PUBLIC SECTOR MODERNIZATION PROGRAM

(ES-0036)

EXECUTIVE SUMMARY

BENEFICIARY:	The Republic of El Salvador
EXECUTING AGENCIES:	The Ministry of Finance and the Comisión Presidencial para la Modernización del Sector Público [Presidential Commission for Modernization of the Public Sector] (CPMSP)/Technical Coordinating Unit (UTC)
AMOUNT AND SOURCE:	IDB (sector loan) from the resources of the Single Currency Facility of the ordinary capital, in the amount of up to US$70 million, that are part of those resources.
FINANCIAL TERMS AND CONDITIONS:	Amortization period (OC): 25 years Disbursement period (OC): 2 years Interest rate: variable Inspection and supervision: 1% Credit fee: 0.75%
OBJECTIVES:	The main purpose of the Bank's financing is to support the government's efforts to implement the structural reform of the public administration and sector reforms with a view to promoting increased private-sector participation in the delivery of public services, in infrastructure sectors that the government considers to have priority under the Programa de Modernización del Sector Público [public sector modernization program] (PMSP). Specifically, the program will support the government's efforts to: (i) consolidate, improve, and expand public-sector reforms in terms of macroinstitutional restructuring, human resource management, and tax administration, including reform of public finances management, in order to maximize efficiency in the use of public funds; and (ii) support sector reforms (electricity, telecommunications, and transportation) with a view to increasing private-sector participation in the delivery of public services and the respective privatization processes, in order to develop efficient sectors through competition, free access, readjustment of the State's role, and implementation of the necessary regulations.

DESCRIPTION:

The proposed sector program is comprised of two main areas:

Public administration reform. This component will support the government's actions in the macro-institutional restructuring being carried out to make public sector entities more efficient, to ensure that public finances and tax administration are managed efficiently and to provide comprehensive human resources management in keeping with the goals of the PMSP. In tax administration the aim is to maximize the effectiveness of fiscal management by setting up a system for the management of the government's finances and integrating it with the administration of taxes and customs.

Sector reforms. This component will support the government's efforts to implement sector reforms (in electric power, telecommunications and transportation) for greater participation by the private sector in the delivery of public services. The specific measures will be designed to (i) put into effect the regulatory framework for the electric power sector, privatize the electricity distributors, and restructure the Comisión Ejecutiva Hidroeléctrica del Río Lempa [Executive Committee of the Lempa River Hydroelectric Company] (CEL) into independent generation and transmission units to enable the electric power sector to operate competitively; (ii) in the telecommunications sector, to put into effect the new regulatory framework and privatize the Administración Nacional de Telecomunicaciones [National Telecommunications Administration] (ANTEL); and (iii) to make the organization and operation of the transportation sector as effective as possible, modernize the Ministry of Transportation and Public Works (MOP) and encourage participation by the private sector in road maintenance and rehabilitation services.

ENVIRONMENTAL CLASSIFICATION:

The Environment Committee, at its meeting of August 20, 1996, classified this as a Category III operation. The environmental summary was approved by the CESI on April 25, 1997.

BENEFITS:

The program's overall benefit is to achieve new forms of institutional, political and social management and organization that are compatible with the government's new strategy of streamlining the public sector and state intervention in the economy.

Private participation in the energy and telecommunications sectors and in road maintenance will enable the country's infrastructure services to become more

efficient and release resources for activities that remain responsibilities of the State, such as education and health.

RISKS:

One of the most important risks lies in the fact that the reforms require a political commitment. Support at the highest political level is essential to successful execution of the program. A modernization process that is not properly organized can generate conflicts within the public sector and raise obstacles to modernization efforts under way independently in other economic and social sectors. This risk shrinks appreciably when it is considered that the government has demonstrated its commitment to reform by setting up a Presidential Commission for Public Sector Modernization and appointing a Commissioner with ministerial rank, and by implementing a number of reforms in addition to reforms in the energy and telecommunications sectors, among others.

Another risk is the possibility of resistance to reform and to privatization by interest groups, which may take the form of actions against the program. Reforms are being instituted that have a high political cost, such as those involving the restructuring of institutions, downsizing and privatization in the energy and telecommunications sectors, among others. These measures are being discussed with civil society and their implementation is well advanced.

THE BANK'S COUNTRY AND SECTOR STRATEGY:

The program is consistent with the government's strategy, and its economic and social framework is likewise in line with the Bank's strategy for El Salvador as set forth in the country programming paper. The principal areas of the Bank's support include: (i) social reform and local development; (ii) the environment and sustainable development; (iii) development of the private sector and promotion of activities with potential; and (iv) modernization of the State. Under this program the Bank will be supporting the restructuring of the public sector, including the privatization of ANTEL and the CEL, the latter in the electric power distribution subsector.

SPECIAL CONTRACTUAL CONDITIONS:

This sector operation is structured in two tranches, the first in the amount of US$30 million and the second, US$40 million. The conditions for disbursements from each tranche, which will be part of the loan contract, are set forth in paragraphs 3.10 and 3.11 of the document. In addition, the loan contract will include the Bank's standard clauses regarding, *inter alia*, audits, tenders, and regular meetings.

I. FRAME OF REFERENCE

A. Macroeconomic characteristics

1.1 El Salvador has made major economic, social and political gains since the beginning of the decade. The end of the war and signing of the peace agreements comprised a profound social and political transformation that involved international supervision. Significant macroeconomic reforms were carried out, which enabled the country to step up the pace of its growth, increase employment and consumption, and streamline the financial system. In addition, a successful process of public sector reform has been launched and many elements are in place for modernization to proceed at a rapid pace.

1.2 The aim of the economic program of President Calderón, who took office in June 1994, is to carry the structural reforms further so as to consolidate macroeconomic stability and move forward with the structural reforms. Thus, the Fiscal Delinquency Law has been approved to support fiscal efforts, and the private portfolio operations of the Central Bank have been transferred to Banco Multisectorial de Inversiones (BMI) to improve their administration. Also approved were the Law on Capital Markets and the Law on Banking Institutions (the latter was amended in December 1995 to allow the entry of foreign banks). Also in 1995, a Presidential Commissioner for Public Sector Modernization was appointed, among other purposes to give momentum to the privatization process. A law has been enacted to streamline employment in the public sector (Law 471 on Monetary Compensation), the Law on the Comprehensive Financial Administration of the State has been approved, privatization of the telecommunications enterprise is moving forward, and provision has been made for participation of the private sector in electric power service.

1.3 The multilateral institutions and international financial community have been providing ongoing support to the country's economic program. In particular, the World Bank has granted financing for two structural adjustment programs (SAL I and II, in February 1991 and March 1993) and for investment projects. IDB support has gone primarily for projects in the transportation, electric power, financial and social sectors, notably the investment sector reform program (loan 714/OC-ES for US$90 million, approved on November 25, 1992). Altogether, external aid aggregating more than US$800 million (IDB US$520 million) was provided from 1990 to 1995. Moreover, the government has entered into several stand-by arrangements with the IMF (1990, 1992, 1993, 1995), the most recent in February 1997 covering a 14-month period (see paragraph 1.7).

1.4 The results of the economic policy have been favorable in some areas and modest in others. Economic recovery has been evidenced

by high rates of GDP growth, which since 1990 has averaged 5.5% a year, the highest in Latin America after Chile and Peru.

1.5 The government's efforts to reform the tax structure, simplification of the tax administration, the imposition of a value-added tax (VAT) in 1992 and its subsequent increase to 13% in June 1995, compilation of a large taxpayers register and the laws implemented to control tax evasion, and a reduction in public spending contributed to a reduction of the fiscal deficit from 4.7% of GDP in 1989 to 2% in 1996.

1.6 Reducing the fiscal deficit combined with improved money management, stabilization of the nominal exchange rate, increased competition from imported goods, and the recovery of GDP helped improve the control of inflation, which dropped from 19.3% in 1990 to 7.4% in 1996.

1.7 On February 28, 1997, the IMF approved a 14-month stand-by arrangement for US$52 million in support of the government's economic program for 1997. The purpose of this program is to reform public finances while increasing spending on infrastructure, keeping monetary policy on its current sound course and persevering with structural reform. In 1997 real GDP growth of 4% is expected, along with a reduction of the overall deficit of the nonfinancial public sector to 1.4% of GDP, a reduction of inflation to a 5% to 6% range, and an increase of net international reserves to the equivalent of five months of imports.

1.8 However, the recovery experienced by the country since 1990 was led by domestic demand in a situation of idle installed capacity and pent-up demand. With domestic demand now saturated, growth will depend on external demand, for which more production capacity is required, higher rates of investment, and a more substantial level of domestic savings. 1/

1.9 The present level of domestic savings in El Salvador (15% of GDP) is not high enough to finance steady economic growth. It is barely two percentage points above the 1980 level and below the Latin American average (20%). Only in 1995 did private savings climb back to rates similar to those of 1980. Meanwhile, after growing at very modest rates during the 1980s, public savings have been recovering steadily since 1992 but remain very low. Though external resources have complemented domestic savings and have

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1/ The medium term is crucial for the country because, though the economy is expected to recover in 1997, to be followed by growth rates of around 5%, these rates only amount to a growth of per capita income averaging 2% a year, which does not assure the goal of reducing the high level of poverty in the population. To move from economic recovery to sustained growth of GDP and per capita income calls for steady expansion of the economy at rates above 7%.

permitted an investment rate similar to the Latin American average (20% of GDP), that level is not high enough for the country to post adequate, sustained growth rates.

1.10 To raise public savings, public finances must be consolidated so that tax revenue may be increased, 2/ for which it is imperative to continue with tax reform, place more emphasis on the control of tax evasion, and foster the strengthening of the institutions that design tax policy and collect the taxes. On the expenditure side, it will be essential to strengthen the financial administration to attain a rational spending policy with reduced expenditures for public services through privatization, and effective programming of public investment.

B. Public administration

1.11 Despite the considerable political and economic progress of the preceding years, the Salvadorian public sector remains plagued by institutional weaknesses and inefficiencies, which are being targeted in the public sector reform programs: (i) institutional weakness caused by inflated staffing levels 3/ and centralization of government; (ii) inefficiency from the extremely rigid, overstaffed organizational structure, with pronounced financial weakness and poor use of human resources, and a low level of technical training of its civil service; and (iii) inefficient service delivery – the public sector continues to monopolize the delivery of infrastructure services in the country and many of the public services (telecommunications, electric power and highway maintenance, for example) that could be more efficiently performed by the private sector.

1.12 This situation results in inefficiencies that affect society as a whole, reduce competitiveness of the economy, and make it difficult to address the greatest challenge facing the country, which is to fight and eradicate poverty. In particular, the bureaucratism of government and its excessive involvement in activities that could be delegated make it more difficult for private enterprise to generate more opportunities for employment and personal advancement in the country, and to be competitive abroad and so obtain more resources and foreign exchange.

2/ The tax burden has grown from 7.6% of GDP in 1989 to 11.8% in 1995, which is still below the Latin American average (16% of GDP) and the level attained by the country in 1986.

3/ The public sector employs about 140,000 people, 90,000 of them in the central government and 50,000 in the autonomous agencies. The composition of the public-sector work force reveals a combination of overstaffing, particularly at the lower levels, and an insufficient number of qualified people in the higher ranks of the public administration.

C. Sector characteristics

1.13 **Electric power sector.** This sector consists of the Comisión Ejecutiva Hidroeléctrica del Río Lempa [Executive Committee of the Lempa River Hydroelectric Company] (CEL) — a state-owned enterprise — five electric power distribution enterprises (four of them owned by the CEL), and one private generation company (Nejapa Power). In 1995 public electric power services had an installed generating capacity of 909 MW (388 MW hydroelectric, 325 MW thermal, 105 MW geothermal, and 91 MW private thermal) to meet a maximum demand of 592 MW. The system has a total of 920 km of transmission lines, 806 km of subtransmission lines, and 20,400 km of distribution lines, and delivers power to 803,000 users.

1.14 Only 70% of the generating capacity is actually available owing to lack of maintenance and obsolescence. The transmission and distribution systems were seriously damaged by the civil war. The service is unreliable and transmission losses are high. The distribution system is overloaded and unreliable because of the growth of demand in the last few years and the limited investments made over the last decade.

1.15 The sector has had no legal framework that would ensure conditions for the establishment of an efficient and competitive electric power system with the same clear rules for all its participants (both public and private).

1.16 The leading problems throughout the energy sector are the lack of coordination among the government agencies in the sector and the lack of regulations and of a regulatory agency immune from political interference that could control the abuses of the electric power and hydrocarbon monopolies.

1.17 **The telecommunications sector** of El Salvador has been one of the weakest in Latin America. In the 1990-1995 period, however, its coverage increased substantially from 2.9 lines per 100 inhabitants in 1989 to 5.3 lines in 1995. That period also saw an improvement in efficiency, from 22 lines per employee in 1989 to 71 in 1995. These levels are still low because the Administración Nacional de Telecomunicaciones [National Telecommunications Administration] (ANTEL) engages in many activities unrelated to the service which could be subcontracted, such as the administration of a hospital and of construction and movables, and because it retains the monopoly on the services and the policy-setting and regulatory functions are in the same institution. The sector has also been without a satisfactory legal and institutional framework that could permit free competition and lay down simple but clear rules for the different participants in the sector (government and private).

1.18 Like many government monopolies, ANTEL is a large source of revenues for the general budget. In 1993 it had profits of 555 million

colones (US$63.6 million). Until 1994 more than 80% of these profits came from expensive international calls. In 1995 the rates were adjusted, reducing the cost of international calls and raising that of local calls.

1.19 **Transportation sector.** The infrastructure of the transportation sector in El Salvador suffered considerable deterioration in the 1980s because of inadequate maintenance, low productivity of maintenance operations, and institutional weakness of the organizations managing it. These deficiencies are associated chiefly with insufficient financing, ineffective planning, and low technical capacity of the personnel, and were aggravated during the armed conflict, to the detriment particularly of the road subsector.

1.20 Because of these problems, only 18% of the national road system for which the Ministry of Public Works, Transportation, Housing, and Urban Development (MOP) is responsible (9,840 km) is in good condition, while 60% is in poor condition. More than 75% of the urban streets need to be rehabilitated, improved, and provided with traffic control devices, chiefly in the metropolitan area of San Salvador.

1.21 As a result of insufficient planning, the budgetary allocations, based on previous fiscal years, have been insufficient in view of the analysis of the real needs of the road system. The problem of insufficient funds is compounded by low productivity of maintenance work and a bloated work force, which absorbs 88% of the budget, leaving only 12% to cover materials and equipment needs.

1.22 The MOP has launched a modernization process and is drawing up a restructuring plan aimed at improving the quality of services by resizing or redefining the institution in keeping with the role of a modern and efficient government that encourages the private sector.

D. The government's public sector modernization program (PMSP)

1.23 The general object of the PMSP is to make the structures in the sector consistent with the demands of the country in a highly competitive world in which national economies are obliged to dismantle bureaucratic barriers and introduce technological advances while preserving government by rule of law.

1.24 Given this general object of the PMSP, the Salvadorian government's specific objectives are to introduce competition in the delivery of public services; adapt the institutional structure of the Executive Branch to the new role and functions that befit in a modern State; foster new modalities for the delivery of public services while making them more accessible to the population; provide the civil service with technical training, promoting a new organizational culture that finds expression in new attitudes, values and princi-

ples of customer service on the part of public servants; optimize the management of the public finances, targeting modernization efforts on tax administration and implementing the integrated financial management system; and establish mechanisms for effective control that make the management of public resources transparent without generating needless costs.

1.25 In view of the diversity of measures, actors and specialized areas involved in the process of transformation of the public sector, the Salvadorian government has established the following areas of reform to carry out the process:

1.26 Institutional restructuring and bureaucratic streamlining. Over the next four years the reform will encompass the Ministries of Finance, Foreign Affairs, Public Works, Environment, Education, Health and Agriculture, and seek to reduce operating costs, support the enhancement of competitiveness and eliminate, simplify or redesign processes that affect the development of the private sector and of civil society in general. 4/

1.27 Integrated financial administration system (SAFI). Includes reforms to the budget, accounting, treasury and public credit sub-systems, with an integrated systems approach. A complementary part of this line of action will be reforms to the tax and customs administration system. 5/

1.28 Reform of the human resources system. The PMSP emphasizes the establishment of policies and procedures that foster the productivity and development of civil servants. To this end a new system will be implemented characterized by policy-making centralization and operational decentralization to the institutions supported by modernization of computer technology. There will be special emphasis on management development and training programs in key posts and on the consolidation of career service.

1.29 Private participation in public services. This will enable the Government of El Salvador to release resources for activities of high priority such as education and health and to adapt the public administration to its new role in a market economy.

4/ The primary strategy for the execution of this component is based on the development of the project "El Salvador Eficiente," which is being executed by the public and private sectors together. The project focuses on improving the services provided by public institutions and envisages the polling of private entrepreneurs on the obstacles encountered by them in dealings with the government and suggestions for eliminating them.

5/ The purchasing and public contracting system will also be modernized in the context of the administration modernization program.

1.30 Reform of the pension system 6/ and the programs for modernization of the education and health sectors, now in implementation.

1.31 The proposed sector program (described in chapter II) would encompass PMSP components in the areas of institutional restructuring, tax and human resources administration, and in the privatization of infrastructure services (energy, telecommunications and road maintenance).

1.32 In November 1995 the President of the Republic appointed a Presidential Commissioner for Public Sector Modernization. He also created a Presidential Commission for Public Sector Modernization (CPMSP), whose members are the Presidential Commissioner, the Ministers of Finance and of Economic Affairs, the technical coordinating unit of the PMSP (UTE), with its own suitable technical staff and budget; the reform groups responsible for implementation of the reforms in the ministries and decentralized entities, and the integrated financial units (UFIs).

E. The Bank's strategy and support for the reforms

1.33 The program is consistent with the government's strategy, and its economic and social framework is in line with the Bank's strategy for El Salvador as set out in the country programming paper. The principal areas of the Bank's support include: (i) social reform and local development; (ii) the environment and sustainable development; (iii) development of the private sector and promotion of activities with potential; and (iv) modernization of the State. Under this program the Bank will be supporting the restructuring of the public sector, including the privatization of ANTEL and the CEL, the latter in the electric power distribution subsector.

1.34 With this operation the Bank complements consistently the actions under its strategy in support of the government's efforts to modernize the State and so to play a leading role in this modernization process with the programs for tax administration modernization, electric power development, support for justice system reform, and institutional strengthening of the MOP. With the investment sector reform program it is also supporting the growing participation of the private sector in the formulation and execution of the government's institutional development and reform strategies. These efforts toward greater participation by the private sector in the delivery of public services began in 1991 as part of the government's efforts to establish free markets and promote the growth of the private sector.

1.35 IDB support for the government's reform effort is part of an ongoing process that began with the investment sector reform

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6/ This reform is being supported by the World Bank.

program (loan 714/OC-ES - US$90 million). 7/ The purpose of this program was to support a wide variety of policy reforms to stimulate domestic and foreign investment and make the economy more efficient, and to lay foundations for the development of regulatory frameworks for the telecommunications and energy sectors and the plan for restructuring the MOP. 8/ This program was fully disbursed when all its objectives were accomplished.

1.36 In the area of tax administration reform, two technical cooperation loans (941/OC for US$3.8 million and 980/OC-ES for US$15,936,000) 9/ are financing a program to (i) modernize the financial administration of the public sector; (ii) strengthen the tax auditing area and the management capability of the respective agency; (iii) make customs management more effective; and (iii) streamline and simplify the procurement and contracting system. This recently-approved program complements the one proposed in the present document and furnishes parallel technical cooperation.

1.37 With electric power development programs I and II the IDB is supporting the restructuring of the energy sector. These programs comprise loan 731/OC-ES for US$125 million, approved in 1991 for the basic purpose of rehabilitating and extending the Salvadorian electric power system and restoring the reliability of electric power supply in the country, and loan 838/OC-ES for US$215 million, approved in 1994 to provide the infrastructure needed to keep pace with the growth of demand for electric energy in the country by rehabilitating and expanding the systems.

1.38 **In the transportation sector**, IDB loans 844/SF-ES, 653/OC-ES and 870/SF-ES, 839/OC-ES and 840/OC-ES, aggregating US$389 million, are financing the rehabilitation of major highways, rural roads and urban streets. These operations include measures to strengthen road administration and planning and modernize the transportation sector and policies on automotive public services and infrastructure. 10/

7/ Approved on November 25, 1992.

8/ Using MIF resources (TC-93-09-50-2) complementary standards and regulations were drawn up for implementation of the new legal and institutional framework of the telecommunications and electric power sectors, establishment of the regulatory body for those sectors, and the study of the restructuring of ANTEL, and studies were done for the drafting of the General Superintendency of Electric Power and Telecommunications (SIGET) Law and the General Law on Electric Power.

9/ Approved in July 1996.

10/ Loans 839/OC-ES and 840/OC-ES include a study for the formulation of alternative arrangements for the financing of road maintenance.

1.39 In addition, the Government of El Salvador, with support from the Bank, is initiating implementation of an environmental project (El Salvador environmental protection program – PEAS – in the amount of US$30 million), which has the following main objectives: (i) to strengthen environmental management in El Salvador by improving the regulatory framework and strengthening the capacity of the respective institutional framework to take action; and (ii) to help reduce the degradation of renewable natural resources in the upper Lempa River basin by diversifying agroforestry activities to contribute to soil conservation. This program is coupled with two technical-cooperation operations in support of environmental management.

1.40 In parallel with the IDB program and to round it out, the World Bank (WB) is supporting the Government of El Salvador in its implementation of public sector reforms in the areas indicated hereafter. In this reform process the IDB and WB are operating in coordination to avoid duplications of effort. Also, the Government of El Salvador has set up an institutional structure (the newly-created CPMSP and UTC) that is coordinating all the reforms being implemented in the country with support from different sources of financing.

1.41 **Institutional restructuring and bureaucratic streamlining.** The WB is assisting the Government of El Salvador with a plan to redefine the functions and size of the public sector and also to identify the services to be performed by the government and those that could be provided by the private sector. 11/

1.42 **Modernization of human resources administration.** The WB is assisting the government in (i) implementing an efficient, accessible integrated central database on all the human resources of the public sector – the integrated human resources system (SIRH), and its connection with the IDB-financed financial administration system; (ii) designing and developing a new system of grades and salaries for the civil service; (iii) framing and developing a policy on human resources; (iv) completing the development of the legal framework; and (v) providing training and instruction.

1.43 **Participation of the private sector in the provision of public-sector services.** The World Bank is supporting the government in the establishment of new institutional rules and provisions for the delivery of public services, including total or partial privatization and the development of new forms of participation by the private sector in the delivery of services, mainly in ports, airports and pension systems. It is also providing direct technical assistance to strengthen the privatization group to guide

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11/ The Bank worked with the WB in the preliminary design of a restructuring plan.

and coordinate the program; equipment for the establishment of the regulatory agencies for the water supply and transportation sectors and a regulatory framework for private participation in the water supply and sanitation sectors, and in the transportation sector (ports and airports). In addition, it is providing assistance in support of selected public utilities (ANTEL and the CEL), financing services of accountants, lawyers, investment banks and other financial advisors, environmental specialists and other experts, to prepare for the sale of enterprises.

1.44 **In the environmental area**. The World Bank is also assisting the government in the area of environmental protection and the formulation of policies for this purpose during the privatization process, especially in the areas of energy, water supply and sanitation, and ports and airports. To do this, it has agreed with the government that (i) environmental requirements will be established for the privatization of public enterprises; (ii) environmental audits will be performed before enterprises are privatized or concessions awarded; (iii) plans of action for the mitigation of environmental externalities will be completed; and (iv) the institutional capability of the public institutions will be increased for the performance of audits, monitoring and the improvement of environmental legislation. There is also a commitment to provide foreign and domestic consultants for the accomplishment of these environmental objectives.

1.45 Finally, other noteworthy projects support the reorganization and institutional strengthening of the Ministries of Education 12/ and Health and the efforts to increase the development of the private sector through the program to increase competitiveness financed by the World Bank.

1.46 Also worth mentioning is the support of UNDP, and the Inter-American Center of Tax Administrators (CIAT) in areas of taxation and customs administration (these efforts are being coordinated under the PMSP), and other efforts supported by the GTZ, UNDP and USAID in areas of modernization, and particularly in municipal decentralization and strengthening.

1.47 Execution of these reform programs will modernize the organizational structure of the public sector and make possible effective implementation of economic and social policies. El Salvador will then have instruments, systems and policies that will improve the management of its public finances and human resources and enable its institutions to function more effectively, and the private sector to play a larger role in the delivery of public services, thereby improving them.

12/ The Bank and the World Bank are working together in this sector.

II. THE SECTOR PROGRAM

A. Objectives of the program

2.1 The principal objective of the Bank's financing is to support the government's efforts to implement the structural reforms in the public administration and sector reforms, with a view to promoting increased private-sector participation in the delivery of public services, in infrastructure sectors that the government considers to have priority under the Programa de Modernización del Sector Público [public sector modernization program] (PMSP). Specifically, the program will support the government's efforts to: (i) consolidate, improve, and expand public-sector reforms in terms of macroinstitutional restructuring, human resource management, and tax administration, including reform of public finances management, in order to maximize efficiency in the use of public funds; and (ii) support sector reforms (electricity, telecommunications, and transportation) with a view to increasing private-sector participation in the delivery of public services and the respective privatization processes, in order to develop efficient sectors through competition, free access, readjustment of the State's role, and implementation of the necessary regulations.

B. Rationale of the loan modality

2.2 Implementing the reforms associated with the public sector modernization program implies significant expenditures that are now being met with short- and medium-term financial obligations. 13/ The use of domestic funds or conversion of reserves to retire these debts could impact on macroeconomic performance and on the monetary and external goals agreed upon with the IMF under the recently concluded stand-by arrangement. These impacts on macroeconomic equilibrium in general would mainly affect the government's capacity to attain the social spending targets set for 1997 (4.8% of GDP) and the years thereafter.

2.3 Other reform-generated financial commitments are also scheduled, such as financing for the workers, employees and officers of the CEL and the four electric power distribution enterprises to

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13/ Under the Law on Temporary Compensation for Services to the Public Sector (Legislative Decree 471), the government paid off about 14,000 employees of the central government and autonomous and decentralized institutions who volunteered for this program. To fund these reductions in force the government issued treasury notes (LETES) maturing in 180 and 210 days in the equivalent of US$77 million. These obligations were covered by funds deposited in the Central Bank for its capitalization and by fresh LETES issues, for a total of about US$115 million.

purchase shares in those enterprises. This provision is in the Law on the Sale of Shares in the Electric Power Distribution Enterprises.

2.4 Implementation of the proposed program would generate a fiscal outlay in the equivalent of not less than US$130 million, as explained in the preceding paragraphs. IDB support to this program in the form of a sector loan is appropriate for two basic reasons: (i) the policy matrix that reflects the structure of the program and links it to the disbursements from the Bank's loan and the sector policy letter both provide for close, effective monitoring of execution of the PMSP and, at the same time, permit the Bank to provide technical and policy support on specific matters that may arise during implementation of the PMSP, and (ii) the proceeds of the loan will finance eligible imports. The free availability of the Bank's financial resources, once disbursed, will enable the Salvadorian government to release other resources to cover a sizable portion of the expenditures incurred in the reform of the public sector, and so minimize the impact of those outlays on domestic equilibrium (fiscal/monetary).

C. Components of the program

2.5 The proposed sector program is comprised of two principal areas: public administration reform, and sectoral reforms and privatization. The measures indicated in the policy matrix (Annex I) are complementary components consistent with the measures and activities being carried out with support from the IDB and the World Bank under the PMSP.

1. Public administration reform

2.6 This component will support the government's actions in the macroinstitutional restructuring being carried out to improve the efficiency of public sector entities, reduce their size, and ensure efficient management of public finances and tax administration and integrated human resources management that is in line with the goals of the PMSP.

a. Macroinstitutional restructuring

2.7 This component will support the launching of a transformation and modernization process involving the institutions of the Executive Branch to streamline their functional organic structure, redesign their operating processes and procedures, adjust the numbers and composition of their personnel and update their legal framework. To accomplish these objectives, the government has drawn up a macroinstitutional restructuring proposal, for which the CPMSP will have to sign agreements that include plans for the restructuring of ministries and decentralized institutions. The government has identified the Ministries of Finance, Foreign Affairs, Public Works, and Environment as the areas in which the reform will be set

in motion. The restructuring of the Vice Ministry of Public Works of the Ministry of Public Works, Transportation, Housing, and Urban Development (MOPTVDU) will complement, and be compatible with, the measures to strengthen the sector being supported by the Bank, through close coordination between the Bank, the World Bank, and the government.

b. Tax administration

2.8 Issuing regulations to implement the Laws on the Tax Code and Customs violations will improve the collection and control of taxes and so reduce tax evasion. The Basic Law on Financial Administration of the State created the integrated financial administration system (SAFI) in order to set up and put into operation in the entities of the public sector the principles, standards, organization, programming, and coordination of the budgetary, treasury, public credit and government accounting procedures that would govern and coordinate the financial management of the public sector. A gradual merger of these subsystems would make the monetary flows of the balance of payments, the fiscal sector and the financial sector mutually compatible, and allow prices and real production to evolve in a setting of macroeconomic stability that would contribute to attainment of the government's economic and social objectives. Meanwhile, integrating the tax and customs subsystems represents an important step toward modernization, government efficiency, and an increase in fiscal revenues and improved performance of those services.

c. Administration of human resources

2.9 The purposes of this component would be to support the Salvadorian government in the consolidation of a new legal, technical and institutional structure that could standardize public service in the country. The approval of a new Civil Service Law strengthens the reforms in the human resources sector. The purpose of reforming the administration and management of human resources is to lay down policies and procedures that help professionalize the civil service as an essential element for the attainment of higher levels of efficiency and effectiveness in government action. The government has the political will to implement an extensive reform program, and has drawn up a plan that focuses its actions on: (i) endowing the central government with the institutional capability to administer, monitor and control its human resources; (ii) gradually developing a quality civil service of an appropriate size; and (iii) establishing conditions for the motivation and development of, and incentives for, its human resources.

2. Sector reforms

a. Electric power sector

2.10 As previously mentioned, important advances have been made in the restructuring and privatization of the sector: (i) passage of several laws (the General Law on Electric Power (LGE), the law creating SIGET, the Law on the National Fund for Investment in Electric Power and Telecommunications, and the Law on the Sale of Shares in the Electric Power Distribution Companies); and (ii) the commissioning of a study for the restructuring of the CEL with a view to setting up the institutions needed for the operation of the competitive market called for in the LGE.

2.11 The fundamental principles of these laws (the LGE and the SIGET law) are: (i) development of a competitive market in the generation, transmission, distribution and marketing of electric power; (ii) free access for generating entities to the transmission and distribution facilities subject to no limitations other than those prescribed by law; (iii) sound and efficient use of resources; (iv) encouragement of access to the electric power supply for all sectors of the population; and (v) protection of the rights of users and of all entities operating in the sector. 14/

2.12 The government intends to begin the privatization process with the sale of the shares of the distributing enterprises now owned by the CEL. Privatization of the generating enterprises will be based on the results of the study for the restructuring of the CEL.

2.13 To proceed with the privatization of the electric power sector, it is necessary that: (i) the regulations implementing the LGE and the law creating SIGET be in force; (ii) SIGET be organized to regulate the sector; (iii) a study be available for the restructuring and privatization of the CEL into independent generating enterprises, a transmission company and a transactions unit, in order to move forward with execution of the plan for restructuring the CEL; and (iv) a plan be in place to incorporate the private sector into the companies resulting from the restructuring of the CEL.

2.14 It is expected that a controlling share in the distribution companies that together account for at least 50% of the volume of electricity distributed nationwide can be transferred to private

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14/ The new legal, institutional and regulatory framework will permit the participation of different generating, transmitting, distributing and marketing enterprises. The coordinated operation of the transmission system and the wholesale market will be in the hands of the Transactions Unit, in which all operators connected to the main transmission system will participate.

investors, including the workers, employees and officers of the electric power sector.

2.15 Programs that contribute to democratic governance, stability in the country, and the viability of the process of state modernization and privatization are of particular importance to the Government of El Salvador. The Law on the Sale of Shares in the Electric Power Distribution Companies, approved by the Legislative Assembly spells out the guidelines for participation by the workers, employees and officers of the electric power sector (up to 20% of the shares in the company at a price that is at least 20% below that paid by the strategic investor, and authorization for the CEL to arrange for or guarantee financing on preferential terms). This provision would make the workers, employees and officers of the CEL participants in the privatization process. The government has undertaken to present to the Bank a plan to ensure this participation by the workers (see Policy Matrix).

b. Telecommunications sector

2.16 The principal aims of the reforms to be made in the sector are to put the new regulatory framework into force and to accomplish the privatization of ANTEL. The government has a General Law on Telecommunications and a study for the development of a competitive sector in telecommunications. On the basis of these elements and the provisions of the Law Establishing SIGET, and with approval of the Law Privatizing ANTEL (approved by the Legislative Assembly on July 26, 1997), in 1998 the government expects to complete the privatization of that company, which is at an advanced stage of preparation with the support of external consultants, and on the verge of selecting by competitive bidding the strategic partners for the successor companies to ANTEL as prescribed in Articles 17 and 18 of the Law Privatizing ANTEL (see the policy matrix in Annex I).

2.17 Completion of the stages referred to in the foregoing paragraph and the sale of shares to the strategic partners for the two successor companies to ANTEL will assure competitiveness and open participation in the privatization process. The aforementioned privatization law also establishes the conditions for the sale of shares to the workers and favorable financing terms and conditions, and provides for the sale of shares to the public.

c. Transportation sector

2.18 The modernization of this sector includes a modernization plan for the MOPTVDU under which, based on existing studies, mechanisms will be identified that ensure financial sustainability of road rehabilitation and maintenance activities. Within the context of the plan to modernize the aforementioned Vice Ministry, private sector participation will be promoted to implement pilot projects

for contracting out such activities, including companies to be set up by workers of the current MOP.

2.19 The institutional restructuring of the MOPTVDU is expected to produce a modern management instrument that will ensure the availability of financial resources for the requisite road maintenance to protect the investments made in the country's highways and roads. Moreover, participation by the private sector in road construction and maintenance will improve the quality and extend the coverage of the services that the public sector offers the Salvadorian population. This reform will involve new forms of private participation in the maintenance of public works through pilot projects.

D. Participation of the workers in the privatization process

2.20 In order to pave the way for increased and improved participation by Salvadorian workers in the process of State reform and privatization, the Government of El Salvador, and labor organizations in the electric power sector expressed their willingness to conduct a program to achieve those ends. Under this process, the following main points have been identified, among others: (i) alternatives for labor-sector participation and financing mechanisms for buying the shares of enterprises that are privatized; (ii) development of a study to introduce an employee stock ownership program into the country; and (iii) development of training programs for workers displaced as a result of modernization and privatization processes, and technical and financial advisory services for the establishment of enterprises by those workers.

2.21 The Bank has expressed its willingness to assist the government – at the latter's request – in the design of a program for employees to acquire stock under the structural reform and privatization process and in training and development of small enterprises with resources from the MIF. With this support, the government would have a mechanism to make available to the workers and would possibly finance parcels of stocks in the companies to be privatized, thereby promoting local capital markets and creating stockholders in a reform economy. Through the development of the ESOP, this experience could be expanded to the other economic sectors.

2.22 The Bank's support would also extend to the design and implementation of an MOP staff training program and the development of alternatives for a program of contributions of seed capital for the establishment of small road maintenance enterprises (see paragraphs 2.18 and 2.19). With regard to the Bank's support, the Government of El Salvador confirmed its interest in requesting technical cooperation funding from the Bank with resources from the MIF.

2.23 These areas of support would supplement the benefits of reform and would help to strengthen the country's stability and the viability of the State modernization and privatization process, as a concrete example of participatory development that contributes to sustained economic growth in El Salvador.

E. Results expected from the proposed program

2.24 **Under the proposed financing,** policy measures will complement the activities envisaged under the different reform programs that the Government of El Salvador is implementing with the support of the aforementioned institutions. These proposed policy measures will make it possible to launch or move forward the privatizations to which the government assigns priority (telecommunications and electric power distribution), and to execute a plan for the restructuring of the Ministries of Finance, Foreign Affairs, and the MOPTVDU, the latter with the identification of financial alternatives to sustain the road restoration and maintenance operations (see activities and expected outcomes in Annex III).

2.25 In the human resources area a legal framework will be put into effect as a basis for the development of more efficient human resources management based on broad political support and a consensus among the parties involved.

2.26 Implementation of the Basic Law on Financial Administration of the State will contribute to the consolidation of its primary purposes, which are the exercise of proper control of public finances and the availability of an instrument that is indispensable for the programming of the country's economic policy.

2.27 Lastly, the new legal and institutional frameworks for the electric power, telecommunications and transportation sectors provides the government with the essential elements it needs to complete the privatizations and concessions, including proposals for the new configuration of the public sector.

2.28 In short, execution of the programs under the present operation will accomplish the institutional changes called for in the reforms to the State's financial administration, especially improvement of the tax collection mechanisms, the privatization and concession of public services, reorganization of the public sector, including the setting up of policy-making, regulatory and subsidiary institutions for the promotion and administration of social programs, dismantling the barriers raised by bureaucratism and making room for increased private participation in the production of public goods and services under competitive conditions. These measures will gradually bring about a smaller State that is strategically strong, operationally efficient and transparent, and minimally interventionist.

III. FINANCING AND EXECUTION OF THE PROGRAM

A. The financing for the program

3.1 The Bank's financing will be chargeable to the resources of the Single Currency Facility of the ordinary capital of the Bank, in the amount of up to US$70 million, that are part of those resources.

Ordinary capital: amortization in 25 years, the first installment to be paid 66 months after the date of the loan contract; the interest rate will be the Bank's standard variable rate; the credit fee will be 0.75% on undisbursed balances; and the fee for inspection and supervision will be 1% of the total loan amount.

3.2 The program is structured in two tranches, the first for US$30 million and the second for US$40 million; a disbursement period of two years is recommended in view of the scope and complexity of the reforms to be carried out under the program.

3.3 The amounts of the operation and its two tranches have been arrived at on the basis of the country's need for support to release resources that will allow it to cover expenditures resulting from implementation of the reforms and ease the fiscal impact of these measures.

3.4 Disbursements from the loan will be made subject to fulfillment of specific conditions that were designed to ensure follow-up on the reforms and presentation of list of eligible imports. Loan disbursements will be made directly to the Ministry of Finance, which will be the executing agency responsible for the elegible imports project.

B. The borrower and executing agency

3.5 The borrower for the program will be the Republic of El Salvador, and the program will be executed by the borrower, through the CPMSP/UTC. The CPMSP was created by presidential decree on May 28, 1996. Its members are the Ministers of Finance and of Economic Affairs, and it is coordinated by the Presidential Commissioner for Public Sector Modernization.

3.6 The CPMSP has a technical coordinating unit (the UTC), which has a technical coordinator, effective technical staff and its own budget, which ensures that it can execute and coordinate the program efficiently. Through CPMSP efficient coordination has been established among all the public-sector entities covered by the PMSP and with the programs being executed by the IDB, WB and other donors, and direct links have been established with the institutions included in the program for reform of the justice system.

The principal purpose of this Commission is to decide on the policies, instruments and guidelines for the design and implementation of the PMSP.

3.7 Significant progress has also been made toward carrying out the policy measures required for approval of the disbursement of the two tranches. Several bills of law have been drafted and progress has been made toward privatization of the electric power distribution companies owned by the CEL and ANTEL and toward the restructuring of the public entities involved, including a plan for the restructuring of the MOPTVDU. The Salvadorian authorities have expressed to the Bank their general agreement on all aspects of the policy conditions described in detail in the paragraphs that follow.

C. Conditions for the release of disbursement tranches

3.8 During prior negotiations the Government of El Salvador and the Bank came to an agreement on the final text of the policy letter and the timetable for launching the reforms. The section that follows indicates the specific policy measures that must be implemented before disbursements from the first and second tranches can be made in each area of the PMSP. In addition, the sector policy letter (see Annex II) describes the program of action and the objectives and policies for reform of the public sector of El Salvador.

3.9 In addition to the conditions stated hereafter, the general conditions precedent to disbursement of the first tranche will be the Bank's standard conditions for operations of this kind.

1. Conditions precedent to the first tranche

3.10 The first tranche will be released upon fulfillment of the following conditions:

a. The macroeconomic framework

Macroeconomic performance is consistent with the sector program;

b. Reform of the public administration

(i) The agreements that include the plans for macroinstitutional restructuring of the Ministries of Finance and Foreign Affairs and the plan to strengthen the Ministry of Environment have been signed by the Commission and these ministries. These plans will include a timetable, goals, and the entities responsible for their execution;

(ii) The budget, treasury, public credit and government accounting subsystems called for in the Basic Law on Financial Administration of the State have been established, based on the Plan of Action dated April 4, 1997, submitted to the Bank;

(iii) The tax code and customs violations bills have been presented to the Legislative Assembly;

(iv) The civil service bill has been drafted.

c. Sector reforms

(i) The regulations implementing the General Law on Electricity (Article 124) and the General Telecommunications Law (Article 119) and the Law Creating the General Superintendency of Electric Power and Telecommunications, SIGET (Article 31) have been issued;

(ii) SIGET's the Electric Power and Telecommunications Departments have been set up and SIGET has been provided with its opening budget (Article 30 of the Law Creating the General Superintendency of Electric Power and Telecommunications);

(iii) The Law on the Sale of Shares in the Electric Power Distribution Companies has entered into force and financing for participation by the workers, employees and officers of the electric power sector in the purchase of shares pursuant to that law has been approved;

(iv) The study for the restructuring of the CEL has been commissioned;

(v) The Law on Privatization of ANTEL has been put into force;

(vi) The plan of action for restructuring the MOPTVDU has been submitted to the Bank and provides for setting up the Public Works Projects Coordinating Unit;

(vii) Consultants have been hired to design a mechanism for achieving long-term financial sustainability of the operations for rehabilitation and maintenance of the road system and a plan of action for the implementation of that mechanism;

(viii) Consultants have been hired to prepare the regulatory framework and mechanisms to facilitate private sector participation in road rehabilitation and maintenance

and the plan of action for execution of pilot projects for this type of activity with the private sector, that will include participation in such projects by companies set up by MOPTVDU workers.

2. Conditions precedent to the second tranche

3.11 The second tranche will be released upon fulfillment of the following conditions:

a. The macroeconomic framework

Macroeconomic management is consistent with execution of the sector program;

b. Reform of public administration

(i) Progress has been made in the execution of the plans for macroinstitutional restructuring of the Ministries of Finance, and Foreign Affairs, and strengthening of the Ministry of Environment, in accordance with their respective goals and timetables;

(ii) Progress has been made towards establishing the budget, treasury, public credit and government accounting subsystems called for in the Basic Law on Financial Administration of the State in accordance with the plan of action agreed upon with the Bank, dated April 4, 1997;

(iii) The regulations implementing the Law on the Tax Code and the Law on Customs Violations have been issued;

(iv) The regulations implementing the Civil Service Law have been issued;

c. Sector reforms

(i) A controlling interest in the shares of distributing enterprises that together account for at least 50% of the volume of electric power distributed in the country have been transferred to private investors, including the workers, employees and officers of the electric power sector;

(ii) Progress has been made in implementation of the recommendations of the study for the restructuring of the CEL, based on the agreed goals and timetables, and the CPMSP has approved a plan for inclusion of the private sector in the companies resulting from that restructuring;

(iii) Pursuant to Articles 17 and 18 of the Law on the Privatization of ANTEL, 51% of the shares in the ANTEL successor enterprises have been awarded to strategic partners selected by competitive bidding;

(iv) Progress has been made in the execution of the plan of action for the restructuring of the Vice Ministry of Public Works in accordance with the agreed timetable and goals, and in setting up its Public Works Projects Coordinating Unit;

(v) The regulatory framework and mechanisms to facilitate private sector participation in road rehabilitation and maintenance have been submitted to the competent authority for approval, and execution of pilot projects for this type of activity with the private sector has begun;

(vi) The legal framework for the implementation of mechanisms that will ensure the financial sustainability of the road rehabilitation and maintenance activities have been submitted to the competent authority.

D. Execution of the program

3.12 The borrower will maintain separate accounts for the transactions relating to requests for disbursements and prepare reports on the program. The associated documents will include enough detail to identify imported goods: the exporter, the cost of the import in each category, and the provenance of the imported goods.

3.13 International public bidding will be used for purchases of the public and private sectors involving amounts above US$5 million. Purchases of the public sector in amounts below that figure will be made following the procedures established in domestic law, provided that they do not run counter to the Bank's policies. For the award of contracts in the private sector in amounts below US$5 million, established commercial practice will be followed provided that the awards are made on the basis of an evaluation and comparison of the tenders of eligible suppliers in at least two countries, except in cases in which direct contracting is permitted.

3.14 Disbursements from the proposed loan will be made on the basis of presentation by the borrower of a report showing, to the Bank's satisfaction, (i) evidence that all the policy conditions have been complied with, and (ii) that, on the basis of the list of imports for each tranche, the expenditures that would be eligible for the purposes of this program have been demonstrated. The report to be presented to the Bank will describe in detail how the conditions have been complied with and will supply evidence that the conditions for eligibility have been fulfilled. The report must be

presented by the borrower with the collaboration of a firm of external auditors approved by the Bank.

3.15 The Bank reserves the right to conduct an ex post inspection of the various documents that support fulfillment of the conditions.

E. Inspection and supervision

3.16 The Bank will establish the inspection procedures that it deems necessary to ensure that the program progresses satisfactorily, and the borrower and guarantor will provide any cooperation that may be required for that purpose. From the amount of the financing US$700,000 will be credited to the Bank's account for general inspection and supervision.

3.17 The borrower and the Bank will meet at the request of either party, to exchange views on progress in implementation of the program and in the fulfillment of the established conditions for disbursements under each tranche, and on the consistency between the economic policy framework and the program. To this end, the borrower agrees to provide to the Bank, prior to each meeting, a report containing a level of detail that the Bank considers reasonable to request, on the progress of the program and the fulfillment of those conditions for analysis and commentary by the Bank.

F. Monitoring of the program

3.18 The program will be monitored with the support of the project team and the Country Office in El Salvador, which will provide all logistical support. Visits to the country by the project team will follow a schedule to be drawn up, and the government will send the Bank a report on the progress of the reforms before each visit.

G. Environmental considerations

a. Classification and recommendations

3.19 In its meeting on August 20, 1996, the CESI classified this as a Category III operation and recommended the preparation of an environmental summary, which was approved at the Committee's meeting on April 17, 1997, and is in the files of the operation. In that summary the CESI recommended as follows:

a. So long as the legal and regulatory framework for environmental management has not been completed, for environmental management in the privatization processes envisaged in the operation under consideration, it is considered important that environmental control plans be drawn up and manuals of environmental procedures prepared, including standards and measures of environmental control. These materials would be used by the environmental units of the public institutions in the electric power distribution, telecommunications, and highway

rehabilitation and maintenance sectors. The cost of preparing these materials is estimated at about US$30,000. The Salvadorian government has agreed to use resources available in loan operations already approved by the Bank that include environmental strengthening components. (See Annex III, Matrix of Activities and Outputs).

b. Consideration should be given to including in the policy letter a specific mention of resettlement regulations as part of the environmental regulatory framework being prepared, when the privatization processes call for population resettlement. In this regard, inasmuch as the privatization processes included in the operation (power distribution and telecommunications) do not call for population relocation, the government authorities involved in this operation have asked the Bank not to include these provisions in the policy letter. Moreover, these matters will be analyzed during drafting of the environmental law and in connection with the establishment of the Ministry of Environment and the water program under preparation.

b. <u>Other considerations</u>

3.20 In accordance with a CESI recommendation, the summary includes more information on the social impact of the human resources management component in regard to the provisions against discrimination in selection, promotion, training and retirement processes and policies that promote a work environment free of any type of hostile behavior. These aspects are under consideration in the design of human resources policies in the above-mentioned processes (see activities matrix in Annex III). In addition, during annual meetings, confirmation will be sought that the Ministry of Environment has been organized and that the human and financial resources necessary to its initial operations have been allocated. Evidence will be provided that satisfactory progress has been made in setting up all the units and hiring staff required for its operations.

IV. BENEFITS AND RISKS

A. Benefits

4.1 The reforms being implemented will bring in their wake new forms of organization and institutional, political and social management compatible with the government's new development strategy, and will firmly establish the market economy, streamline public administration, and reduce government intervention in the economy. The participation of private enterprise in the delivery of services and provision of infrastructure will increase competition and enable the government to concentrate on and improve its efficiency and effectiveness in areas it will continue to manage (for example, the social area). Its management in more essential areas, such as those of regulation and sector policy formulation, will also improve.

4.2 The program will also contribute to the government's efforts to correct structural weaknesses that have caused difficulties in its fiscal management, especially in areas related to control of public finances and their connection with macroeconomic policy.

4.3 After being in the throes of a protracted armed conflict for more than 10 years, there is now broad consensus on the democratic political system and on development based on reform of the public sector and the administration of justice. These processes are leading to an important change in relations between the government and civil society in El Salvador. Moreover, through the privatization processes, with changes in government intervention, a model of economic growth is being adopted based on expansion of the role of the private sector and the concentration of the State on its functions as facilitator, policy-maker and regulator.

4.4 The PMSP, and especially its component of support for reform and privatization of the electric power sector, is of fundamental importance as an instrument for creating conditions favorable for other IDB projects in the electric power sector, such as project CA-0007 – the Central American Electric Interconnection System (SIEPAC) – which is supporting the institutional and regulatory reforms needed to create a competitive integrated electric power market in Central America.

B. Risks

4.5 There are several potential risks in the proposed operation. One of them lies in the political commitment required for the reforms. Support at the highest political level is essential to successful execution of the program. A modernization process that is not properly organized can generate conflicts within the public administration and raise obstacles to modernization efforts going

forward independently in other economic and social sectors. This risk shrinks appreciably when it is considered that the government has demonstrated its commitment to reform by setting up a Presidential Commission on Modernization and appointing a Commissioner with ministerial rank. In addition, reforms are being implemented that have high political cost, such as those for institutional restructuring and downsizing and privatizations in the energy and telecommunications sectors, among others. These measures are being discussed with civil society and their implementation is well advanced.

4.6 Moreover, the government has been in touch with the CEL and ANTEL labor unions, and legal provision has been made for participation by workers and officers in the purchase of shares in the private electricity distribution enterprises. The government is also engaged in projects of investment in infrastructures to improve services, and is facilitating reforms and reducing the risk of resistance to them.

4.7 To minimize the risk of poor design and/or weak implementation of the proposed program, a product of the as yet brief experience in government reform, the government has identified some elements of other experiences of the Bank, the World Bank and of its own. Lessons learned in other public sector reform processes in El Salvador (the program for reform of the investment sector), and the recommendations of the study "Institutional Aspects of Public Enterprise Reform" and the privatization experiences of the World Bank in Latin American countries have enabled both the Bank and the Salvadorian government to avoid some conceptual and design problems.

4.8 From the standpoint of implementation and execution of the program, experience demonstrates that it is essential for the government to set up a high-level political agency (the CPMSP and the technical coordinating unit of the PMSP), staffed with qualified people and clearly identified with the purposes of reforms, to direct the program, and so bring about the needed consensus among the different agents to carry out the measures that the reforms require. Building a consensus is the point of departure for obtaining the necessary political and local social support.

4.9 Another risk to which operations of this complexity are exposed is the obstacles to its execution that arise from lack of coordination within the international community financing or supporting them. The CPMSP is working constantly to coordinate the measures of the different donors so as to optimize the use of resources.

EL SALVADOR. PUBLIC SECTOR MODERNIZATION PROGRAM (ES-0036) POLICY MATRIX			
BJECTIVES	MEASURES ADOPTED	CONDITIONS TO BE MET PRIOR TO RELEASE	
		First tranche (US$30 million)	Second tranche (US$40 mi
OMIC POLICY			
appropriate macro- work for execution of	The government has devised a medium-term macroeconomic program compatible with execution of the sector program and supported by a 14-month stand-by arrangement concluded with the IMF on February 28, 1997.	Macroeconomic management consistent with execution of the sector pro	
PUBLIC ADMINISTRATION			
itutional structure:			
ate strategically ionally efficient and nd minimally t.	The Presidential Commission for Public Sector Modernization (CPMSP) has been created.	The agreements that include the plans for macroinstitutional restructuring of the Ministries of Finance and Foreign Affairs and the plan to strengthen the Ministry of Environment have been signed. These plans will include a timetable, goals, and the entities responsible for their execution.	Progress in execution of the macroinstitutional restructu plans of the Ministries of F and strengthening of the Min Environment, in accordance w respective goals and timetab
ministration:			
management of public aximize the efficiency government funds.	The Legislative Assembly approved the Basic Law on Financial Administration of the State, whose implementation is being supported by the financial administration modernization program (loan 941/OC-ES).	The budget, treasury, public credit and government accounting subsys called for in the Basic Law on Financial Administration of the State have been set up in accordance with the plan of action presented to	
coverage in the area of and strengthen the ction and control. To toms controls.	The tax code and customs violations bills have been prepared.	The tax code and customs bills violations have been presented to the Legislative Assembly.	The regulations implementing on the Tax Code and the Law Customs Violations have been
ation of human resources:			
information mechanisms the comprehensive control of human he public sector.	A Central Human Resources Management Unit has been set up in the Ministry of Finance.	The civil service bill has been drafted.	The regulations implementing on the Civil Service have be issued.

EL SALVADOR. PUBLIC SECTOR MODERNIZATION PROGRAM (ES-0036)
POLICY MATRIX

OBJECTIVES	MEASURES ADOPTED	CONDITIONS TO BE MET PRIOR TO RELEASE	
		First tranche (US$30 million)	Second tranche (US$40 mi
EFORMS AND PRIVATIZATION			
power sector			
efficient electric y introducing ree access to networks, he role of the d implementation of the lations.	The Legislative Assembly has approved the General Law on Electric Power (LGE), which lays the foundations for an efficient and competitive electric power sector, and the Law Creating the General Superintendency of Electric Power and Telecommunications (SIGET).	The regulations for the LGE (Article 124) have been issued, the regulations implementing the Law on SIGET (Article 31) have been issued, and the Electric Power Department of SIGET has been organized and provided with its opening budget (Article 30).	
	The Law on the Sale of Shares in the Electricity Distribution Companies has been drafted, to permit privatization of the electricity distributing companies owned by the Executive Committee of the Lempa River Hydroelectric Company (CEL).	The Law on the Sale of Shares in the Electricity Distribution Companies has entered into force and the financing has been approved for participation by the workers, employees and officers of the electric power sector in the purchase of shares in accordance with that law.	A controlling proportion of shares in distributing ente that together account for a 50% of the volume of electr distributed nationwide has transferred to private inve including the workers, empl officers of the electric po sector.
	The CPMSP has framed the terms of reference of the study for the restructuring of the CEL into independent generating enterprises, a transmission company, and a transactions unit.	The study for the restructuring of the CEL has been commissioned.	Progress has been made in i tion of the recommendations by the study for the restru the CEL, based on the goals timetables agreed upon, and has approved a plan for inc the private sector in the c resulting from the restruct the CEL.

EL SALVADOR. PUBLIC SECTOR MODERNIZATION PROGRAM (ES-0036)
POLICY MATRIX

OBJECTIVES	MEASURES ADOPTED	CONDITIONS TO BE MET PRIOR TO RELEASE	
		First tranche (US$30 million)	Second tranche (US$40 m
unications sector			
of a legal and framework for the ations sector that will competition, minimize the ations, and redefine the State.	The Legislative Assembly has approved the General Law on Telecommunications (LGT) and the Law on the Privatization of ANTEL, which will make it possible to lay the foundations for a competitive and efficient telecommunications sector.	The regulations implementing the LGT (Article 119) have been issued, the regulations implementing the Law on SIGET (Article 31) have been issued, the Telecommunications Department has been set up in SIGET and it has been provided with its opening budget (Article 30). The Law on the Privatization of ANTEL has entered into force.	Pursuant to Article 17 and Law on the Privatization of 51% of the shares in the su firms to ANTEL have been aw strategic partners selected competitive bidding.
tation sector			
the Ministry of Public courage the participation e sector in the delivery	The government has drawn up drafts of a plan of action for modernization of the Vice Ministry of Public Works.	The plan for restructuring the MOPTVDU has been submitted to the Bank.	Progress has been made in e of the plan of action based agreed timetable and goals, Public Works Projects Coord Unit has been set up.
	The government has proposed studies to define a mechanism for making the operations for rehabilitation and maintenance of the road system financially sustainable in the long run.	Consultants have been hired to design a mechanism to make the operations for rehabilitation and maintenance of the road system financially sustainable in the long run, and of a plan of action for the implementation of that mechanism.	The mechanism to make the o for rehabilitation and main the road system financially sustainable in the long run accordance with the agreed and goals, has been submitt approval by the competent authorities.
	The plan of action for modernization of the Vice Ministry calls for actions that allow and promote private sector participation in service delivery in the transportation sector, including the development of pilot projects.	Consulting services have been hired to prepare the regulatory framework and mechanisms that will facilitate private sector participation in road rehabilitation and maintenance and to prepare a plan of action for execution of pilot projects for this type of activity with the private sector, that include participation in such projects by companies set up by workers of the MOPTVDU.	The regulatory framework an mechanisms that will facili private sector participatio rehabilitation and maintena been presented to the compe authorities and execution o pilot projects with the pri sector has started.

San Salvador, August 26, 1997

Mr. Enrique V. Iglesias
President
Inter-American Development Bank
Washington, D.C. 20577

Dear Mr. Iglesias:

The purpose of this letter is to sum up the principal efforts in the areas of policy and reform adopted by the Government of El Salvador and to seek the support of your institution for the public sector reform program with financing in the amount of US$70 million.

1. The recent economic situation

Since 1989 the Government of El Salvador has been making great efforts to establish a market economy and to carry further the structural reforms needed to consolidate macroeconomic stability. The purpose of the economic program of President Calderón Sol, who took office in June 1994, is to further the structural reforms needed to consolidate macroeconomic stability and advance in the globalization process. The objective is to attain equitable growth with competitiveness and to promote national and foreign investment by reducing domestic costs.

In addition to our efforts to maintain macroeconomic stability, a series of laws have been introduced to carry the reforms further and implement those that have been pending. Thus, to support our fiscal efforts the Law on Fiscal Delinquency and the Basic Law on Financial Administration of the State have been prepared and the value-added tax (VAT) has been introduced. The private portfolio of the Central Bank has been transferred to Banco Multisectorial de Inversiones. Other laws have been approved as well, such as the Law on Capital Markets and the Law on Banking Institutions (amended in December 1995 to allow the entry of foreign banks). Also, in 1995 a Presidential Commissioner for Public Sector Modernization was appointed with the function of promoting the modernization program, including the privatization process. A law has been enacted (Law 471 on Monetary Compensation) to streamline employment in the public sector, progress is being made toward privatization of the telecommunications enterprise, and the private sector is expected to participate in the delivery of the public services in electric energy, water supply, transportation, and pensions.

Moreover, the multilateral institutions and international financial community have been lending ongoing support to the country's socio-economic program. In particular, in February 1991 and March 1993 the World Bank granted financing for two structural adjustment programs (SAL I and II) and for investment projects in the agriculture and education sectors and projects to increase competitiveness, while IDB support has been provided mainly for projects in the transportation,

electricity, financial and social sectors. Altogether, external aid during the years 1990 to 1995 came to more than US$800 million (of which the IDB provided US$520 million). In addition, the Government has concluded several stand-by arrangements with the IMF (1990, 1992, 1993, and 1994), the latest of them in February 1997.

The economic recovery has been evidenced by high rates of GDP growth, which between 1990 and 1996 averaged 5.5 percent a year, the next-highest rate in Latin America after Chile. This remarkable economic recovery occurred in a highly favorable climate that included the end of the armed conflict, the receipt of foreign exchange from foreign loans, an influx of remittances from abroad, and the existence of high levels of idle installed capacity in the country.

The Government has been making great efforts to reform the tax structure and simplify tax administration, enacted the value-added tax (VAT) in 1992 and raised it to 13 percent in July 1995, compiled a register of large taxpayers, implemented the laws for the control of tax evasion, and at the same time reduced public spending. These efforts facilitated a reduction of the fiscal deficit from 4.7 percent of GDP in 1989 to 2 percent in 1996. Tax revenues have risen steadily from 11 percent of GDP in 1989 to 17 percent in 1996.

Reduction of the fiscal deficit combined with improved monetary management, stabilization of the nominal exchange rate, greater competition from imported goods and the growth of GDP contributed to better control of inflation, which dropped from 19.3 percent in 1990 to 7.4 percent in 1996.

Despite the positive economic developments in El Salvador in the last few years, starting in the second half of 1995 there was a tendency for the growth rate to slow down. This particularly affected the fiscal accounts.

2. The public sector modernization program

Since 1989, concurrently with the negotiations that brought the armed conflict to an end and with the fulfillment of its obligations under the Peace Agreements, the Government of El Salvador has been promoting major reforms that have resulted in a significant improvement in macroeconomic indicators.

In the institutional field the principal changes have been reforms in the tax system and improvement of the revenue collection mechanisms, the privatization of banking, reformulation of the role of the Central Bank, elimination of some ministries and public institutions, the creation of policy-making, regulatory and subsidiary institutions for housing and of institutions for the promotion and administration of social equalization programs such as the Social Investment Fund (FIS) and its reform and the National Secretariat for the Family, and the privatization of public institutions.

The Government has decided to rectify the deficiencies of its present social insurance system by approving the Law on the Savings and Pensions System and has created the Superintendency of Pensions. The purposes of the reforms are (a) to establish a pension savings system that is privately administered and capitalized by individuals, in which the Government's role is to regulate, control and oversee the system, and (b) to set up a mutual social insurance system, with subsidiary Government support, for contributors with little savings capacity.

To complement the benefits it will generate for individuals, from the economic standpoint, the new pension savings system will become one of the most powerful instruments for the promotion of higher rates of domestic savings and a strong promoter of investment that will facilitate long-term financing in the country.

In the stage of transition to the new system, the traditional pension system will be streamlined, especially by standardizing the requirements, benefits, and subscription and contribution rates to eliminate the differences among the present pension plans.

These are highly important reforms. However, to move forward toward the goal of a State whose role is consistent with the demands of the market and society, which are evolving in a highly competitive world, the barriers raised by bureaucratism must be eliminated and room made for the increased participation of private enterprise in the production of public goods and services under competitive conditions. These measures will gradually bring about a smaller Government that is strategically strong, operationally efficient and transparent, and minimally interventionist.

To this end the Government has decided to integrate and carry further its reform efforts by executing the public sector modernization program (PMSP), which provides for the development of short-, medium- and long-term measures essentially in the following areas:

Institutional restructuring. The institutional restructuring will enable the Government to streamline the macroinstitutional structure of its organizations, adjust the size, quality, and composition of its work force, and update its legal framework.

The institutional restructuring will encompass all the institutions of the Executive Branch; the process must, however, be gradual, progressive, and uninterrupted. In the next four years it will be carried out on a priority basis in the Ministries of Finance and Foreign Affairs, the Vice Ministry of Public Works, and the Ministries of Education, Health and Agriculture. In the three last-named ministries the work has already started with financial support from the Inter-American Development Bank and the World Bank.

The restructuring will apply the following criteria, among others: transfer of operational functions from the central organizations to

autonomous or decentralized institutions, public nongovernmental organizations, and the private sector; and setting up of appropriate mechanisms for coordination, evaluation and control to assure as much consistency as possible in the conduct and application of public policies and the efficient and effective use of resources.

Bureaucratic streamlining. While comprehensive institutional restructuring and modernization plans are being implemented to reduce operating costs and support increased competitiveness, the Government will be promoting and carrying out measures for the prompt elimination, simplification or redesign of processes in the public sector that hinder the development of the private sector and civil society in general.

The primary strategy for the implementation of this component is based on development of the project known as "El Salvador Eficiente" ("An Efficient El Salvador"), which is being executed jointly by the public and private sectors. The project focuses on improving the services of public institutions and calls for the conduct of opinion polls among entrepreneurs on the obstacles they encounter in their dealings with the Government and their suggestions for eliminating them. On the basis of the first poll and of cost/benefit criteria, opportunity and short- and medium-term feasibility, it has been decided that the first procedures to be simplified are those involving municipal clearances, driver's licenses, and declarations for the clearance of merchandise through customs and the crossing of the border by people (from Guatemala).

Decentralization. A primary element in the efforts for institutional modernization of the public sector will be deconcentration and/or decentralization of the planning, administrative, decision-making and resource allocation functions currently concentrated at the upper, geographically centralized, institutional levels. This effort will take account of different decentralization modalities: deconcentration, delegation, and devolution.

Decentralization will proceed gradually to maximize the efficiency, coverage, quality and relevance of the public services and thereby help to strengthen the State's subsidiary and facilitating role and to increase citizen participation in the framing and implementation of public policies in order to make communities the promoters of their own development.

Along this line, at the central level a broad campaign of public information will be conducted on decentralization as a modernization policy, and the pilot experiments being carried out with the support of different bilateral and multilateral agencies will be followed up. In addition, a municipal modernization program will be supported.

Private participation. El Salvador has a very dynamic private sector. With privatization of the commercial banks, sugar mills and other assets formerly owned by the State, the private sector accounts for more than

93 percent of the employment and 92 percent of GDP. Results have been satisfactory in recent years, with an economic growth rate that has ranged between 3.5 percent in 1990/91 and 6 percent in 1994-1995.

The Government now faces the challenge of increasing that growth by improving competitiveness in all areas of the economy. This is why the priorities relating to private participation involve the sectors where the results of reform are expected to substantially improve the competitiveness of enterprises in general. These sectors are telecommunications, the distribution, transmission and generation of electric power, ports and airports, highways, water supply and sewer systems, and pensions.

To assure the efficiency of the market and competition in these sectors while promoting private participation, new regulatory frameworks have been promoted which eliminate existing distortions and the monopolistic concessions that had traditionally been granted to government enterprises.

The process includes the establishment of specialized entities to properly monitor and regulate the markets of the services to be privatized and to oversee the quality of those services.

In accordance with the priorities established, the national telecommunications company and the electric power distribution companies are scheduled to be privatized in 1997 and 1998. It is also expected that by 1998 the competitive conditions necessary to set up new private electric power generation enterprises will be established.

The electric power sector. A new legal and institutional framework has been designed for the modernization of this sector. The purpose of this framework is to introduce competition and deregulation, thereby making the sector more efficient. The Government intends to start the privatization process by selling shares in the distribution companies, now owned by the CEL, after the bill of law has been presented to the Legislative Assembly.

To ensure that demand is satisfied, the CEL will continue to execute, until they enter into operation, the generation and transmission projects for which it has already obtained financing from the Inter-American Development Bank. The transmission enterprise will remain in the hands of the State during execution of these projects.

The private sector may make decisions on and execute new investments.

The new legal framework is comprised of the General Law on Electric Power and the Law Creating the General Superintendency of Electric Power and Telecommunications (SIGET). The principles underlying these laws are (i) development of a competitive market for the generation, transmission, distribution and marketing of electric power; (ii) free access for the

generating entities to the transmission and distribution lines, subject to no limitations other than those stated in the law; (iii) economical and efficient use of resources; (iv) promotion of access to electric energy supply for all sectors of the population; and (v) protection of the rights of users and of all entities operating in the sector.

SIGET is an independent technical agency in charge of monitoring activities in the sector and granting concessions for the use of public natural resources for the generation of electricity and use of the radio spectrum. The regulations implementing the Law on SIGET will require consultation with the Water Resources Authority to grant concessions for the use of water resources.

The new framework will permit the participation of different generating, transmitting, distributing and marketing enterprises. All operators connected to the main transmission system will be represented in the Transactions Unit, which will be in charge of the coordinated operation of the transmission system and of the wholesale market.

While the restructuring plan is in implementation, the CEL will carry out administrative measures to adjust to the requirements of the new regulatory framework, including internal unbundling of the functions of generation, transmission and operation of the electric power system, the signing of energy sales contracts in accordance with the new arrangement, and training for the institution's personnel in key aspects of the reform.

When the new law enters into force and so long as the CEL retains most of the installed generating capacity and the transmission enterprise, the Transactions Unit will be governed by temporary internal regulations that provide equitable, transparent mechanisms for decision-making on operation of the system.

Energy prices at the levels of generation and consumer sales will be determined by agreement between the parties, but charges for the use of transmission and distribution systems will be regulated.

To protect the low-income consumer and gradually eliminate subsidies, the law authorizes SIGET to establish the top prices to residential users whose consumption averages less than 500 kWh a month for three years, which will be adjusted gradually.

These measures are part of a comprehensive plan that also includes the strengthening of the environment and consumer protection authorities and the establishment of a legal framework that promotes free competition in all economic sectors of the country.

The Government of El Salvador is implementing an energy efficiency program to expedite marketing by encouraging investments to economize in the end uses of energy. The purpose of the program is to support the establishment and development of a new technical and financial services

industry needed for implementation of projects increasing energy efficiency. It is proposed that a trust be set up to administer the funds available in IDB loan 838/OC-ES and other resources for support of the energy efficiency effort. In addition to monetary benefits to final users and to the energy sector enterprises associated with development of the national capacity to implement investments in this field, these projects also yield environmental benefits. The Government is aware that significant opportunities will emerge in the future to coordinate the development of institutional capacity for monitoring the environmental impacts of energy supply projects and the development of institutional capacity for implementing energy efficiency projects.

The telecommunications sector. The Government has undertaken a far-reaching reorganization of telecommunications to make the sector more efficient in view of the greater competition allowed by technological advances in telecommunications and the interest in making the private sector a participant. In general, the sector organization model proposed is enormously open and allows competition in all segments of the market. The model retains only a minimum of regulatory provisions and leaves all other market adjustments to the forces of competition.

The proposal identifies permanent elements of industrial organization regarded as essential for its implementation, and transitory elements that are needed in the initial phase of the model. The permanent elements are the right and obligation that all commercial operators be interconnected; the use of essential "bottleneck" installations or resources; equal access to competing systems, and mechanisms for the expeditious settlement of disputes. In addition, it is considered essential to set up a new system for the award and use of the spectrum, including the satellite space-link segment.

The regulatory authority, SIGET, has very specific powers so that it will not act arbitrarily. The establishment of a National Electric Power and Telecommunications Investment Fund (FINET) was approved to promote the penetration of telecommunications and electric power services into the rural and more needy sectors.

The restructuring of the sector was based on the following: (i) an adjustment of rates to restore balance among the prices of the different services; (ii) the splitting of ANTEL into two enterprises in the form of variable-capital corporations that would be privatized through contracts with strategic partners, and (iii) an open door to the entry of third parties to compete with these two ANTEL successor companies.

The Government has commissioned a highly reputable investment bank to advise it in the privatization of the ANTEL successor companies, to prepare the pertinent information, to promote the process internationally, and to take other actions for the privatization of ANTEL. With these measures the Government of El Salvador expects to privatize the telecommunications enterprises in the course of 1998.

In the transportation area the Government is working on a regulatory policy and on standards that will create the competitive conditions needed to promote private sector participation in the contracting of road rehabilitation and maintenance services. Appropriate financial mechanisms are being designed to sustain this activity. To this end, the Government is planning to execute pilot projects involving the hiring of private enterprises, including those set up by workers of the current Ministry of Public Works and Transportation. It will also move forward with awarding concessions to the private sector for new services at the international airport of El Salvador and for port services.

In the basic sanitation area, by 1997-98, the Government expects to have a regulatory and institutional framework that will enable the private sector to participate in the provision of water supply and sewerage services.

Modernization of public administration systems. This area comprises the modernization of key administrative systems that exist throughout the public sector, such as human, financial and material resources and government control.

Modernization of human resources management and administration will center on the establishment of policies and procedures that promote productivity and the development of civil service personnel and are generally applicable throughout the Executive Branch. This will be done by continuing with the design and implementation of a new computerized system in which standard-setting is centralized and operations are institutionally decentralized. In addition, the present Law on Civil Service will be replaced by a new law that will set up an integrated human resources management system to regulate relations between the State and its personnel and favor conditions for efficiency and effectiveness in public administration. The implementation of programs for managerial development and training in key posts of public administration will be essential components of the work in this area.

Modernization of the financial administration system (SAFI) comprises reforms in the budget, accounting, treasury and public credit systems with an integrated systems approach. In this area, major efforts have been made including promulgation of the Law on Financial Administration, which establishes the basic principles, standards and elements that underlie the operation of those systems as an integral whole.

The new SAFI procedures will be implemented gradually in recognition that they entail cultural and technological changes in the management of the Government's financial resources.

Another part of this line of action will be continuation of the reforms in the **tax administration and customs system.**

The procurement and contracting system will be modernized on the basis of a system to be designed to ensure that public resources are efficiently used, which entails the establishment of a new legal and procedural framework so that purchases of goods and services and works contracts will be carried out expeditiously, efficiently, transparently, and with attention to quality.

3. **Environmental aspects**

The Government of El Salvador has launched a vast program for the institutional strengthening of the principal components of the National Environmental System (Sistema Nacional de Medio Ambiente), the establishment and implementation of environmental policies, and the development of a framework of environmental standards and laws. In addition, the Government has created the Ministry of Environment and given it regulatory functions, and a multisector vision. In this setting, the Ministry will act in coordination with SIGET to apply environmental regulations and procedures in the energy sector. This will also apply to the Ministry of Public Works in relation to the transportation sector.

The Government will keep the Bank informed on progress in these reforms in the context of the present operation.

4. **Support of the Inter-American Development Bank**

This document attests to the depth of the public sector modernization program and of the economic modernization on which El Salvador has embarked. The Government recognizes that the support of the Inter-American Development Bank is important to the success of the program and that financial assistance is of utmost importance for the satisfactory implementation of the reforms the Government has begun.

We thank you in advance for the Bank's support for this important program and avail ourselves of this opportunity to convey to the President the assurances of our highest consideration.

[Signature]

Manuel Enrique Hinds
Minister of Finance

[Signature]

Ana Cristina Sol
Presidential Commissioner
for Public Sector
Modernization

EL SALVADOR. PUBLIC SECTOR MODERNIZATION PROGRAM (ES-0036
MATRIX OF ACTIVITIES AND INDICATORS

REA	ACTIVITY	INDICATORS
ional	Plans for restructuring of the Ministries of Finance and Foreign Affairs, and strengthening of the Ministry of Environment.	Agreements signed by the CPMS and the respective Ministries, containing the restructuri **(September 1997)** Presentation of the plan or matrix illustrating in detail the reforms being implemented anc the financial entities and the coordination established between them and the CPMSP **(Ma**
istration	Establishment of the budget, treasury, public credit and government accounting subsystems called for in the Law on the Financial Administration of the State.	Incorporation of the public investment system into the integrated financial system througl credit subsystem. **(September 1997)** Establishment of 90 integrated financial units (UFIs) with standardized processes, manua reengineered. **(September 1997)** 1998 budget constructed with the integrated human resources system (SIRH) in eight pul institutions. **(September 1997)**
	Law on the Tax Code and Law on Customs Violations.	Presentation to the Legislative Assembly of the tax code and customs violations bills. **(December 1997)** Publication in the *Official Gazette* of the tax code and the customs violations regulations. **(January 1998)**
irces	Civil Service Law.	The civil service bill has been drafted. **(September 1997)** Publication in the *Official Gazette* of the Civil Service Law regulations. **(March 1998)**
	Human resources policies.	Design of a human resources policy for recruitment, selection and hiring of new personn remunerations policy, personnel training and development, and performance evaluation. **(January 1998)** Human resources information system completed in all ministries. **(January 1998)**
r sector	General Law on Electric Power, Law on SIGET, and organization of the Electric Power Department of SIGET.	Publication in the *Official Gazette* of the regulations involving the General Law on Electric the Law on SIGET. **(September 1997)** SIGET *report demonstrating that the Electric Power Department has been created and ha* appropriate personnel and its own budget. **(September 1997)**

REA	ACTIVITY	INDICATORS
	Sale of shares in electric power distribution companies.	Publication in the *Official Gazette* of the Law on the Sale of Shares in the Electric Power I Companies. **(September 1997)**
		Approval of a financing plan for the purchase of shares for the workers, employees and c the electric power sector pursuant to the Law on the Sale of Shares in the Electric Power Companies. **(September 1997)**
		Environmental control plans and manuals of environmental procedures, including enviror control standards and actions. **(December 1997)**
		Private investors, including workers, employees and officers of the electric power sector, controlling shares in distribution enterprises accounting for at least 50% of the volume of electricity. **(March 1998)**
	Restructuring of the CEL into independent generating enterprises, one transmission company and one transactions unit.	Hiring of consultants to perform study for restructuring of the CEL. **(September 1997)**
		Presentation of the study for restructuring of the CEL approved by the CPMSP. **(March 1**
		Plan for inclusion of the private sector in the companies resulting from the restructuring o **(June 1998)**
n sector	Restructuring of the MOP's Vice Ministry of Public Works.	Plan of action for the restructuring of the MOP's Vice Ministry of Public Works. **(September 1997)**
		Organization of the Public Works Projects Coordination Unit. **(September 1997)**
	Long-term sustainability of the road rehabilitation and maintenance operations.	Consulting services contract to design a mechanism for ensuring long-term financial susta the road rehabilitation and maintenance activities. **(December 1997)**
		The bill to implement a mechanism for ensuring long-term financial sustainability of the ro rehabilitation and maintenance activities has been submitted to the Legislative Assembly. not necessary, the Executive Decree has been issued. **(June 1998)**
	Regulatory framework and pilot projects to incorporate the private sector in road rehabilitation and maintenance activities.	Consulting services contract to design the regulatory framework and plan of action for pil to incorporate the private sector into road rehabilitation and maintenance activities. **(December 1997)**
		Contracts with private companies to carry out the pilot projects. **(June 1998)**
		The bill to implement the regulatory framework for incorporating the private sector in road rehabilitation and maintenance activities has been submitted to the Legislative Assembly. not necessary, the Executive Decree has been issued. **(June 1998)**

REA	ACTIVITY	INDICATORS
ications sector	General Telecommunications Law and organization of the Telecommunications Department of SIGET.	Publication in the *Official Gazette* of the Presidential Decree regarding the General Telecommunications Law regulations. **(September 1997)**
		SIGET report showing that the Telecommunications Department has been created and ha appropriate personnel and its own budget. **(September 1997)**
	Privatization of ANTEL.	Publication of the Law on Privatization of ANTEL published in the *Official Gazette*. **(September 1997)**
		Environmental control plans and manuals of environmental procedures, including enviro control standards and actions. **(December 1997)**
		Award of 51% of shares in the successor enterprises to ANTEL to strategic partners selec competitive bidding. **(May 1998)**

PROPOSED RESOLUTION

EL SALVADOR. LOAN ___/OC-ES TO THE REPUBLICA DE EL SALVADOR
(Program for the Modernization of the Public Sector)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República de El Salvador, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Program for the Modernization of the Public Sector. Such financing will be for the amount of up to US$70,000,000, which are part of the resources of the Single Currency Facility of the Ordinary Capital of the Bank, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.