, formerly by loan 937/SF-HO (canceled). In Nicaragua, the public service enterprises reform program is supported by loan 933/SF-NI, non-reimbursable technical cooperation ATN/SF-4724-NI and MIF grant 94-07-04-1. With the Dominican Republic now an observer at CCHAC meetings, mention should be made of its public enterprise reform program that includes reform of the hydrocarbons subsector, with support from MIF grant TC-94-10-50-7 and prospective loan DR-0089.

V. AVAILABILITY OF MIF RESOURCES

- 5.1 Funding for this Project will be in the form of a grant, based on the following considerations: the Donors' Committee has declared all six countries eligible for all financing modalities from the MIF; the eligibility memorandum for each country describes how the latter has complied with conditions for grant eligibility; and the proposed Project will serve as a strong catalyst for investment flows, as required under Article III, Section 5(a) of the Agreement Establishing the MIF, the objective of which is to build an enabling climate to boost private investment.

**PROGRAM OF HARMONIZATION AND INTEGRATION OF THE HYDROCARBONS MARKET
IN THE CENTRAL AMERICAN ISTHMUS**

Objectives, Outputs and Activities	Objectively Verifiable Indicators	Means of Verification	Assumptions
<p><u>Objective of Program</u></p> <p>Development of the hydrocarbons subsector in the Central American Isthmus.</p>			Continued commitment by the six Isthmus countries to the Program and the ongoing process of regional economic integration.
<p><u>Objective of Project</u></p> <p>Conditions established for a more competitive regional market.</p>	Conditions at end of Project: proposals prepared to incorporate strategies and concrete actions necessary for harmonization and integration of the Central American market into national policies of the Isthmus countries.		Continued commitment by the six Isthmus countries to the Project; and coordination with ECLAC/GTZ project.
<p>Prepared and initiated to harmonization and based on sector diagnostic</p>	<p>Diagnostic study and action plan finalized and presented to Directors General of Hydrocarbons (DGHS) in year one of Project.</p> <p>National workshops held.</p> <p>Action plan approved by DGHS and ratified by ministers responsible for hydrocarbons subsector, in year one of Project.</p> <p>Type and number of action plan activities carried out.</p>	<p>Ongoing monitoring; semi-annual reporting; technical and annual meetings of the Project.</p> <p>Government publications.</p> <p>Reports of third parties.</p>	<p>To achieve outputs 1, 2, 3 and 4:</p> <p>National governments maintain policies and move ahead on harmonization and integration of hydrocarbons market in the Central American Isthmus.</p> <p>Authorities in charge of hydrocarbons subsector are prepared and have resources necessary to implement specific initiatives.</p> <p>ECLAC regional office has staff and resources to support project.</p>

Objectives, Outputs and Activities	Objectively Verifiable Indicators	Means of Verification	Assumptions
<p>prepared for harmonization of laws, regulations, and technical standards, and approved.</p> <p>prepared on convergence of pricing policies.</p> <p>prepared for eliminating obstacles to promotion of regional projects, and for important projects.</p>	<p>Proposals prepared for changes that would harmonize laws and regulations.</p> <p>Draft regional regulatory framework prepared for natural gas.</p> <p>National workshops held on marketing standards for hydrocarbons.</p> <p>Fuels specifications, environmental standards, and technical specification standards for hydrocarbons marketing harmonized and approved.</p> <p>Study finalized and presented to DGHS in year two of Project.</p> <p>National workshops held on pricing policy study.</p> <p>Study and recommendations of DGHS presented to their respective Ministers, in year two of project.</p> <p>Number of profiles prepared, with recommendations on solving specific obstacles.</p>	<p>Idem.</p> <p>Idem.</p> <p>Idem.</p>	

Objectives, Outputs and Activities	Objectively Verifiable Indicators	Means of Verification	Assumptions
<p>Action plan prepared and initiated to facilitate market harmonization and integration, based on sector diagnostic study.</p> <p>Carry out diagnostic study of petroleum industry in the Central American Isthmus. Prepare action plan to facilitate harmonization and integration of the petroleum markets. Organize workshop in each country to discuss the diagnostic study and action plan. Organize regional technical seminar to discuss draft action plan. Organize meeting at ministerial level to ratify action plan.</p>			
<p>Proposals prepared for harmonization of laws and regulations, and technical standards harmonized and approved</p> <p>Prepare draft amendments to harmonize national hydrocarbon laws and regulations. Update harmonized fuels specifications (technical and environmental), with short-term goals. Define harmonized standards and specifications for infrastructure, transport and distribution. Organize a workshop in each country to discuss proposal 2.3. Organize a regional technical meeting for discussion of issues 2.1-2.3 above. Organize a regional training seminar for hydrocarbons regulatory bodies on infrastructure standards. Organize a regional technical meeting to discuss draft regulatory framework for natural gas.</p>			
<p>Study prepared on convergence of hydrocarbons pricing policies</p> <p>Prepare study to promote the convergence of pricing policies. Organize a workshop in each country to discuss the study. Organize regional technical meeting for discussion of the study.</p>			
<p>Proposals prepared for eliminating obstacles to promotion of regional projects, identifying the most important projects</p> <p>Propose changes to existing legal, economic and institutional conditions, to encourage the entry of new investments. Preliminary evaluation of high-priority regional infrastructure projects. Prepare project profiles and prepare promotion campaign. Organize technical meeting to discuss changes proposed to existing conditions. Organize project promotion seminar with private investors.</p>			

of Objectives, Outputs and Activities	Objectively Verifiable Indicators	Means of Verification	Assumptions
T: NEW PHASE			
<p>Objective of project</p> <p>ies promote a more ization of hydrocarbons in</p>		<p>Development plans of the countries.</p>	<p>Private sector supports government initiatives.</p>
<p>ountries have initiated or activities to increase efficiency hydrocarbons.</p> <p>ountries have initiated or activities to lessen the impact of the use and f hydrocarbons.</p>	<p>Number of activities, projects or programs relating to efficiency in the use of hydrocarbons, being programmed or executed in the Isthmus countries.</p> <p>Legal and normative initiatives to improve energy efficiency in the use of hydrocarbons in the Isthmus countries.</p> <p>Number of activities, projects or programs to lessen the environmental impact of the use and management of hydrocarbons in programming or execution in the Isthmus countries.</p> <p>Legal and normative initiatives to lessen the environmental impact of the use and management of hydrocarbons in the Isthmus countries.</p>	<p>Reports and publications of the governments; reports of third parties; annual project report.</p> <p>As above.</p> <p>As above.</p> <p>As above.</p>	<p>MIF project is carried out successfully coordination by regional bodies with to bring together those concerned; governments seek consistency in s policies.</p>

PROPOSED RESOLUTION

**REGIONAL. NONREIMBURSABLE TECHNICAL COOPERATION FOR THE PROGRAM
ON HARMONIZATION AND INTEGRATION OF THE HYDROCARBONS
MARKET IN THE CENTRAL AMERICAN ISTHMUS**

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank or such representative as he shall designate, is authorized, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary, and to take such additional measures as may be pertinent, for the execution of the project proposal referred to in Document MIF/AT- with respect to a technical cooperation to develop a program on harmonization and integration of the hydrocarbons market in the Central American isthmus.
2. That up to the amount of US\$1,100,000, or its equivalent in other convertible currencies, is authorized for the purpose of this resolution, chargeable to resources of the Technical Cooperation Facility of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on nonreimbursable basis.