Statement by Matthias Meyer  
Date of Meeting: November 29, 2001

**El Salvador: Country Assistance Strategy, and Earthquake Emergency Reconstruction and Health Services Extension Project**

Overall, the CAS presents a good analysis of the political, social and economic context in El Salvador, including the impact of the two earthquakes and other important developments during 2001. We welcome the proposed concentration on selected development issues and the complementarity with the IDB program. The five planned operations (emergency and health care, judicial reform, rural community development, environmental services, land administration) respond to urgent needs of the country and correspond to key challenges of the current government. We agree that rebuilding social infrastructure is a particularly important priority because of its long-term effect on poverty and because of its political relevance (political consensus building, fostering societal cohesion). We trust that the Bank will pay due attention to the efficient use of its resources. I can therefore endorse this CAS together with the proposed lending scenarios. I also support the proposed loan for the "Earthquake Reconstruction and Health Services Extension Project".

I will focus my comments on three areas: the proposed CAS, the consultation process, and some economic aspects.

**CAS FY 02 - 04:** I welcome the overarching poverty reduction objective of this CAS, aiming at contributing to Government’s intention to further reduce national poverty to 35-40 percent by 2005 (Fig. 1). We recognize that the CAS incorporates the lessons of OED’s review of previous Bank’s assistance. Despite the urgency of the reconstruction efforts, it is essential for the Salvadorian authorities to sustain macroeconomic stability while addressing the critical factors mentioned in para 62. We welcome the intention to mainstream gender aspects into all Bank supported operations and encourage authorities and staff to vigorously pursue this objective. I agree with the triggers suggested for the low-case scenario as well as with the operational indicators to measure the CAS’s effectiveness (Box 3 and Annex B1).

The CAS presents a sound analysis of the competitiveness at the national level. We appreciate the individual paragraphs on the activities by the different members of the World Bank Group, like WBI, IFC and MIGA, besides IBRD. However, the strategy lacks attention and focus on those elements that are particularly important for a more broad based economic development and for poverty reduction, i.e. small and medium enterprise development and microfinance. The division of labor with IDB with respect to supporting the productive sectors is not clear and should be more specific.

- The CAS proposes a series of rather isolated activities but lacks a coherent approach. For
example, IFC is supporting one company (FUNDAPYME) that provides consulting services to SMEs. However, the more strategic question of how to build more sustainable markets and enhance demand-orientation with regard to nonfinancial services for SME is not addressed.

- The proposed support of IFC to the regional bank and credit rating agency is an important contribution towards restructuring and strengthening of the micro-finance sector. However, additional efforts are needed to strengthen the micro-finance sector, because access to micro-credit remains mostly limited to the sector of commerce and to departmental capitals. Moreover, approaches of different institutions and donors are quite diverse and none of the multilateral institutions assumes a clear lead-role. *Could the World Bank Group play a stronger role in promoting coherence and donor coordination in the micro-finance sector?*

- Given the fact, that the diagnostic work on business environment as it impacts on SMEs is nearly completed, we would have expected a more strategic and coherent approach by the Bank with regard to SME development and micro-finance.

We would also have appreciated that the CAS would address issues like:

- the strengthening of the national disaster prevention and preparedness framework.
- the impact of this summer’s drought that hit small farmers hardest in the eastern part of the country; as well as efforts to prevent at least 50,000 people from facing food shortages and malnutrition this year need to be strengthened.
- ways to reduce corruption, which is on the rise; the weakness of the judicial system, its incapacity to contain the severe security problem and the related growing corruption in the police and prison administration.
- reforms in the banking sector; lack of efficiency is a major problem in El Salvador’s smaller banks, particularly as demand for credit has slowed. Agriculture has also suffered from banks’ unwillingness to grant credit to small producers.

**CAS consultation process:** The CAS consultation process was more participatory compared to the last one and quite innovative in terms of methods used. We commend staff for the frank analysis (annex F) with respect to the quality of the consultation process (need to improve transparency, clarity of communication) and expect that lessons learnt will be applied in the future.

The consultation process with stakeholders highlighted important areas where differences remain, such as privatization or concessioning of public services, dollarization, timing and strategy for decentralization. These differences concern fundamental issues of the development process in El Salvador and should not be underestimated in the context of the very polarized Salvadorian society. The CAS does not present a convincing strategy for dealing with these differences. The CAS only suggests the *"need for strong ownership based on up-front consensus for reform"* and *"close consultation with the legislature from the earliest stages of project preparation"*. This is not enough. The Bank should develop a clear strategy for dealing with the strongly polarized political situation that will become even more complicated as the next elections will approach. Pushing important reforms rapidly through parliament without broad consensus can put the very fragile political balance in danger. The Bank should seek to foster innovative and transparent consultation processes with different sectors of society, and support the resumption of the national dialogue process (“plan de nacion”) that was interrupted subsequent to the earthquakes and because of the controversy around the dollarization issue.
Economic issues: The analysis of the economic context is excellent and addresses well the impacts of recent developments (earthquakes, global economic slow-down, etc.). However, in two aspects, it seems somewhat optimistic:

- the external and internal debt is rising rapidly (plus 260% and 460% during 2000 and 2001 respectively, source: FUSADES) – albeit from a low basis thanks to a prudent borrowing policy in the past. There is a risk that fiscal imbalances increase if this trend continues.
- the bi-monetary policy already contributed to lower interest rates. However, other positive effects in terms of stimulating investment and consumption did not yet materialize. These effects may materialize later than expected and only if no further external shocks occur.

Finally, the implementation of the CAS faces substantial risks which need to be carefully monitored by staff and authorities, in order to be adequately mitigated. We wish the people and the authorities of El Salvador success in their reconstruction and long term poverty reduction efforts.