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EL SALVADOR

FISCAL STRENGTHENING FOR INCLUSIVE GROWTH II

(ES-L1137)

LOAN PROPOSAL

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ABBREVIATIONS

AFP	Administradora de Fondo de Pensión [pension fund administrator]
API	Fondo Apuesta por InversionES [Investment Promotion Fund]
BCR	Central Reserve Bank
BOLPROS	Bolsa de Productos y Servicios de El Salvador [Salvadoran Goods and Services Exchange]
CGS	Cuenta de Garantía Solidaria [Solidarity Guarantee Account]
CIAT	Inter-American Center of Tax Administrations
CIP	Certificados de Inversión Previsional [pension investment certificates]
CNR	Centro Nacional de Registros [National Registry Center]
COMPRASAL	Sistema Electrónico de Compras Públicas de El Salvador [Salvadoran electronic procurement system]
DCTA	Tax and Customs Arrears Collection Division
DGA	Customs Department
DGICP	Investment and Public Credit Administration
DGII	Internal Revenue Department
DGP	Budget Department
DGT	Treasury Department
DINAFI	National Financial Administration and Innovation Department
FGR	Office of the Attorney General
FOP	Fideicomiso de Obligaciones Previsionales [Pension Trust Fund]
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH [German Agency for International Cooperation]
IMF	International Monetary Fund
INSAFOCOOP	Instituto Salvadoreño de Fomento Cooperativo [Salvadoran Institute for the Promotion of Cooperatives]
ISSS	Salvadoran Social Security Administration
IT	Information technology
LACAP	Government Procurement Act
LRF	Fiscal Responsibility Act for the Sustainability of Public Finances and Social Development
MLTFF	Medium- and long-term fiscal framework
MTEF	Medium-term expenditure framework
MTIF	Medium-term institutional framework
NFPS	Nonfinancial public sector
OECD	Organization for Economic Cooperation and Development
OMR	Organismo de Mejora Regulatoria [Regulatory Improvement Agency]
OVE	Office of Evaluation and Oversight
PBL	Policy-based loan
RBB	Results-based budgeting
RNPN	Registro Nacional de las Personas Naturales [National Citizen Registry]
SAFI-II	Sistema de Administración Financiera Integrado [integrated financial management system]
SAP	Sistema de Ahorro para Pensiones [pension savings system]
SETEPLAN	Technical Secretariat of the Office of the President
SIRH	Sistema Integral de Recursos Humanos [Comprehensive Human Resource Management System]
SPP	Sistema Público de Pensiones [public pension system]

SSF	Office of the Superintendent of the Financial System
UNAC	Unidad Normativa de Adquisiciones y Contrataciones de la Administración Pública [Government Procurement and Contracting Regulatory Unit]
USAID	United States Agency for International Development

PROJECT SUMMARY

EL SALVADOR
FISCAL STRENGTHENING FOR INCLUSIVE GROWTH II
(ES-L1137)

Financial Terms and Conditions				
Borrower			**Flexible Financing Facility**[a]	
Republic of El Salvador			**Amortization period:**	20 years
Executing Agency:			**Disbursement period:**	12 months
Ministry of Finance			**Grace period:**	5.5 years[b]
Source	**Amount (US$)**	**%**	**Interest rate:**	LIBOR-based
IDB (Ordinary Capital):	200,000,000	100	**Credit fee:**	[c]
			Inspection and supervision fee:	[c]
Total:	200,000,000	100	**Weighted average life:**	12.75 years
			Currency:	U.S. dollar

Project at a Glance

Project objective/description: The general objective of this programmatic series is to strengthen fiscal sustainability, protecting public investment and social program funding to favor inclusive growth. The specific objectives are to: (i) boost the efficiency of fiscal management (with particular emphasis on the efficiency of public expenditure); and (ii) improve pension sustainability.

This is the second of two operations under a programmatic policy-based loan.

Special contractual conditions precedent to the sole loan disbursement: The sole disbursement under this operation is contingent on compliance with the policy reform conditions as established in the Policy Matrix (Annex II), the Policy Letter, and the remaining conditions established in the loan contract (paragraph 3.3).

Exceptions to Bank policies: None.

Strategic Alignment						
Challenges[d]:	SI	☑	PI	☑	EI	☐
Crosscutting themes[h]:	GD	☐	CC	☐	IC	☑

[a] Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule, as well as currency, interest rate, and commodity conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.

[b] Under the flexible repayment options of the Flexible Financing Facility, changes to the grace period are permitted provided that they do not entail any extension of the original weighted average life of the loan or the last payment date as documented in the loan contract.

[c] The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the relevant policies.

[d] SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

[e] GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, and rationale

1.1 This operation is the second in a programmatic series of two policy-based loans (PBLs). The series was initiated in 2018 (loan 4542/OC-ES) and with the objective of strengthening fiscal sustainability, thereby protecting public investment and social program funding to favor inclusive growth. The targeted areas are macrofiscal management, government procurement management, results-based budgeting and the medium-term expenditure framework, public investment management and private investment facilitation, tax collection and tax transparency, and institutional strengthening of the pension system.

1.2 Key policy measures supported under the first operation included: (i) approval and entry into force of a Fiscal Responsibility Law for Sustainability of the Public Finances and Social Development, which includes fiscal rules and the creation of a Medium and Long-Term Fiscal Framework; (ii) progress in the implementation of an electronic procurement system (COMPRASAL); (iii) laying the foundations for the adoption of results-based budgeting and its coordination with the public investment system; (iv) the signing of regulatory improvement plans; (v) strengthening of the tax collection department; and (vi) approval and entry into force of two laws supporting pension system reform. This second operation supports the deepening and consolidation of the reforms in line with the objectives originally set out for the programmatic series.

1.3 **Macroeconomic context.**[1] El Salvador's economy is the fourth largest in Central America. It is open, dollarized (since 2001), and vulnerable to external shocks and natural disasters. Economic growth averaged 2% per year from 2000 to 2008. The economy shrank by 2.1% in 2009 due to the world financial crisis, and economic growth has averaged 2.5% since then (to 2018) (Central Reserve Bank (BCR), 2018). Growth potential is relatively low (2.2%)[2]—just one half of the Central American average. In the medium term, real GDP growth is expected to be between 2.2% and 2.6%.[3]

1.4 The current account deficit has averaged 4% of GDP over the last decade, driven by the trade deficit (averaging 19% of GDP) and a heavy flow of external payments, albeit moderated by the flow of remittances (averaging 18.9% of GDP) and other net transfers from abroad. In 2018, the current account deficit totaled 3.9% of GDP—almost double the 2017 level (2% of GDP). Projections for the next five years suggest a current account deficit of between 4.2% and 4.8% of GDP, resulting from the high import propensity that is the norm for the country and also a possible decline in family remittances (stemming from uncertainty about changes in U.S. immigration policy and fluctuations in the U.S. economy).

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1 These figures have been adjusted, where necessary, to reflect the 2018 national accounts revision, which led to a reduction in GDP of around 10.8%. This accounts for differences with respect to the first loan document in the series (contract 4542/OC-ES).

2 World Economic Outlook (October 2018).

3 The International Monetary Fund (IMF) projects growth of 2.3% in 2019, remaining thereafter at around 2.2% over the medium term. The BCR projects growth of 2.6% in 2018 and similar levels in the following years.

1.5 The BCR has a prudent level of international reserves, totaling US$3.354 billion in December 2018: sufficient to cover 3.8 months of imports and equivalent to three times the projected current account balance and 129% of external short-term debt plus long-term external debt amortizations.

1.6 The Salvadoran economy has been characterized by low inflation, which stood at 0.4% at the end of 2018. Fluctuations in commodity prices have a direct impact on inflation; the country is a net importer of these products and has a dollarized monetary system, meaning that that there is almost instantaneous transmission from the external environment into domestic prices. In the medium-term, inflation is expected to converge to levels of around 2%—slightly below U.S. inflation (2.2%).

1.7 **Fiscal context.** The overall fiscal deficit averaged 3.7% of GDP from 2000 to 2008, rising to 6.7% in 2009 due to a drop in revenue of 1.3% of GDP and an increase in expenditure of 1.6% of GDP.[4] Revenue recovered to its 2008 level, but spending continued to grow. The deficit averaged 4.4% until 2013, when various reforms were introduced, including the creation of new taxes and increases in income tax rates and the rates and bases of selective taxes.[5] As a result, the tax burden rose from 16.7% of GDP in 2010 to 18.6% in 2018 (Ministry of Finance, 2019).[6][7]

1.8 Public expenditure is rigid and has been countercyclical only in times of recession. Spending rose from 23.7% of GDP in 2007 to 26.6% in 2013, driven primarily by the increase in nonfinancial public sector (NFPS) wages (1.3% of GDP), goods and services (0.5% of GDP), and subsidies (0.9% of GDP) (Ministry of Finance, 2019). Since then, and to supplement the tax policy measures, the government lowered its spending to 23.3% of GDP in 2017. This drop is partly explained by the targeting of energy subsidies[8] and lower oil prices, which generated savings of 0.9% of GDP in 2017 (Ministry of Finance, 2019). Capital expenditure was reduced from 3.6% of GDP to 2.7% over the same period. These revenue and expenditure measures helped generate a positive primary balance from 2017 onwards (see Figure 1).

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4 Hereinafter, unless otherwise stated, the deficit and expenditures both include pension spending.

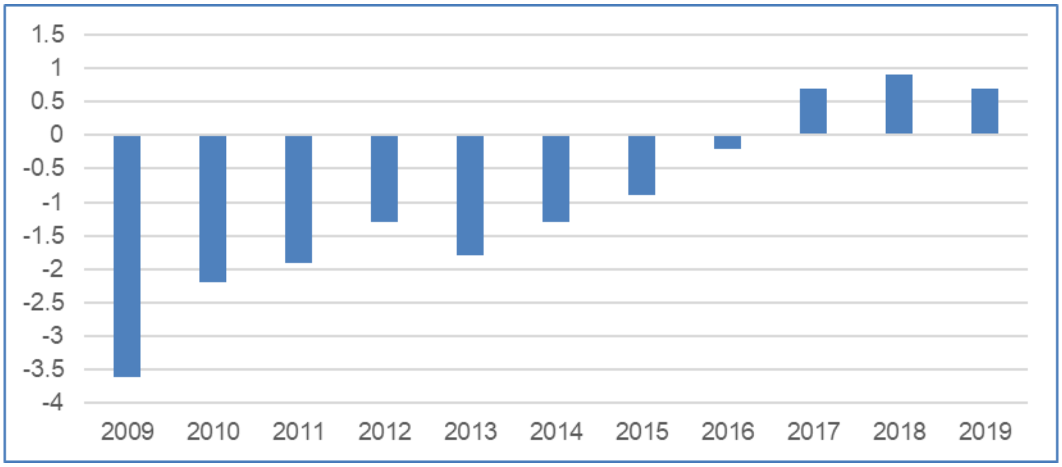
5 The income tax rate for the highest bracket was increased from 25% to 30%, and the minimum exemption was also raised (Legislative Decree 957-2011). A financial operations tax was created (Legislative Decree 764-2014, declared unconstitutional by the Supreme Court in 2018), as well as a large taxpayer contribution (Legislative Decree 161-2015) and a special contribution for security (Legislative Decree 162-2015).

6 Total revenue rose from 21.6% of GDP to 23.1%.

7 The government decreed a fiscal amnesty in October 2017 which extended until August 2018. The measure generated additional revenue of US$130 million (0.5% of GDP).

8 Executive Decrees 35-2011, 197-2014, and 6-2017. This targeting involved excluding beneficiaries that owned beach or mountain homes or had more than one home in their name. It was subsequently established that the subsidy would only apply to low-income residential users.

Figure 1. Primary balance, 2009-2019 (as a % of GDP)



Source: Ministry of Finance (2019).

1.9 The public debt rose substantially in 2009, when it climbed to 58.7% of GDP (compared to 48.8% of GDP in 2008). This increase was due to the deterioration in the fiscal situation and the economic contraction in 2009. Nonetheless, despite the recovery in economic activity and fiscal consolidation efforts, the debt continued to grow at an annual average rate of almost 1.4 percentage points of GDP between 2010 and 2018, reaching 71.2% of GDP at the end of that period. Debt dynamics have been heavily affected by low economic growth rates (averaging 2% over the last two decades). As a result, additional fiscal measures will be required in coming years to comply with the public debt sustainability rule contained in the Fiscal Responsibility Act for the Sustainability of Public Finances and Social Development (LRF) (60% of GDP by 2030).[9]

1.10 The Sistema de Ahorro para las Pensiones [pension savings system] (SAP) was introduced in 1998 to replace the Sistema Público de Pensiones [public pension system] (SPP). It has contributed to the increase in expenditure since 2001 and, hence, to the fiscal deficit and the public debt. Miscalculation of the technical reserves needed to finance the transition period for workers belonging to the SPP forced the government to include the missing reserves in the annual budget.[10] A Fideicomiso de Obligaciones Previsionales [Pension Trust Fund] (FOP)[11] was set up in 2006 to cover these obligations and to issue Certificados de Inversión Previsional [pension investment certificates] (CIP). In 2017, a reform of the SAP was approved, which provided financial relief to the government. Among other measures, the reform increased contributions, reduced the fees paid to pension fund administrators (AFPs), set maximum SPP pension rates, created a Solidarity Guarantee Account (CGS) to cover part of the government's obligations using funds from SAP contributions, and required that the government contribute up to

9 Amendments to the LRF (Legislative Decree 188-2018).

10 Four years after implementation of the reform, the reserves were exhausted (Mesa-Lago and Durán, 1998 and Mesa-Lago, 2012).

11 The FOP law (Legislative Decree 98-2006) allowed the government to borrow from AFPs at below-market rates, thus curtailing the fiscal costs of pension commitments.

2.25% of net current revenue to the CGS. A restructuring of CIPs was also approved, resulting in the postponement of payments falling due in the short term.

1.11 **Macrofiscal management and public debt sustainability.** In 2016, based on dialogue and consensus-building among the country's different sectors, the authorities were able to reach important political agreements. As a result, the government passed the LRF at the end of 2016 and an amendment to the law in 2018; the SAP was modified at the end of 2017. The Bank provided support for the process of reforming the LRF and SAP regulatory frameworks from the idea stage, and subsequently provided technical advisory services to the Ministry of Finance during the reform itself and during its drafting and regulatory stages, the latter of which is ongoing (paragraph 1.24). These reforms of the LRF and SAP regulatory frameworks coincided with the preparation of this programmatic series with the Bank and are included in it. By providing technical inputs,[12] the Bank also helped build a consensus that facilitated passage of the 2018 budget as an integral part of the process of preparing this operation (paragraph 1.24).

1.12 The LRF established fiscal rules that limit the fiscal deficit, borrowing, and current expenditure growth.[13] Given the upward trend in debt observed until 2016, the LRF established a three-year period of fiscal consolidation during which debt stabilization measures would be implemented (2017-2019),[14] followed by a two-year sustainability period (2020-2021). The LRF created the medium- and long-term fiscal framework (MLTFF), which introduces a medium-term perspective into management of the public finances that incorporates the fiscal obligations generated by the pension system and projects a multiyear baseline for fiscal policy decisions. In 2018, the Legislative Assembly approved amendments to the LRF to adjust quantitative targets to the new GDP base year announced by the BCR, causing an increase in all GDP-related variables.[15] As part of this reform, the period of fiscal consolidation was extended until 2021, the current spending target was replaced with a consumption spending target,[16] and a public debt target of 60% of GDP was established for 2030, among other changes.[17]

1.13 Current spending has risen by 2.5% of GDP over the last 10 years, mainly due to increases in public sector payroll and purchases of goods and services. This acts as a constraint on the ability to achieve primary surpluses and thus needs to be addressed by mitigation measures that, at the same time, protect the budgets of programs targeting vulnerable and poor populations. In relation to the wage bill, decentralized human resource management places upward pressure on current expenditure, and discussions are currently underway about a civil service act that

[12] Technical analysis of the draft 2018 budget law (IDB, 2017).

[13] Fiscal rules in Central America have sought to bring about sustainability, reduce the procyclicality of fiscal policy (Klem, 2014), and optimize the size of government (IMF, 2009).

[14] The first operation in the series helped stabilize the public debt, particularly in the pension reform component.

[15] This nominal increase stems solely from a change in the GDP base year and not from any changes in the behavior of variables over time.

[16] Consumption spending is current spending minus debt interest payments and current transfers.

[17] The changes to the fiscal rules concerning the public debt target were sanctioned by the IMF, as established in the IMF's October 2018 and March 2019 visits to the country (press release). See the full detail of the proposed LRF Reform.

would create an oversight body for the human resource system and give the Executive Branch the authority to issue a wage policy. In parallel, the Ministry of Finance has developed a new version of the Human Resource Information System (SIRH-II) that includes a payroll module integrated with the Integrated Financial Administration System (SAFI-II). The module will be populated with data during 2019 with a view to its launch in 2020.

1.14 **Government procurement management.** Estimates indicate that inefficiencies in public procurement processes increase the Salvadoran government's costs by around 1% of GDP.[18] These inefficiencies stem from shortcomings in the legal framework, the institutional architecture, and operating capacity and transparency,[19] as well the delay in implementing a electronic transactional portal that would lead to public expenditure savings.[20] The Ministry of Finance's electronic procurement system is mainly informative and is in the process of transitioning to an electronic procurement system with transactional functionality (COMPRASAL-II), beginning with implementation of the module for shopping—a method that accounts for 26% of all procurement. Consolidating this system is an important challenge that will require steady progress in developing transactional modules and issuing new rules, with training conducted in parallel.

1.15 With respect to regulations, the 2000 Government Procurement Act (LACAP) is now outdated in several key respects, including: (i) it does not take into account the principle of regulatory centralization and operational decentralization, instead creating just one procurement unit, the Government Procurement and Contracting Regulatory Unit (UNAC), which reports to the Ministry of Finance but has little capacity to manage and control procurement for the entire government; (ii) it fails to clearly specify that the use of COMPRASAL-II is mandatory and that the system contains a master register of suppliers; and (iii) it does not include new types of contracting, such as standard agreements or reverse electronic auctions, and also does not specify that their use is mandatory in certain cases. The government is in the process of submitting a LACAP reform to the legislature for consideration and has managed to include significant measures to enhance the efficiency and transparency of public procurement processes. These measures are included in this programmatic series (paragraph 1.40).

1.16 **Results-based budgeting (RBB) and the medium-term expenditure framework (MTEF).** The current budget model—based on management areas—prevents allocated public funds from being linked to the objectives, targets, and achievements for which they are intended. El Salvador does not have RBB or mechanisms for measuring spending efficiency.[21] To date, it has not adopted a

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[18] The efficiencies, savings, and advantages that would be obtained from adopting the best practices used in other country procurement systems are estimated at 0.8% of GDP (IDB, 2016d).

[19] In 2010, El Salvador had an average score of 1.2 (out of a maximum of 4) in an evaluation of public procurement systems carried out by the Organization for Economic Cooperation and Development (OECD).

[20] The benefits from the use of electronic procurement systems include faster transaction times, electronic catalogues, greater standardization, a wider supplier base, and scalability, all of which yield savings and foster transparency (Oxford CoP&S, ND).

[21] El Salvador scored below the regional average in the RBB index (0.8 compared to 1.9) (Kaufman et al., 2015). The measurement was based on 2013 data.

MTEF that would let NFPS institutions set performance targets that extend beyond the annual budget. El Salvador adopted a budget reform plan based on four pillars: (i) replacement of the current management-area based budget model (which stresses the allocation and use of inputs) by RBB (which focuses on the attainment of objectives and expected results of public programs); (ii) implementation of an MTEF and medium-term institutional frameworks (MTIFs);[22] (iii) creation of a system for monitoring and evaluating program performance; and (iv) development of capacity throughout the public sector.

1.17 The Ministry of Finance has spearheaded the development of regulations, concepts, and methodological tools (manuals, guidelines, instructions, etc.), as well as training in the Budget Department (DGP) and throughout the NFPS. Adjustments have made in parallel to the budget formulation and execution module of the new SAFI-II. According to the implementation strategy, the 2019 budget was to be approved and executed using the new methodology; however, the information technology (IT) modules were not delivered in time to conduct comprehensive execution tests before the beginning of the 2019 fiscal year.[23] Accordingly, the launch has been postponed until the 2020 fiscal year, by which time the IT systems will need to have been tested, program structures approved, and the 2020 budget policy issued in accordance with the new methodology. Adjustments to the Government Financial Administration Act will also be required, so the new model's instruments can be incorporated in the formal budget cycle.

1.18 **Public investment management and private investment facilitation.** Public and private investment levels are low, averaging of 14.1% of GDP from 2011 to 2016 compared to 18.9% in the rest of the Northern Triangle countries and 23.2% in Latin America (IMF, 2018). There are inadequacies[24] in the planning, ex ante review, project identification, and budget allocation stages of public investment management, investment execution is low (65% of programmed investment),[25] and there is little ex post evaluation of the investment project results (Armendariz and Contreras, 2016).[26] Private investment facilitation is ineffective due to the complexity of the process for starting a business and the periodic obligations that companies must meet.[27] The average cost of these bureaucratic processes is 41.1% of average per capita income—above the average for Latin American

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[22] MTIFs are prepared by each institution in the NFPS and set out sector/institutional objectives and strategic planning priorities, physical and financial programming, and revenue projections for four-year periods. The MTEF is developed by analyzing and consolidating the MTIFs, with reference to the five-year development plan, the MLTFF, the budget policy, and the medium-term institutional spending caps.

[23] Beginning budget execution without duly tested financial management IT systems (budget, cash management, and accounting at a minimum) would be highly risky. A failure in any one of these systems could force a suspension of budget execution with serious consequences for the public sector.

[24] USAID, 2012.

[25] Investment and Public Credit Department (DGICP), 2018.

[26] The results of the study show that El Salvador scores 1.7 on the public investment efficiency index (out of a maximum of 4 points), indicating that there is room to improve investment management. The worst-performing areas are planning/prioritization, ex ante project review, and selection criteria (scores of less than 1). There are also shortcomings in public access and scrutiny across the entire cycle, as well in the use of digital tools to facilitate investment processes.

[27] Regulatory Improvement Agency (OMR), 2017.

countries (37.5%).[28] There is also a lack of funding for public goods and services that leverage private investment (United States Agency for International Development (USAID), 2012 and 2017).[29]

1.19 The government has made progress in improving the quality of public investment by coordinating investment projects with the program-based budget, fostering an integrated vision of the value chain in government programs. This progress has included the formal definition of a macroprocess encompassing all stages of the public investment cycle, including the roles of the different institutions involved in each stage of that cycle. In particular, a process has been established to ensure that projects are also aligned with national-level plans. A new methodology manual has also been developed for project formulation and evaluation that will support the prioritization of investments of high technical quality and yield. To facilitate private investment, a law was enacted to formalize the Regulatory Improvement System led by the Regulatory Improvement Agency (OMR), and so was the Elimination of Bureaucratic Barriers Act, which creates an independent Elimination of Bureaucratic Barriers Tribunal and promotes the prevention and elimination of administrative processes to improve the efficiency of public service delivery.

1.20 **Management of tax collection and tax transparency.** The collection function is crucial for the effectiveness of tax administration, yet the process is weak in El Salvador due to its fragmentation across various institutions: the Office of the Attorney General (FGR) and the Treasury Department (DGT), which in turn are poorly coordinated with the Internal Revenue Department (DGII) and the Customs Department (DGA).[30] To enhance the effectiveness of collection, a Tax and Customs Arrears Collection Division (DCTA) was created in the DGT. The DCTA's mandate is to consolidate DGII and DGA collection in coordination with the FGR's Tax Appeal Tribunal. A tax moratorium was also approved, which allowed the regularization of accumulated long-standing debts.[31] At the same time, integration with third-party databases is limited and data cross-referencing is ad hoc. Improvements in coordination between the DGT, DGII, and DGA should therefore be accompanied by improvements in access to data from the main public registers, so that information can be periodically cross-referenced for more effective tax control.[32]

1.21 El Salvador complies with requirements for the exchange of information for tax purposes with other jurisdictions, consistent with its commitments to the Global

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[28] World Bank, 2018.

[29] A survey of 200 companies in different productive sectors showed that investment is affected by: (i) burdensome government regulations and procedures governing economic activity; (ii) deficiencies in the provision of public goods to facilitate private investment; (iii) poor efficiency in sectors that are key for competitiveness; (iv) a shortage of skilled workers; and (v) insufficient or substandard logistics infrastructure (USAID, 2011).

[30] The structure of the Ministry of Finance is inadequate for the effective collection of tax debts. Recovery of the tax debt is 25% lower than the Latin American average and the debt is three times older (Inter-American Center of Tax Administrations (CIAT), 2016).

[31] Legislative Assembly Decision 292, October 2017. As of 31 December 2018, 16.2% (US$94,615,397.06) of the accumulated debt at the beginning of the amnesty had been recovered (report of the DCTA director).

[32] Aspectos claves a considerar para el fortalecimiento de las Administraciones Tributarias y Aduaneras [Key issues to consider in strengthening tax and customs administrations] (IMF, 2014).

Forum on Transparency and Exchange of Information for Tax Purposes. The country joined the Forum voluntarily and has been rated largely compliant (OECD, 2017).[33] The country has complied with the first two standards on transparency and the exchange of information for tax purposes developed by the Global Forum (OECD, 2016),[34] which involve the elimination of banking secrecy (and with it, the elimination of bearer shares companies) and the authorization of information exchange with other jurisdictions. However, it has not approved the third standard relating to the identification of ultimate beneficial owners. Accordingly, the combat of international fiscal evasion and fraud falls short, and suitable legislation addressing this standard needs to be prepared to mitigate reputational risks that could affect El Salvador's commercial and financial position.

1.22 **Pension system reform.** Prior to the 2017 reform, the SAP Act did not consider longevity risk, and low, strongly regressive replacement rates meant that the system was unsustainable. In the absence of reforms, and with increases in the minimum pension and guarantees for contributors opting to migrate to the SAP, the demand for fiscal resources from the pension system was set to grow, rising to 3% of GDP in 2024 (Melinsky, 2017). Between 2009 and 2016, the government transferred an annual average of 1.8% of GDP to cover pension obligations, administrative costs, and the redemption of transfer certificates held by workers in the old SPP and those who opted into the new system.

1.23 In addition to these fiscal problems, the pension system did not fulfill its basic purpose of providing stable pensions that would cover the longevity risk. There were no lifetime pensions but rather programmed retirements that could vary in length. Furthermore, SAP pensions only replaced between 35% and 40% of earnings—partly because of the low returns on pension savings[35] and the costs of administering the funds,[36] but also because the contribution rate was not high enough to finance larger pensions (Méndez et al., 2015). The benefits provided under the system were also regressive, since replacement rates for higher-income workers exceeded 70%—significantly higher than the regional average—representing an implicit, unfunded subsidy (Bosch, 2018). Technical, transparent management of the pension system requires the creation of independent committees to evaluate risk and manage actuarial calculations, as well as regulations for longevity insurance. In the medium term, the main challenges are ensuring greater rates of return on retirement savings, curbing contribution evasion and avoidance, broadening coverage, and increasing competition in the pension market.

[33] Report on the results of the assessments. Yaoundé, Cameroon (Global Forum - OECD, 2017).

[34] Fiscal transparency (OECD, 2016).

[35] Average interest rates accrued by pension investment certificates (CIPs) are lower than the market rates for sovereign securities with similar conditions, jeopardizing the return on workers' savings. CIP A and CIP B, which must be purchased from the FOP, earned an average of 1.9% and 2.19% in 2016, respectively, compared to approximately 8% paid by the government on comparable obligations on international markets. This difference means that an increase in the rates paid on the certificates is long overdue, which would improve individual pension earnings (Iniciativa Ciudadana para las Pensiones, 2017).

[36] Administrative and insurance fees could be reduced from 2.2% to 2% over a 10-year period (Melinsky, 2017).

1.24 **Bank value added and experience with the country.**[37] For a number of years, the Bank has supported and encouraged the process of strengthening the public finances in El Salvador and the policy reforms presented in this operation in particular. The Bank provided technical assistance for designing a legal framework for fiscal accountability, preparing draft legislation, and promoting dialogue and discussion among relevant political stakeholders to promote the regulations approved in November 2016. It also supported better public debt management and adoption of the first medium- and long-term fiscal framework (MLTFF) in El Salvador.[38]

1.25 Tax administration benefited from IDB technical assistance focusing on the Ministry of Finance entity responsible for taxation.[39] Execution of a US$30 million investment loan (loan 3852/OC-ES) to strengthen tax administration began in 2019. The loan will give continuity to the measures supported under this operation to integrate databases with the Vice Ministry of Revenue, and it will complement actions to improve the sustainability, efficiency, and effectiveness of public finances, mainly through implementation of electronic invoicing, development of a data center for the Vice Ministry of Revenue, and improvements to customs control systems.

1.26 The Bank supported the search for alternative reforms to make the SPP financially sustainable.[40] It provided technical assistance to El Salvador's Office of the Superintendent of the Financial System (SSF) for projecting the fiscal costs of the public pension programs, and it financed studies and training to enhance actuarial skills for developing reform proposals. It also made recommendations, several of which were incorporated into the reform, including strengthening the system's institutional framework and making it more equitable.[41]

1.27 The Bank also provided technical assistance to El Salvador to improve remuneration spending efficiency, public procurement processes and systems, and results-based management with a focus on the budget system. In addition, it supported investment project management to boost budget execution capacity and the fulfillment of disbursement targets, with a view to attaining the country's development goals.[42] The Ministry of Finance benefited from IDB financial and technical support for development of the payroll module in SIRH-II.[43]

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[37] Details in the Summary Table of Recent Related Fiscal Operations in El Salvador.

[38] Technical cooperation operations ATN/OC-16234-ES, ATN/FI-12988-ES, ATN/FI-15360, ATN/FI-12417-ES, ATN/KM-10650-ES, and ATN/SF-9888-ES and loan 2269/OC-ES.

[39] Technical cooperation operations ATN/SF-11956-ES, ATN/SF-11796-ES, and ATN/FI-15360-ES, and loans 2296/OC-ES and 2710/OC-ES.

[40] Technical cooperation operation ATN/OC-13798-ES supported the creation of a database for pension reform deliberations, which provided information on labor transitions between the formal and informal sectors and members' views and expectations of the system. The Technical Secretariat of the Office of the President (SETEPLAN) published a diagnostic analysis of the pension system based on data from the longitudinal survey of social protection.

[41] Technical cooperation operations ATN/SF-11951-ES, ATN/OC-14802-ES, and ATN/OC-15675-ES.

[42] Technical cooperation operations ATN/SF-11363-ES and ATN/OC-15728-ES.

[43] Consultancy to Support Implementation of the New Payroll Management Module, financed under technical cooperation operation ATN/OC-16621-ES.

1.28 **Bank experience in the sector.** This program is in keeping with the support that the Bank has provided for reform processes in other countries through investment and policy-based loans, which have aimed to improve tax administration, enhance the quality of public spending, strengthen fiscal sustainability, and reforming pension systems.[44]

1.29 The Bank has extensive experience in providing technical assistance[45] for the implementation of transparency and information exchange standards by countries in the region belonging to the Global Forum. It also coordinates a fiscal transparency support group together with the OECD, CIAT, and the World Bank.

1.30 **Lessons learned.** Lessons learned from the Office of Evaluation and Oversight's (OVE) Country Program Evaluation for El Salvador 2009-2014 and OVE's recommendations in the fiscal area for the IDB Country Strategy with El Salvador 2015-2019 were incorporated into the design of the programmatic series. These included: promoting policy measures for fiscal sustainability; not allowing budget support objectives prevail over reform objectives; and supporting the sustainability of the pension system and preparation of the LRF. This program has also drawn on lessons learned from Bank experience in the sector (paragraph 1.28) and was based on technical inputs generated through technical assistance (paragraphs 1.24 to 1.27), reflecting the complementarity between technical cooperation projects, investment projects, and policy-based loan programs. Lessons learned that were applied during the design of this programmatic series include: (i) addressing fiscal issues in a holistic manner, including revenue, expenditure, and fiscal responsibility measures; (ii) incorporating measures to protect more vulnerable populations from the impact of fiscal adjustment; and (iii) moving forward gradually with reforms that require significant institutional strengthening efforts, as in the case of public procurement.

1.31 Another lesson learned is the importance of technical coordination between international cooperation agencies (paragraph 1.32). In the case of this programmatic series, several of the policy measures have been supported by other donors—particularly USAID in the areas of budgeting, taxation, and public investment. The Bank has made substantial efforts to coordinate with other donors to ensure complementarity between the different interventions, as explained in the following section.

1.32 **Coordination with other donors.** Since the design phase of the programmatic series, the Bank has been engaged in constructive technical coordination with the IMF, the World Bank, and USAID. Together with the World Bank and Ministry of Finance, support was provided for the creation of a donor roundtable to support fiscal policy in El Salvador, chaired by the Minister of Finance and with the

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[44] Further details on Bank operations in the areas of fiscal management, taxation, and tax administration can be found in the Fiscal Policy and Management Sector Framework Document (document GN-2831-8) (IDB, 2018).

[45] Strengthening Fiscal Transparency (technical cooperation operation ATN/AA-16113-RG) and Support for Transparency and Exchange of Information (technical cooperation operation ATN/AA-16708-RG).

participation of other development partners.[46] The dialogue with the IMF has allowed for the sending of joint messages, the exchange of information under the umbrella of the macrofiscal monitoring framework, and a cohesive stance on fiscal policy. Achievement of the policy measures envisioned in the programmatic series required constant coordination with USAID, which has provided technical assistance for developing SAFI-II, COMPRASAL-II, public investment macroprocesses and methodologies, and risk management systems for tax collection.

1.33 **Strategic alignment.** The program is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008) and is aligned with the challenge of social inclusion and equality through the inclusion of a clause in the 2018 Budget Act that states that budget allocations for social programs benefiting women, children, and other vulnerable or poor groups are nontransferable. It also promotes intergenerational equity through pension reform. It is consistent with the development challenge of productivity and innovation through the promotion of technological and management tools to strengthen fiscal sustainability (particularly public investment), such as COMPRASAL-II, the budget formulation and execution module for SAFI-II, and the integration of databases for tax purposes. The program is also aligned with the crosscutting area of institutional capacity and rule of law, through its promotion of the approval and entry into force of legal, regulatory, and operational instruments to improve tax management, enhance public spending efficiency, and strengthen fiscal sustainability. The program will contribute to the Corporate Results Framework 2016-2019 (document GN-2727-6) through the following indicators: government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery, and countries benefitting from IDB projects aimed at improving domestic resource mobilization. The program is aligned with the Sector Strategy on Institutions for Growth and Social Welfare (document GN-2587-2) as it helps strengthen tax administration, public expenditure management, and fiscal sustainability. It is consistent with: (i) the Fiscal Policy and Management Sector Framework Document (document GN-2831-8), since it promotes policies and actions to reinforce fiscal sustainability, stregthen the efficiency of tax administration and the use of public resources, and creating the conditions for the mobilization of private investment for higher growth; and (ii) the Labor Sector Framework Document (document GN-2741-7), since it prioritizes the sustainability of the pension system. It is also aligned with the objectives of the Country Strategy with El Salvador 2015-2019 (document GN-2828), since the expected outcomes of this operation correspond directly to the following strategy objectives: (i) strengthen fiscal sustainability; (ii) improve the efficiency and equity of public spending; and (iii) improve the effectiveness of investment by prioritizing projects with high social returns. The operation is included in the Operational Program Report for 2019 (document GN-2948). Lastly, this operation is aligned with the Plan of the Alliance for Prosperity in the Northern Triangle through the strategic line of stregnthening institutions, as it improves the financial capacity of the State.

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[46] The participating development partners are the IDB, the World Bank, the European Union, USAID, the Spanish Agency for International Development Cooperation (AECID), and Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH [the German Agency for International Cooperation] (GIZ). Oxfam, the Japan International Cooperation Agency (JICA), and Luxembourg participate as observers.

B. Objectives, components, and cost

1.34 The general objective of this programmatic series is to strengthen fiscal sustainability, protecting public investment and social program funding to favor inclusive growth. The specific objectives are to: (i) boost the efficiency of fiscal management (with particular emphasis on the efficiency of public expenditure); and (ii) improve pension sustainability.

1.35 This second operation in the programmatic series complements the first one in supporting a comprehensive package of measures in key fiscal management areas (paragraph 1.1), based on a coordinated approach involving technical design, legal provisions, and implementation. Its action areas have a direct impact on fiscal aggregates and the efficiency of public sector investment and current spending, as reflected in the results matrix for the programmatic series. The first operation supported important legal reforms in the areas of fiscal responsibility and pensions, while the second supports their implementation. In the areas of government procurement and budget reform, the first operation promoted the development of systems and new methodologies that will be consolidated through legal reforms under the second operation. Taken as a whole, the series reflects the Government of El Salvador's structured and ordered approach to strengthening its public finances. The components of this operation are as follows:

1.36 **Component I. Macroeconomic stability.** The objective of this component is to maintain of an appropriate macroeconomic framework that is consistent with program objectives, as established in the Policy Matrix. (Annex II).

1.37 **Component II. Policy reforms and management of public expenditure and revenue.** This component encompasses policy measures in five areas relating to the sustainability, efficiency, and effectiveness of public finances. The modifications, deletions from, and additions to the policy conditions presented below (paragraphs 1.38 to 1.45) do not affect attainment of the development objectives, and thus the original results matrix remains unchanged (see Comparative Matrix).

1.38 **Macrofiscal management.** The specific objective is to create a regulatory framework for fiscal responsibility that promotes the sustainability of public finances. The following original measures remain the same: (i) the fulfillment of measures consistent with the targets for the primary balance (≥0% of GDP) and NFPS pension debt (≤72.9% of GDP)[47] established in the LRF and included in the 2019 budget; (ii) publication of the MLTFF for 2018-2028; (iii) inclusion of a clause in the 2019 Budget Act that states that budget allocations for social programs benefiting women, children, the disabled and elderly, and other vulnerable or poor groups are nontransferable; and (iv) the strengthening of processes, IT tools, and internal controls on payroll spending through the development of electronic payroll software (as part of the SIRH-II human resource information system) to support operations management and payroll processes at central government institutions.

[47] As mentioned above, the modification in 2018 of the base year for the system of national accounts led to a 10.8% drop in nominal GDP, leading to recalculation of the debt target as a percentage of GDP. In the matrix for the first program, the target was under 65%.

1.39 The macrofiscal targets envisaged in the original matrix for the programmatic series were based on the LRF prior to its amendment, which established that the fiscal consolidation period would end in 2019. With the extension of this period to 2021 (as a result of the modifications in 2018), there are no formal targets for 2019. The 2019 budget was evaluated based on the original targets, however, and all were met with the exception of the ceiling of 18.5% of GDP on current spending minus pensions. Once adjusted for the new base year, this amounts to 20.7% of GDP, whereas the expected outcome in the 2019 budget is 21.4% of GDP. This difference is due to the fact that, despite a reduction of 0.4% of GDP in consumption spending from 2018 to 2019, these savings were offset by an increase in debt interest payments (Ministry of Finance, 2019). As a result, this measure, which was included in the original matrix, has been eliminated. It should be noted that the changes to the LRF include replacement of the current expenditure target with a consumption spending target, which excludes interest payments and transfers. The Ministry of Finance considers this change warranted due to the volatility of interest rates.

1.40 **Government procurement management.** The objective is to enhance the efficiency and transparency of government procurement processes. No changes have been made to the policy conditions originally planned for this component, which are focused on consolidating government procurement management: (i) implementation of the public procurement module (phase 2) of the COMPRASAL-II electronic procurement portal, including: (a) developing the second transaction module (competitive bidding) in the COMPRASAL-II portal; (b) approving the operating regulations for procurement using the COMPRASAL-II competitive bidding module; and (c) providing training on the shopping module in COMPRASAL-II and implementing it in at least 30 public sector institutions; and (ii) preparation and submission to the Legislative Assembly of amendments to the Government Procurement Act (LACAP) to incorporate efficient and transparent contracting mechanisms, including the compulsory use of electronic reverse auctions, framework agreements, and electronic catalogues.

1.41 **Results-based budgeting (RBB) and the medium-term expenditure framework (MTEF).** The objective is to promote the implementation of budgetary reforms that link resources to outcomes. The following measure is maintained as originally planned under the program: submission to the Legislative Assembly of draft amendments to the Government Financial Administration Act, establishing mechanisms for planning, programming, execution, and evaluation of the new budgeting system, and making the use of SAFI-II, the MTIF, and the MTEF compulsory. However, the following original measures have been eliminated and replaced with the two measures presented in paragraph 1.42: (i) approval of RBB in 100% of public sector institutions; (ii) implementation of the budget formulation and execution modules in SAFI-II; and (iii) approval by 100% of central government institutions of a MTIF which will, in future, serve as input for the MTEF. Although the programmatic series was expected to culminate with the approval and execution of a results-based budget in 2019, this was postponed to the 2020 budget because the IT modules were not delivered in time for comprehensive execution tests to be conducted before the beginning of the 2019 fiscal year (as explained in detail in paragraph 1.17). This represented a considerable risk, given

that a failure in any one of the computerized financial management systems could have led to a halt in budget execution.

1.42 To ensure that the 2020 budget is formulated and executed using the RBB methodology, the program includes two additional measures that are part of the budget cycle and that lay the regulatory and operational groundwork for RBB. These measures are: (i) approval by the Council of Ministers of a 2020 budget policy mandating the formulation of a results-based budget. The budget policy is a document approved by the Council of Ministers that contains budget formulation instructions for public entities, including expenditure ceilings and the processes and systems that should be used to formulate the budget; and (ii) approval by the Ministry of Finance's DGP of program structures[48] for all entities included in the central government budget.

1.43 **Public investment management and private investment facilitation.** The specific objective is to strengthen public investment management, reduce the costs of red tape for businesses, and facilitate logistics to leverage private investment. All of the policy actions originally planned for the second operation are still included, though one has been deepened:[49] (i) approval of the macroprocess for public investment management, including its conceptual and functional definition; (ii) simplification of public sector administrative procedures through the: (a) approval and entry into force of an Administrative Procedures Act; and (b) implementation of plans for regulatory improvements in five public sector institutions; and (iii) signing of at least two additional agreements with public sector enterprises under the umbrella of the Investment Promotion Fund (API).

1.44 The following new elements have been included in the program to help strengthen it and broaden its scope of action: (i) Ministry of Finance approval (through the DGICP) of a project formulation and evaluation methodology that reflects international good practices in public investment; (ii) approval and entry into force of the Regulatory Improvement Act to create the Regulatory Improvement System; (iii) approval and entry into force of the Elimination of Bureaucratic Barriers Act; and (iv) signing of plans to simplify administrative procedures (for regulatory improvement) in four additional public institutions. Respectively, these additional measures: (i) help strengthen the quality of public investment projects; (ii) help formalize the oversight body for regulatory improvements and improve technical processes to reduce regulatory burdens, with emphasis on facilitating private investment; (iii) help reduce bureaucratic barriers by creating a specialized tribunal; and (iv) reflect the public institutions that have prepared improvement plans.

1.45 **Management of tax collection and tax transparency.** The specific objective is to strengthen institutional capacity for tax collection and assist the country in adhering to international transparency standards. For this second phase, two of the original plan measures have been maintained and one has been modified: (i) strengthen collections management and the Ministry of Finance's tax information and control system through the following measures: (a) launch of the DCTA through the

[48] Program structures are the framework within which entities formulate their budgets, define indicators, and link those indicators to planning targets.

[49] The original condition (2)(i)—"drafting and submitting of an administrative procedures bill"—has been changed to "approval and entry into force" of the law.

establishment of a risk management system for tax and customs debts that accounts for traditional criteria, such as debt age, amount, and sector characteristics, in accordance with the international standards reviewed in a study of comparative implementation at the regional level (CIAT-IDB-GIZ, 2016);[50] and (b) signing of a contract with the National Registry Center (CNR), and implementation of signed agreements and the exchange of information between the National Citizen Registry (RNPN), Salvadoran Social Security Administration (ISSS), and the Salvadoran Institute for the Promotion of Cooperatives (INSAFOCOOP) on one hand, and the Ministry of Finance's internal revenue, customs, and treasury departments on the other;[51] and (ii) prepare draft legislation supporting compliance with the Global Forum on Transparency and Exchange of Information for Tax Purposes beneficial ownership transparency standard, in coordination with CIAT and validated by the Bank and the OECD.[52]

1.46 **Component III. Pension system reform.** The specific objective is the institutional strengthening of the pension system to attain long-term stability, provide lifetime pensions, and improve intergenerational equity. This second operation in the programmatic series maintains the focus on issuing regulations for the implementation of the Pension Savings System (SAP) and Pension Trust Fund (FOP) acts. Of the four measures originally planned under this component, two remain unchanged and two have been deepened[53] and contribute to the attainment of this operation's development objectives. The measures are as follows: (i) implementation of an increase in the SAP contribution rate from 13% to 15% (remaining in force for at least one year), a reduction in contractual payments to AFPs for disability and survivor insurance and administrative fees on individual accounts from 2.2% to 2%, and the issuance of CIPs that reflect an increase in the interest rate from 2.6% to 6%; (ii) approval and publication of regulations governing longevity insurance, including regulations for the Solidarity Guarantee Account (CGS) to finance that insurance; (iii) approval and publication of operating regulations for the Risk Committee and regulations for the Actuarial Committee that determines the minimum pension amount, reviews life expectancy to determine retirement ages, and reviews the adequacy of the CGS; and (iv) implementation of the changes in pension benefits for SPP pensioners,

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[50] Manual de Recaudación y Cobranza de Tributos [Manual on Tax Collection and Recovery] (CIAT-BID-GIZ, 2016) and the technical evaluation of the DCTA's processes manuals by the lead coordinator of the Manual on Tax Collection and Recovery (informative document, 29 January 2019).

[51] The following changes were made to the original matrix: The word "agreement" in relation to the CNR is replaced by "contract," as this is the correct legal modality for ensuring access to CNR information. The reference to "integration of databases" is replaced by "exchange of information," as not all entities that provide data have structured databases that can be effectively integrated with those of the Ministry of Finance, and so the expectation is that computer files will be exchanged on a regular basis.

[52] The wording of this condition differs from the one proposed in the original matrix for the programmatic series. An adjustment was made to clarify the scope of beneficial ownership regulations, but there was no substantive change to the policy measure. This measure complements El Salvador's membership of the Global Forum (supported under the first operation in the programmatic series), as it promotes specific legislation to support compliance with Global Forum standards.

[53] The original conditions (ii) and (iii) under the component—originally envisioned as "preparation"—have been changed to "approval and publication" of the respective regulations. With respect to condition (iii), the operating regulations for the actuarial committee have been added (see Comparative Matrix).

pensioners who migrated from the SPP to the SAP, and disability and survivor pensioners.

1.47 **Beneficiaries.** Fiscal sustainability has direct and indirect benefits for the country's entire population, as it enables uninterrupted financing for government services, raises the quality of public investments, and supports a macroeconomic context that is favorable to production-related activity and development. The program also benefits vulnerable groups (women, children, and the elderly) by promoting specific measures to protect social spending. Lastly, the program benefits the private productive sector through measures that simplify regulations and facilitate investment.

C. Key results indicators

1.48 To measure the expected medium-term effects of the reform measures, a Results Matrix that indicates the impacts, outcomes, and outputs expected under the program was prepared with the borrower. Table 1 summarizes this matrix. Changes have been made to the Results Matrix originally proposed for the programmatic series because the impact and result indicators were recalculated due to the new GDP base year. As mentioned above, the new base year entailed a 10.8% decrease in nominal GDP (see original target compared to adjusted target in Table 1). Outcomes associated with the new measures in the Policy Matrix have also been added, as specified in the Comparison Matrix.

Table 1. Summary of expected results

Indicators	Unit	Baseline		Target*		
		Value	Year	Original	Adjusted	Year
Expected Impact: Stable macroeconomic framework and sustainable fiscal balance						
Impact 1. NFPS primary balance / GDP	%	-1.2%	Average 2013-2015	0.3%	0.34%	2019
Impact 2. Public investment / GDP	%	2.4%	2017	2.8%	3.1%	2019
Impact 3. Annual variation in real GDP ($\frac{PIB\ real_t}{PIBreal_{t-1}}$)-1	%	1.8%	Average 2013-2015	2.3%	2.3%	2019
Specific Objective 1: Improve the efficiency of fiscal management						
Outcome 1. Total NFPS current spending excluding pensions / GDP	%	18.7%	Average 2013-2015	18.5%	20.7%	2019
Outcome 2. Total amount of procurement through the COMPRASAL-II portal / total value of government procurement	%	0%	2017	7%	7%	2019
Outcome 3. Total amount of tax arrears collected during the moratorium / total tax debt during the same period	%	0%	2016	15%	15%	2019
Specific Objective 2: Improve the sustainability of the pension system						
Outcome 4. Total pension spending financed through the FOP / GDP	%	2.0%	2017	1.6%	1.8%	2019
Outcome 5. Annual benefits from the conservative fund / amount invested	%	3.8%	2017	4.8%	4.8%	2019

1.49 **Economic analysis.** Based on OVE's recommendations in its 2011 Evaluability Review of Bank Projects[54] and on the findings of the review of evaluation practices and standards for policy-based loans by the Evaluation Cooperation Group (comprising the independent evaluation offices of the multilateral development banks),[55] as provided for in paragraph 1.3 of the Review of the Development Effectiveness Matrix for Sovereign Guaranteed and Non-sovereign Guaranteed Operations (document GN-2489-5)—both of which indicate that an analysis of efficiency in the use of financial resources is unnecessary—[56] it was determined that an economic analysis would not be carried out for this type of loan, as reported to the Bank's Board of Executive Directors. Accordingly, this loan operation does not include an economic analysis, and therefore the economic analysis is not considered in measuring the evaluability score for this program's Development Effectiveness Matrix.

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[54] Document RE-397-1: "Currently, the economic analysis section is computed as the maximum between the cost-benefit analysis and the cost-effectiveness analysis, yet neither a cost-benefit analysis nor a cost-effectiveness analysis is applicable to PBLs."

[55] Good Practice Standards for the Evaluation of Public Sector Operations. Evaluation Cooperation Group, Working Group on Public Sector Evaluation, 2012 Revised Edition. February 2012.

[56] According to the ECG, PBLs can be evaluated in terms of relevance, effectiveness, and sustainability. Efficiency was not included as a criterion, since the size of the PBL is related to a country's financing gap, independent of the project's benefits.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 This operation is structured as a programmatic policy-based loan (the second in a series of two operations), based on the guidelines and directives established in the lending framework (document GN-2200-13) and in “Policy-based Loans: Guidelines for Preparation and Implementation. Update” (document CS-3633-2).

2.2 **Operation amount.** Consistent with paragraph 3.27(b) of “Policy-based Loans: Guidelines for Preparation and Implementation. Update” (document CS-3633-2), the size of the operation was based on the country’s fiscal resource needs for the 2019 fiscal year. The government’s financing needs, as authorized in the 2019 budget, are US$1.3 billion, including a bond issue to refinance debt of US$800 million and borrowing of US$497 million to bridge the budget gap for the year. This operation provides US$200 million (40%) to close the budget gap, and the government plans to issue bonds to cover the remainder. It should be noted that the Bank is the main source of multilateral financing in the country, accounting for 53.3% of total multilateral debt (Ministry of Finance, 2019).

B. Environmental and social risks

2.3 In accordance with Directive B.13 of the Environment and Safeguards Compliance Policy (Operational Policy OP-703), this operation does not require classification. The operation supports the definition of policies, rules, management tools, and other institutional strengthening actions that do not generate any environmental or social impacts. The program will not finance any infrastructure or civil works components.

C. Fiduciary risks

2.4 No fiduciary risks associated with the operation have been identified. The financial instrument used does not include procurement, and the proceeds of this operation will be disbursed directly into the treasury single account to cover financing requirements. The executing agency has suitable financial management tools and control systems for this purpose. The proceeds will be disbursed once the policy measures established in the loan contract have been fulfilled.

D. Other risks and key issues

2.5 **Fiscal sustainability risk.** There is a medium risk that public expenditure will grow more than expected due to rising interest rates, increased municipal transfers, or other external factors such as increases in the oil bill. This could hinder compliance with outcome indicator 1. Although this risk cannot be completely controlled, the IDB will continue its policy dialogue with the outgoing and incoming authorities,[57] providing a technical foundation for budget decisions. The support of the development community is vital for enabling mitigating measures, and the donor roundtable to support fiscal policy in El Salvador makes this support a reality (paragraph 1.32). Although the country does not have an active IMF program, visits as part of the Article IV consultations are extremely useful for building consensus around fiscal consolidation measures.

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[57] The President-elect takes office on 1 June 2019.

2.6 **Public management and governance risk.** Three public management and governance risks have been identified and are classified as medium: (i) reforms to the Government Procurement Act (LACAP) or its regulations may not be approved in a timely manner or with the planned content due to the priorities of the Legislative Assembly or a lack of technical capacity in the Ministry of Finance to develop the regulations, thus limiting use of the COMPRASAL-II platform and hindering compliance with outcome indicator 2. To mitigate this risk, the IDB will continue to monitor and support the process of drafting and approving LACAP, while also providing technical assistance for the regulations and training; (ii) when crossreferencing databases to increase collections, third-party information may be deficient or incomplete, affecting compliance with outcome indicator 3. To mitigate this risk, the quality of the data supplied by entities such as the CNR and RNPN has been reviewed, and technical support for INSAFOCOOP is planned to ensure the quality of data for tax purposes; and (iii) there may be a significant delay in legislative ratification of the loan, which could delay disbursement and create an imbalance in financing for 2019. Although the 2019 budget law already authorizes borrowing by the government, this is considered to be a medium risk because legislative ratification will be requested by an incoming government with low representation in the Assembly. To mitigate this risk, the Bank is engaged in an ongoing dialogue regarding fiscal matters with the Legislative Assembly commission and is providing the necessary technical support to the Ministry of Finance using resources from the technical cooperation agreement that supports this operation.[58]

2.7 **Reform sustainability.** The programmatic series comes to a close at a time of government transition. Although it is generally aligned with the plan of the incoming administration, the Government of El Salvador will need to continue strengthening its institutional and technical capacity to ensure that the reform consolidation measures proposed here come to fruition. This operation supports the submission of three pieces of draft legislation to the Legislative Assembly, which will require the government's attention if they are to be approved with the planned content and within the expected time frame, before continuing with the development of associated regulations and implementation. Similarly, the new government will require institutional and managerial capacity in order to comply with LRF parameters, consolidate budget and public investment reform processes, and deepen improvements to the procurement system. The Bank has the necessary human and financial resources (including technical cooperation funding) to support the new government in promoting the sustainability of the reforms and to deepen the technical dialogue surrounding other measures with fiscal impact (paragraph 1.32). The IMF will continue to monitor the macroeconomic situation through its Article IV visits.

2.8 Consolidation of the reform program in the medium term will require future measures, including a tax reform to improve income tax yield and implement a property tax, combating evasion of the value-added tax, tightening control over increases in current spending (particularly the wage bill), and improving the targeting of subsidies for electricity, water, liquid petroleum gas, and public

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[58] Support for Strengthening Tax Administration and Fiscal Policies for Inclusive Growth (technical operation ATN/OC-16234-ES). See Summary Table of Recent Related Fiscal Operations in El Salvador.

transportation. The incoming administration has proposed several of these measures in its plan for government (Plan Cuscatlán), which—with assistance from the Bank and other development partners—will further fiscal sustainability and inclusive growth.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 **Borrower and executing agency.** The Borrower will be the Republic of El Salvador through the Ministry of Finance. The executing agency is responsible for: (i) maintaining official communication with the Bank (either directly or by assigning responsibility) and submitting reports and evidence of compliance with conditions under the operation and any other reports that are required, pursuant to the agreed time frames and conditions; (ii) promoting actions to attain the policy objectives established in the program; and (iii) compiling, filing, and providing the Bank with all information, indicators, and parameters that contribute to monitoring, measuring, and evaluating the program's results.

3.2 The Ministry of Finance will be responsible for coordinating the fulfillment of the measures in the programmatic series and will coordinate with the DGICP in compiling the necessary information. The Ministry of Finance will use the institutional means at its disposal to ensure effective coordination among public agencies as regards the policy measures included in this operation. It will also cooperate with the Bank in coordinating with these agencies to facilitate the monitoring of policy actions.

3.3 **Special contractual conditions precedent to the sole loan disbursement: The first and only disbursement under this operation is contingent on compliance with the policy reform conditions included in the policy matrix (Annex II), the Policy Letter, and the other conditions set out in the loan contract.**

B. Summary of arrangements for monitoring results

3.4 **Monitoring.** Once the operation has been declared eligible, the Ministry of Finance will provide the information required to verify fulfillment of the operation's progress indicators and full implementation of agreed reforms.

3.5 To execute the program, the Bank has implemented the following strategy: (i) appoint a principal specialist as team leader, based in El Salvador; (ii) provide the necessary technical assistance in areas that have already been identified; (iii) organize special missions to coincide with key points in the design and implementation of the operation; and (iv) working with the government, conduct close monitoring to anticipate and adequately resolve the risks and strategic, technical, and coordination difficulties associated with execution of the operation. Both compliance with the measures and the administration's performance will be evaluated, determining corrective measures and good management practices where necessary (Monitoring and Evaluation Plan).

3.6 **Evaluation.** The evaluation strategy will have two parts. The first involves monitoring, which will be performed through official reports that will include detailed information and evidence of compliance with the conditions under the programmatic series. The second covers ex post program evaluation. The main questions to be included in the evaluation will address attainment of the desired impacts and outcomes in terms of fiscal sustainability (Monitoring and Evaluation Plan). A project completion report (PCR) will be also prepared when execution of the programmatic series is complete.

IV. POLICY LETTER

4.1 The Policy Letter reiterates the government's commitment to the objectives and actions pursued by the programmatic operation as a whole. The Bank and the Government of El Salvador have also agreed on a policy matrix that describes the policy actions under this programmatic operation.

Development Effectiveness Matrix		
Summary		
I. Corporate and Country Priorities		
1. IDB Development Objectives	**Yes**	
Development Challenges & Cross-cutting Themes	**-Social Inclusion and Equality -Productivity and Innovation -Institutional Capacity and the Rule of Law**	
Country Development Results Indicators	**-Government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery (#)* -Countries benefited by IDB's projects aimed at improving domestic resource mobilization (#)***	
2. Country Development Objectives	**Yes**	
Country Strategy Results Matrix	**GN-2828**	**(i) Strengthen fiscal sustainability; (ii) Improve the efficiency and equity of public spending; and (iii) Improve the effectiveness of investment by prioritizing projects with high social returns**
Country Program Results Matrix	**GN-2948**	**The intervention is included in the 2019 Operational Program.**
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution	**9.6**	
3.1 Program Diagnosis	**3.0**	
3.2 Proposed Interventions or Solutions	**3.6**	
3.3 Results Matrix Quality	**3.0**	
4. Ex ante Economic Analysis	**N/A**	
5. Monitoring and Evaluation	**6.7**	
5.1 Monitoring Mechanisms	**2.5**	
5.2 Evaluation Plan	**4.2**	
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood	**Medium**	
Identified risks have been rated for magnitude and likelihood	**Yes**	
Mitigation measures have been identified for major risks	**Yes**	
Mitigation measures have indicators for tracking their implementation	**Yes**	
Environmental & social risk classification	**B.13**	
IV. IDB´s Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)	**Yes**	**Financial Management: Budget, Treasury, Accounting and Reporting, Internal Audit. Procurement: Information System, Price Comparison.**
Non-Fiduciary	**Yes**	**Statistics National System.**
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	**Yes**	**Technical assistance and financing was provided for the development of the SIRH-II payroll module, MH was advised on the modernization of the LACAP Law, and an international review of the Law proposal on Ultimate Beneficial Owner was coordinated**

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

This is the second operation of the two that comprises this Programmatic Loan to Support Policy Reforms (PBP). This PBP consists of two contractually independent and technically linked loans The general objective is to strengthen fiscal sustainability, protecting public investment and financing of social programs to promote inclusive growth. The specific objectives are: (i) to improve the efficiency of fiscal management, with special emphasis on the efficiency of public spending and (ii) to improve the sustainability of the pension system.ES

The diagnosis presented indicates the main problem as low fiscal sustainability. The specific problems identified are: (i) inadequate macro fiscal management, (ii) low efficiency in public procurement management, (iii) inadequate budget management, specially lack of connection with medium and long term goals, (iv) inefficiency of public and private investment management, (v) low efficiency of collection management and low tax transparency, and (vi) increasing demand for fiscal resources for the pension system. The main causes of these problems are: (i) lack of fiscal rules, (ii) deficiencies in the legal, operational and technological framework for public procurement processes, (iii) lack of a budget model based on results, (iii)) strategic, functional and operational shortcomings in the management of public and private investment (iv) inadequate organizational structure for debt collection and (v) absence of an institutional framework to undertake reforms for a sustainable pension system. The main beneficiaries are all the citizens of El Salvador. Increasing efficiency in public expenditure management release resources that can be spent in more public goods, public investments and social programs.

The PBP presents adequate evidence of internal (but not external) validity for the proposed solutions. The vertical logic is clear and well specified. The Result Matrix is adequately constructed. The PBP identifies and adequately addresses the monitoring and evaluation requirements. It also proposes an ex post economic analysis to estimate the fiscal financial savings resulting from the intervention. The PBP's overall risk is rated Medium. Risks are mainly related to fiscal sustainability and governance. Mitigation measures were identified with appropriate monitoring indicators.

POLICY MATRIX

Objective: The general objective of this programmatic series is to strengthen fiscal sustainability, protecting public investment and social program funding to favor inclusive growth. The specific objectives are to: (i) boost the efficiency of fiscal management (with particular emphasis on the efficiency of public expenditure); and (ii) improve pension sustainability.

Components/ Policy Objectives	Policy conditions Programmatic operation I	Policy conditions Programmatic operation II	Status of compliance with conditions for Programmatic operation II[1]
Component I. Macroeconomic stability			
Macroeconomic stability	1.1 Maintenance of an appropriate macroeconomic framework that is consistent with program objectives, as established in the Policy Matrix.	1.1 Maintenance of an appropriate macroeconomic framework that is consistent with program objectives, as established in the Policy Matrix.	Achieved
Component II. Policy reforms and management of public expenditure and revenue			
Macrofiscal management	2.1 Approval and entry into force of the LRF, containing the following minimum measures for the NFPS: (i) Fiscal rules that set caps on the primary balance and government borrowing; and (ii) Creation of the medium- and long-term fiscal framework (MLTFF).	2.1 Fulfillment of measures consistent with the targets for the primary balance (≥ 0%) and the NFPS pension debt (≤ 72.9% of GDP) established in the LRF for the 2019 budget.	Achieved 4th quarter 2018
	2.2 Publication of the MLTFF (2017-2027), including aggregate projections for the main fiscal variables as a guide for fiscal policy.	2.2 Publication of the MLTFF (2018-2028).	Achieved 3rd quarter 2018

[1] This information is purely indicative as of the date of this document. In accordance with "Policy-based Loans: Guidelines for Preparation and Implementation" (document CS-3633-2), the fulfillment of all disbursement conditions, including the maintenance of an appropriate macroeconomic framework, will be verified by the Bank upon receipt of the disbursement request from the Borrower and reflected in a timely manner in the disbursement eligibility memorandum.

Components/ Policy Objectives	Policy conditions Programmatic operation I	Policy conditions Programmatic operation II	Status of compliance with conditions for Programmatic operation II[1]
	2.3 Inclusion of measures for compliance with the LRF in the 2018 budget: (i) Prohibition on creating positions not provided for in the budget, new financial benefits for public employees, and the purchase of extravagant goods and equipment; and (ii) Clause that states that budget allocations to finance social programs benefiting women, children, the elderly, family farmers, and other vulnerable and poor groups are nontransferable.	2.3 Inclusion of a clause in the 2019 Budget Act that states that budget allocations for social programs benefiting women, children, the disabled and elderly, and other vulnerable or poor groups are nontransferable.	Achieved 4th quarter 2018
	2.4 Strengthening of processes and internal controls on payroll spending in the Ministries of Education and Health and the National Water and Sewer Administration through studies on payroll optimization, with recommendations for improving the efficiency of payroll management.	2.4 Strengthening of processes, IT tools, and internal controls on payroll spending through the development of electronic payroll software (as part of the SIRH-II human resource information system) to support operations management and payroll processes at central government institutions.	Achieved 1st quarter 2019
Government procurement management	3.1 Implementation of the COMPRASAL-II electronic procurement portal, beginning with the shopping module (phase 1), including: (i) Approval and entry into force of measures making it compulsory for all government institutions to gradually migrate to COMPRASAL-II; (ii) Approval of operating rules for procurement conducted through the COMPRASAL-II shopping module; and (iii) Training in and implementation of the shopping module in at least 15 public sector institutions[2].	3.1 Implementation of the public procurement module (phase 2) of the COMPRASAL-II electronic procurement portal, including: (i) Development of the second transactional module in the COMPRASAL-II portal (competitive bidding); (ii) Approval of operating rules for procurement using the COMPRASAL-II competitive bidding module; and (iii) Training in and implementation of the COMPRASAL-II competitive bidding module in at least 30 public sector institutions.	Achieved 2nd quarter 2019 Achieved 2nd quarter 2019 Achieved 2nd quarter 2019

[2] The institutions include at least 5 of the 13 ministries of the executive branch.

Components/ Policy Objectives	Policy conditions Programmatic operation I	Policy conditions Programmatic operation II	Status of compliance with conditions for Programmatic operation II[1]
	3.2 Elimination of the use of brokers for central government institutions in the reverse auctions administered by the Salvadoran Goods and Services Exchange (BOLPROS).	3.2 Preparation and submission to the Legislative Assembly of amendments to the Government Procurement Act (LACAP) to incorporate efficient and transparent contracting mechanisms, including the compulsory use of electronic reverse auctions, framework agreements, and electronic catalogues.	Achieved 2nd quarter 2019
Results-based budgeting (RBB) and the medium-term expenditure framework (MTEF)	4.1 Replacement of the system of budgeting by management areas with a new RBB system (phase 1): (i) Training of the employees responsible for the budget and planning in 100% of public sector institutions, in accordance with the training and technical assistance plan for the implementation of budget system reforms; (ii) Development of at least 95% of the budget formulation and execution modules in the SAFI-II integrated financial management system; (iii) Preparation of pilot plans for a medium-term institutional framework (MTIF) in at least five institutions[3] as an input for the MTEF; and (iv) Approval of a new edition of the Public Sector Financial Transactions Classification Manual, to be used as the basis for formulating and executing RBB.	4.1 Replacement of the system of budgeting by management areas with an RBB system (phase 2): (i) Submission to the Legislative Assembly of draft amendments to the Government Financial Administration Act, establishing mechanisms for planning, programming, execution, and evaluation of the new budgeting system, and making the use of SAFI-II, the MTIF, and the MTEF compulsory; (ii) Approval by the Council of Ministers of a 2020 budget policy mandating the formulation of a results-based budget; and (iii) Approval by the Ministry of Finance's Budget Department of program structures for all entities included in the central government budget.	(i) Achieved 2nd quarter 2019 (ii) Achieved 2nd quarter 2019 (iii) Achieved 2nd quarter 2018

[3] Ministry of Health; Ministry of the Economy; Ministry of Education; Ministry of Public Works, Transportation, Housing, and Urban Development; and the Salvadoran Institute for Comprehensive Child and Adolescent Development.

Components/ Policy Objectives	Policy conditions Programmatic operation I	Policy conditions Programmatic operation II	Status of compliance with conditions for Programmatic operation II[1]
Public investment management and private investment facilitation	5.1 Improvement of the system for public investment management by coordinating investment projects with the new RBB system, including pilot projects with at least four central government institutions, as well as progress in preparing the conceptual and functional model for the public investment system.	5.1 (a) Approval of the macroprocess for public investment management, including its conceptual and functional definition.	Achieved 1st quarter 2019
		5.1 (b) Ministry of Finance approval (through the Investment and Public Credit Administration (DGICP)) of a project formulation and evaluation methodology reflecting international good practices in public investment.	Achieved 2nd quarter 2019
	5.2 Simplification of administrative procedures affecting business (i) Publication of the Regulatory Improvement Agency's operations manual to determine the organizational and functional structure of the agency's different areas; and (ii) Signing of plans for simplifying administrative procedures (regulatory improvements) for companies in at least five public institutions.	5.2 Simplification of public sector administrative procedures by: (i) Approval and entry into force of an Administrative Procedures Act that simplifies procedures, general rules, and the use of new technologies in public administration procedures; (ii) Approval and entry into force of the Elimination of Bureaucratic Barriers Act; (iii) Approval and entry into force of the Regulatory Improvement Act to create the Regulatory Improvement System; (iv) Signing of plans for simplifying administrative procedures (regulatory improvements) for companies in four additional public institutions; and (v) Implementation of plans for simplifying administrative procedures (regulatory improvements) for companies in five public institutions.	 Achieved 1st quarter 2019 Achieved 1st quarter 2019 Achieved 4th quarter 2018 Achieved 1st quarter 2019 Achieved 2nd quarter 2019

Components/ Policy Objectives	Policy conditions Programmatic operation I	Policy conditions Programmatic operation II	Status of compliance with conditions for Programmatic operation II[1]
	5.3 Implementation of an Investment Promotion Fund (API)[4] through the following measures: (i) Approval and publication of instruments governing the API; and (ii) Signing of at least two agreements with private enterprises.	5.3 Signing of at least two additional agreements with public sector enterprises under the umbrella of the API.	Achieved 2nd quarter 2018
Management of tax collection and tax transparency	6.1 Implementation of a program to strengthen collection management and the Ministry of Finance's tax information and control system, through the following measures: (i) Creation of a Tax and Customs Arrears Division (DCTA) to improve management of enforced collection; (ii) Signing of agreements to integrate databases belonging to public agencies—including the National Citizen Registry (RNPN), the Salvadoran Social Security Administration (ISSS), and the Salvadoran Institute for the Promotion of Cooperatives (INSAFOCOOP)—with the Ministry of Finance; and (iii) Approval and entry into force of a temporary law to facilitate voluntary compliance with tax and customs obligations.	6.1 Strengthen collection management and the Ministry of Finance's tax information and control system through the following measures: (i) Launch of the DCTA through the establishment of a risk management system for tax and customs debts; and (ii) Signing of a contract with the National Registry Center (CNR) and implementation of signed agreements and exchange of information between the RNPN, CNR, ISSS, and INSAFOCOOP on one hand, and the Ministry of Finance's internal revenue, customs, and treasury departments on the other.	 Achieved 1st quarter 2019 Pending 2nd quarter 2019
	6.2 Inclusion of El Salvador as a full member of the Global Forum and satisfactory compliance with the standard of exchange of tax information on request with other member jurisdictions.	6.2 Preparation of draft legislation supporting compliance with the beneficial ownership transparency standard issued by the Global Forum on Transparency and Exchange of Information for Tax Purposes.	Achieved 2nd quarter 2019

[4] The API is a nonreimbursable line of support designed to provide public goods and services to facilitate and supplement private investment. The regulatory tools establish that it functions under a competitive and transparent process to identify, complement, and leverage private investment.

Components/ Policy Objectives	Policy conditions Programmatic operation I	Policy conditions Programmatic operation II	Status of compliance with conditions for Programmatic operation II[1]
Component III. Pension system reform			
Institutional strengthening of the pension system to attain long-term stability, provide lifetime pensions, and improve intergenerational equity	7.1 Approval and entry into force of the Pension Savings System (SAP) Act and the Pension Trust Fund (FOP) Act, which include the following measures as a minimum: (i) A change in the SAP contribution rate from 13% to 15%; a reduction in contractual payments to pension fund administrators (AFPs) for disability and survivor insurance and administrative fees on individual accounts from 2.2% to 1.9% in 2022, and an increase in the interest rate on CIPs from 2.6% to 6%; (ii) Creation of longevity insurance to ensure continuous and permanent income for old-age and survivors pensioners, and creation of a Solidarity Guarantee Account (CGS) to finance the longevity insurance; (iii) Establishment of a risk committee to determine investment caps for the different types of instruments and minimum risk ratings for the instruments invested in the pension funds, and creation of an actuarial committee to determine minimum pension amounts, review life expectancy for determining the retirement age, and review the adequacy of the CGS; and (iv) Modification of pension benefits through the following measures: (a) cap of US$2,000 on the maximum monthly benefit for SPP pensioners; (b) incorporation of a maximum pension of 55% of earnings into the pension-calculation formula for workers who migrated from the SPP to the SAP; and (c) a reduction in disability and survivor pensions from 70% to 50% of earnings.	7.1 Issuance of regulations for the implementation of the SAP and FOP acts, including the following minimum measures: (i) Implementation of an increase in the SAP contribution rate from 13% to 15%, (remaining in force for at least one year), a reduction in contractual payments to AFPs for disability and survivor insurance and administrative fees on individual accounts from 2.2% to 2%, and the issuance of CIPs that reflect an increase in the interest rate from 2.6% to 6%; (ii) Approval and publication of regulations governing longevity insurance, including regulations for the CGS to finance that insurance; (iii) Approval and publication of operating regulations for the Risk Committee and regulations for the Actuarial Committee that determines the minimum pension amount, reviews life expectancy to determine retirement ages, and reviews the adequacy of the CGS; and (iv) Implementation of the changes in pension benefits for SPP pensioners, pensioners who migrated from the SPP to the SAP, and disability and survivor pensioners.	Achieved 3rd quarter 2018 Achieved 1st quarter 2019 Achieved 1st quarter 2019 Achieved 1st quarter 2019

RESULTS MATRIX

Objective:	The general objective of this programmatic series is to strengthen fiscal sustainability, protecting public investment and social program funding to favor inclusive growth. The specific objectives are to: (i) boost the efficiency of fiscal management (with particular emphasis on the efficiency of public expenditure); and (ii) improve pension sustainability.

EXPECTED IMPACT

Indicators	Unit of Measure	Baseline	Baseline year	Target[1]		Year Final	Means of Verification	Comments
				Original	Final			
Stable macroeconomic framework and sustainable fiscal balance								
Indicator 1. Nonfinancial public sector (NFPS) primary balance / GDP	%	-1.2%	Average (2013-2015)	0.3%	0.34%	2019	Ministry of Finance, Annual Report on Management of the Public Finances	**Baseline:** Primary balance = Total revenue - (total spending - interest payments) To attenuate the cyclical aspects of the variable, the average for 2013-2015 is used as the baseline.
Indicator 2. Public investment / GDP	%	2.4%	2017	2.8%	3.1%	2019		**Baseline:** Gross public investment = US$757.7 million
Indicator 3. Annual variation in real GDP **($\frac{PIB\ real_t}{PIBreal_{t-1}}$)-1**	**%**	1.8%	Average (2013-2015)	2.3%	2.3%	2019	Statistics on El Salvador's System of National Accounts, Central Reserve Bank (BCR).	**Baseline:** average growth rates for the 2013-2015 period. Use of the average allows growth trends to be captured better over a longer period and smooths out any positive or negative factors that affected growth in a specific year.

[1] The original target is the one included in the document for the first policy-based loan in the series. The adjusted target is the original target recalculated to account for the new GDP base, which is 10.8% lower. The original target is included for the purposes of comparison.

EXPECTED OUTCOMES

Indicators	Unit of Measure	Baseline	Baseline year	Target		Final year	Means of Verification	Comments[2]
				Original	Final			
Specific Objective 1: Improve the efficiency of fiscal management								
Indicator 1. Total NFPS current spending excluding pensions / GDP	%	18.7%	Average (2013-2015)	18.5%	20.7%	2019	Treasury data.	Preliminary data from the Economic and Fiscal Policy Department show current NFPS spending of 20.1% of GDP in 2019. The definition of current spending includes interest payments, according to the initial definition in the Fiscal Responsibility Act (LRF). This was changed with the amendments to the LRF.
Indicator 2. Total amount of procurement through the COMPRASAL-II electronic procurement portal / total value of government procurement	%	0.0%	2017	7%	7%	2019	COMPRASAL-II statistics.	Initial value 2017: Total public procurement recorded in the national budget: US$900 million.
Indicator 3. Total amount of tax arrears collected during the moratorium / total tax debt during the same period	%	0%	2016	15%	15%	2019	Statistics from the Tax and Customs Arrears Division (DCTA) in the Ministry of Finance.	Tax debt as of October 2016: US$560 million.
Specific Objective 2: Improve sustainability of the pension system								
Indicator 4. Total pension spending financed through the Pension Trust Fund (FOP) / GDP	%	2.0%	2017	*1.6%*	1.8%	2019	Ministry of Finance fiscal statistics.	Before and after comparison.

Indicators	Unit of Measure	Baseline	Baseline year	Target		Final year	Means of Verification	Comments[2]
				Original	Final			
Indicator 5. Annual benefits from the conservative fund / amount invested	%	3.8%	2017	*4.8%*	4.8%	2019	Publication of statistical reports on the pension system by the Office of the Superintendent of the Financial System (SSF).	Conservative fund nominal yield (net of administration fee) The conservative fund establishes a maximum investment in variable yield securities of 20% so that changes in securities markets will not have a significant impact on the value of pension savings. The 2017 figure is for October 2016 to October 2017, before and after comparison.

OUTPUTS

Outputs	Unit of Measure	Baseline	Year Baseline	2018[2]	2019	Final Target (2019)	Means of Verification	Comments
Component II. Policy reforms and management of expenditure and revenue								
Macrofiscal management								
LRF approved and in force	Law	0	2016	1		1	Publication of Legislative Decree No. 533 in the Official Gazette. LRF.	
Medium- and long-term fiscal framework (MLTFF) published	Document	0	2016	1	1	2	Publication of MLTFF on the Ministry of Finance website.	The MLTFF is submitted alongside the annual budget law each year for the approval of the Legislative Assembly, and its baseline and targets are updated for a 10-year period.

[2] The 2018 targets relate to the outputs of the first operation in the series (loan 4542/OC-ES).

Outputs	Unit of Measure	Baseline	Year Baseline	2018[2]	2019	Final Target (2019)	Means of Verification	Comments
Budget laws with clauses for LRF compliance approved	Laws	0	2016	1	1	2	Publications in the Official Gazette of the budget laws for the 2018 and 2019 fiscal years.	Amendment of the LRF means that there are no quantitative targets for 2019.
Technical Secretariat of the Office of the President (SETEPLAN) report on payroll optimization, with recommendations for the Ministries of Health and Education and the National Water and Sewer Administration, completed	Reports	0	2016	1		1	SETEPLAN reports on payroll optimization consultancies for the Ministries of Health and Education and the National Water and Sewer Administration	
Electronic payroll software (as part of the SIRH-II human resource information system) to support the payroll and operations management processes of central government institutions, implemented	Computer program	0	2017		1	1	Report of the National Financial Administration and Innovation Department (DINAFI) certifying the development of the electronic payroll software.	This software refers to a module that will be integrated into the SAFI-II integrated financial management system at a later stage.
Government procurement management								
Regulations under the Government Procurement Act (LACAP) making it compulsory for all government institutions to gradually migrate to COMPRASAL-II, approved and in force	Regulation	0	2016	1		1	Executive decree - Amendment of the regulations under LACAP.	
Guidelines to procurement using the COMPRASAL-II shopping module, including operating rules, approved	Guidelines	0	2017	1		1	Government Procurement and Contracting Regulatory Unit (UNAC) guideline 01-2017, operating rules for procurement using the shopping module in COMPRASAL-II.	

Outputs	Unit of Measure	Baseline	Year Baseline	2018[2]	2019	Final Target (2019)	Means of Verification	Comments
Shopping module implemented and being used in public institutions	Transaction module	0	2017	1		1	UNAC report certifying implementation of the transaction module.	
Public institutions trained in the use of the COMPRASAL-II shopping module	Public institutions	0	2016	15	30	45	UNAC report certifying the number of institutions trained in the use of the shopping module.	
Law eliminating the use of brokers for central government institutions in the reverse auctions administered by the Salvadoran Goods and Services Exchange (BOLPROS), approved	Law	0	2017	1		1	Legislative Decree 875, Amendment of the Goods and Services Exchange Act.	
Competitive bidding module for the COMPRASAL-II portal developed	Transaction module	0	2017		1	1	UNAC report certifying development of the competitive bidding module.	
Guidelines to procurement using the COMPRASAL-II competitive bidding module, including operating rules, approved	Guidelines	0	2017		1	1	UNAC guidelines that establish the rules for procurement using the competitive bidding module in COMPRASAL-II.	
Draft LACAP amendments incorporating efficient and transparent contracting mechanisms developed and submitted to the Legislative Assembly	Draft legislation	0	2017		1	1	Copy of the draft LACAP amendments submitted by the Presidency to the Legislative Assembly, incorporating these mechanisms.	

Outputs	Unit of Measure	Baseline	Year Baseline	2018[2]	2019	Final Target (2019)	Means of Verification	Comments
Results-based budgeting and the medium-term expenditure framework								
Public institutions with trained budget and planning officials	Public institutions	1	2015	114		114	Budget Department (DGP) memorandum.	Training in accordance with the training and technical assistance plan for the implementation of budget system reforms.
A new edition of the Public Sector Financial Transactions Classification Manual approved	Manual	0	2016	1		1	Ministry of Finance Executive Agreement.	
Pilot medium-term institutional framework (MTIF) plans prepared	Pilot plans	0	2016	5		5	Ministry of Finance report certifying the approval of at least five MTIFs.	
A 2020 budget policy mandating the formulation of a results-based budget approved.	Policy	0	2016		1	1	2020 budget policy incorporating results-based budgeting (RBB) approved by the Council of Ministers.	
Public institutions with validated budget programs	Public institutions	0	2015		114	114	Note from the Ministry of Finance's DGP submitting the approved program structures.	
SAFI-II budget formulation and execution module developed	Module	0	2016		1	1	DGP and DINAFI report.	
Draft amendments to the State Financial Management Act (AFI) submitted to the Legislative Assembly	Draft legislation	0	2017		1	1	Copy of the draft AFI amendments submitted by the Presidency to the Legislative Assembly.	

Outputs	Unit of Measure	Baseline	Year Baseline	2018[2]	2019	Final Target (2019)	Means of Verification	Comments
Pilot investment project plans, coordinated with the new RBB system, prepared	Pilot plans	0	2017	4		4	Investment and Public Credit Administration (DGICP) report on the development of pilot tests for public investment projects in at least four executing agencies.	
Public investment management and private investment facilitation								
Model macroprocess for public investment management prepared and approved	Document	0	2017	0	1	1	Conceptual model of the public investment system approved by the DGICP.	The macroprocess will be designed in 2018 and is expected to be approved in 2019.
Project formulation and evaluation methodology reflecting international good practices in public investment approved	Document	0	2017	0	1	1	Project formulation and evaluation methodology approved by the DGICP.	
Regulatory Improvement Agency (OMR) operating manual published and available online	Manual	0	2017	1		1	Publication of the OMR operating manual.	Established under Article 16, Section 3 of Executive Decree 90, Creation of the OMR.
Public administrative procedures simplification act approved and published	Law	0	2017		1	1	Publication of the Administrative Procedures Act in the Official Gazette.	
Elimination of Bureaucratic Barriers Act approved and published	Law	0	2017		1	1	Publication of the Elimination of Bureaucratic Barriers Act in the Official Gazette.	

Outputs	Unit of Measure	Baseline	Year Baseline	2018[2]	2019	Final Target (2019)	Means of Verification	Comments
Regulatory Improvement Act approved and published	Law	0	2017		1	1	Publication of the Regulatory Improvement Law in the Official Gazette.	
Plans for simplifying administrative procedures (regulatory improvements) for companies at public institutions signed	Plans	0	2017	5	4	9	Regulatory improvement plans signed by ministries.	The regulatory improvement plans establish specific actions to simplify administrative procedures, with a view to facilitating business creation and business compliance with periodic obligations. The first five regulatory improvement plans have been signed with the Ministries of the Interior and Regional Development, Finance, the Economy, Health, and Public Works.
Plans for simplifying administrative procedures (regulatory improvements) for companies implemented at five public institutions public institutions	Plans	0	2017		5	5	OMR report on the implementation of regulatory improvement plans.	The plans to be implemented are from the following five ministries: the Interior and Regional Development, Finance, the Economy, Health, and Public Works.

Outputs	Unit of Measure	Baseline	Year Baseline	2018[2]	2019	Final Target (2019)	Means of Verification	Comments
Manuals for the Investment Promotion Fund (API) approved and published	Manual	0	2017	2		2	Investor and project evaluation manuals published by FOMILENIO.	FOMILENIO is a special program that falls under the SETEPLAN institutional umbrella.
Investment agreements with private companies under the API framework signed	Investment agreements	0	2017	2	2	4	Investment agreements signed with private companies under the API framework.	Published by FOMILENIO.
Management of tax collection and tax transparency								
DCTA created	Department	0	2016	1		1	Ministerial agreement creating the DCTA.	Ministerial agreement 1817 of 5 December 2016.
Manual for the tax and customs debts risk management system prepared by the DCTA and published	Manual	0	2017		1	1	Independent consultant report confirming the creation of the risk management system.	
Temporary law to facilitate voluntary compliance with tax and customs obligations approved	Law	0	2016	1		1	Publication in the Official Gazette of the temporary law to facilitate voluntary compliance with tax and customs obligations.	Decree 889 of 17 January 2018 extended the law.
Information exchange agreements or contracts between the Ministry of Finance and four public sector institutions signed	Agreement	0	2016	3	1	4	Agreement or contract documents signed between the Ministry of Finance and the government institutions.	The agreements signed are between the Ministry of Finance and the National Citizen Registry (RNPN), Salvadoran Social Security Administration (ISSS), and the Salvadoran Institute for the Promotion of

Outputs	Unit of Measure	Baseline	Year Baseline	2018[2]	2019	Final Target (2019)	Means of Verification	Comments
								Cooperatives (INSAFOCOOP), and the contract signed is between the Ministry of Finance and the National Registry Center (CNR).
Report on the exchange of information between the Ministry of Finance and the RNPN, CNR, ISSS, and INSAFOCOOP	Report	0	2016		1	1	Ministry of Finance report on the exchange of information.	
Standard of exchange of information on request implemented and approved by the Global Forum	International Standard	0	2016	1		1	Global Forum Annual Report.	Approval by the Global Forum.
Draft legislation supporting compliance with the beneficial ownership transparency standard issued by the Global Forum on Transparency and Exchange of Information for Tax Purposes prepared	Draft law	0	2016		1	1	Draft legislation supporting compliance with the beneficial ownership transparency standard issued by the Global Forum on Transparency and Exchange of Information for Tax Purposes, prepared in coordination with the Inter-American Center of Tax Administrations (CIAT) and submitted to the Organization for Economic Cooperation and Development (OECD).	

Outputs	Unit of Measure	Baseline	Year Baseline	2018[2]	2019	Final Target (2019)	Means of Verification	Comments
Component III. Pension system reform								
Amended Pension Savings System (SAP) Act approved.	Law	0	2017	1		1	Publication in the Official Gazette.	
Amended Pension Trust Fund (FOP) Act	Law	0	2017	1		1	Publication in the Official Gazette.	
Risk committee that determines investment caps by instrument type and minimum risk ratings for the instruments invested in the pension funds established	Committee	0	2017	0	1	1	Regulations for the SAP risk committee, establishing the procedure for electing committee members, published by the BCR.	
Actuarial committee that determines minimum pension amounts, reviews life expectancy to determine the retirement age, and reviews the adequacy of the Solidarity Guarantee Account (CGS) created	Committee	0	2017	0	1	1	Regulations for the SAP actuarial committee, establishing the procedure for electing committee members, published by the BCR.	
Longevity insurance that ensures continuous and permanent income for old-age and survivors pensioners implemented	Insurance	0	2017	0	1	1	Publication of the regulations and technical standards for the CGS issued by the BCR Standards Committee.	Technical Standards: (i) for granting old-age benefits under the SAP; and (ii) for the administration and management of the CGS.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-_/19

El Salvador. Loan _____/OC-ES to the Republic of El Salvador
Fiscal Strengthening for Inclusive Growth II

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of El Salvador, as borrower, for the purpose of granting it a financing to cooperate in the execution of the project " Fiscal Strengthening for Inclusive Growth II''. Such financing will be for the amount of up to US$200,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on __ _________ 2019)

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