Second Development Policy Loan (DPL II)

El Salvador is a lower-middle-income country with a remarkable record of structural reforms that have resulted in major benefits in terms of macroeconomic stability, improved social conditions, trade liberalization, and access to international markets.

However, a series of external factors (the fall in coffee prices, the international crisis, the impact of the 2001 earthquakes and, more recently, and the rise in oil prices) slowed down the country’s economic growth and progress on social indicators during 2000-2005.

Despite El Salvador’s accomplishments, the World Bank’s poverty assessment for the country concludes that most of the progress on poverty reduction and social indicators has been maintained, but an additional boost is needed to continue improvements.

Consequently, in 2004 the Government of El Salvador adopted its “Safe Country 2004-2009” program focusing on greater economic growth, sound fiscal management, and public sector modernization. The plan requires that a policy and investment agenda be implemented to reinvigorate economic growth through job creation and poverty reduction, together with efforts to redirect fiscal trends and make greater financial management improvements.

What is DPL II?

In broad terms, Development Policy Loans (DPL) provide quick-disbursing assistance to countries with external financing needs, to support structural reforms in a sector or the economy as a whole. They support the policy and institutional changes needed to create an environment conducive to sustained and equitable growth.

Prior to receiving a development policy loan, an agreement on institutional reforms must be reached at the government level to ensure accountable policy measures and sound macroeconomic management. Coordination with the International Monetary Fund (IMF) is a key aspect in the preparation of a development policy loan.

DPL II is, therefore, the second in a series of up to four DPLs to support the 2004-2009 “Safe Country” program, the Government of El Salvador’s key development strategy aimed at accelerating broad-based and equitable economic growth. Based on the success of the first DPL that has been implemented, the new loan will focus on addressing fiscal challenges, improving the business and investment climate, and enhancing transparency and efficiency in public spending.

The World Bank, through the DPL II, supports the implementation of the following development policies:

- Ratification of the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) and measures to ensure the broad dissemination of its benefits;
- Approval of a new Consumer Protection Law; Approval of fiscal reforms aimed at improving public spending;
- Submission of a budget for 2006 in line with the medium-term macroeconomic plan;
- Preparation of a new procurement regulation to improve the efficiency and transparency of public spending;
- Preparation of new rules on loan classification and the establishment of reserves to enhance the financial and banking sector;
- Preparation of regulations to implement the Procurement Law;
- Progress in implementing the e-government strategy with the launch of the acquisitions portal (COMPRASAL) and the module to publish government payments;
- Progress in Public Financial Management evidenced by the finalization of the project for internal control system regulation by the Ministry of Finance;
- Implementation of a plan to increase tax revenues and improve tax collection.

Program Monitoring and Evaluation

The Government of El Salvador and the World Bank agreed to regularly monitor the progress of the development policies supported
through the DPL II, including annual reviews of the Country Assistance Strategy. Likewise, bi-annual reviews will be conducted by the Technical Secretariat of the Presidency and the World Bank team in order to identify the program’s strengths and weaknesses and any technical assistance that may be required to ensure the achievement of medium-term results.

The government and the Bank will take advantage of several important data sources to assess the progress of the DPL II, including:

- Central government and non-financial sector public sector budget monitoring from the Ministry of Finance;
- Reports from the National Directorate for Statistics and Censuses (DIGESTYC);
- Investment climate monitoring;
- Central Bank of El Salvador reports and analyses;
- Reviews on the enforcement of laws and regulations;
- World Bank and International Monetary Fund supervision missions;
- Annual reports from the World Economic Forum;
- Annual reports from Transparency International.

Financial Administration

The World Bank policy requires an assessment of the financial management capacity of the country being supported through a DPL. According to World Bank studies on the country’s financial status (evaluation of the country’s financial management capacity and assessment of its procurement procedures), the Government of El Salvador was deemed to have the administrative and financial capacity needed to implement the DPL II.

Expected Benefits

The key benefits expected from the project are:

- Integrating financial and fiscal needs. The disbursement of this loan will help the government meet its objective of diversifying financing sources. This will support the government’s goal of fiscal stabilization in terms of addressing social needs by achieving greater and more efficient management of public spending.
- Accelerated economic growth. The loan will help strengthen a series of measures linked to El Salvador’s efforts to further its development agenda. Among these are strategic actions of the complementary agenda for policy and institutional reforms to ensure that the country takes full advantage of the DR-CAFTA and ensure its integration in the global economy. Key complementary actions include the expansion of trade and investment levels, improvements in the investment climate, investments in infrastructure and services, and promotion of innovation and technology.
- Increased efficiency and transparency of public sector management. The loan supports efforts to modernize the public sector by improving public spending efficiency, governance and anti-corruption initiatives, with special emphasis on government efficiency and financial management. The efforts underway in these areas are also expected to improve the investment climate and increase growth.

Suggested performance indicators to monitor ongoing achievement of expected benefits:

1. Exports (excluding coffee and maquila exports) reach 9% of GDP by the end of 2008;
2. The level of direct foreign investment reaches no less than an amount equivalent to 1.5% of GDP in the 2005-2008 period;
3. Tax collection grows gradually to reach 14.5% in 2008;
4. Reducing the time to start a business from 115 to 70 days (according to the most recent Doing Business report, this goal has been met since El Salvador reduced the time to 40 days after opening a single registration window for such procedures).

Frequently Asked Questions

Is the current level of public debt sustainable?
Yes. Given the current economic growth rate (almost 4.2% per year in 2006 and 2007) and fiscal revenue collection efforts, public debt is currently stable and manageable. This is reflected in the high credit rating for the country; El Salvador is the only Central American country with an investment grade.

What type of analysis does the World Bank conduct to determine the impact of the loans on El Salvador’s debt?
Before new loans can be issued, the Bank conducts a thorough assessment of the credit risk assumed by means of a debt sustainability
Given that the current level of borrowing in El Salvador seems acceptable, the World Bank Board has approved several loans in accordance with its Country Assistance Strategy. Aside from the DPLs, these loans are aimed at supporting investments in human capital and will have a significant impact on the education, health and nutrition of poorer households. Investments in human capital are key to increased economic growth, productivity and competitiveness, in addition to contributing directly towards the reduction of poverty and inequities.

**Can the DPL be redirected to combat and prevent crime and violence?**
The World Bank understands that there is a national interest in increasing the public security budget and recognizes the urgent need to strengthen measures to combat and prevent crime and violence. In contractual terms, DPL resources are aimed at funding the National Government’s Budget and, therefore, do not need to be redirected to any particular purpose. The government only needs Legislative Assembly approval to have DPL II resources available and must then redefine the general budget to increase spending for crime and violence prevention and control.

*Contact us* for more information

*Prepared by: Karla Villanueva*

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