

Document of  
The World Bank

Report No: NCO0000530

NOTE ON CANCELLED OPERATION REPORT  
(IBRD-73000, GEF Grant 024109)

ON A

LOAN

IN THE AMOUNT OF US\$ 5.0 MILLION

AND

A GLOBAL ENVIRONMENT FACILITY TRUST FUND

IN THE AMOUNT OF US\$ 5.0 MILLION

TO THE

REPUBLIC OF EL SALVADOR

FOR AN

ENVIRONMENTAL SERVICES PROJECT

May 16, 2007

Sustainable Development  
Central America Country Management Unit  
Latin America and the Caribbean Region

## CURRENCY EQUIVALENTS

Currency Unit = US\$ 1.00

FISCAL YEAR  
July 1 – June 30]

## ABBREVIATIONS AND ACRONYMS

CABEI	Central American Bank for Economic Integration
CAS	Country Assistance Strategy
CMU	Country Management Unit
FAO	Food and Agriculture Organization
FONASA	National Environmental Services Fund
GEF	Global Environmental Facility
IDB	Inter-American Development Bank
MAG	Ministry of Agriculture and Livestock
MARN	Ministry of Environment and Natural Resources
MEF	Ministry of Economy and Finance
NGO	Nongovernmental Organization
PCU	Project Coordination Unit
PES	Payment for Environmental Services

Vice President: Pamela Cox  
Country Director: Jane Armitage  
Sector Manager: Abel Mejia  
Project Team Leader: Mark Austin  
NCO Team Leader: Anna Corsi

**EL SALVADOR**  
**Environmental Services Project**

**CONTENTS**

Data Sheet

A. Basic Information

B. Key Dates

C. Ratings Summary

D. Sector and Theme Codes

E. Bank Staff

F. Ratings of Program Performance in ISRs

1.	Context, Project Development Objectives, and Design.....	1
2.	Post-Approval Experience and Reasons for Cancellation .....	4
3.	Assessment of Bank Performance .....	5
4.	Assessment of Borrower Performance.....	5
5.	Lessons Learned.....	6
	Annex 1. Bank Lending and Implementation Support/Supervision Processes.....	8
	Annex 2. List of Supporting Documents .....	10

<b>A. Basic Information</b>			
Country:	El Salvador	Project Name:	El Salvador Environmental Services Project
Project ID:	P064910,P070352	L/C/TF Number(s):	IBRD-73000,
NCO Date:	06/13/2007		
Lending Instrument:	SIL,SIL	Borrower:	REPUBLIC OF EL SALVADOR
Original Total Commitment:	USD 0.0M,USD 0.0M	Disbursed Amount:	USD 0.0M,USD 0.0M
<b>Environmental Category: B,B</b>		<b>Focal Area: B</b>	
<b>Implementing Agencies:</b> Ministry of Environment and Natural Resources (MARN)			
<b>Cofinanciers and Other External Partners:</b>			

<b>B. Key Dates</b>				
<b>El Salvador Environmental Services Project - P064910</b>				
Process	Date	Process	Original Date	Revised / Actual Date(s)
Concept Review:	03/06/2003	Effectiveness:		
Appraisal:	04/18/2005	Closing:	07/15/2012	07/15/2012
Approval:	06/02/2005			

<b>GEF - El Salvador Environmental Services Project - P070352</b>				
Process	Date	Process	Original Date	Revised / Actual Date(s)
Concept Review:	03/06/2003	Effectiveness:		
Appraisal:	04/18/2005	Closing:		
Approval:	06/02/2005			

<b>C. Ratings Summary</b>	
<b>Performance Rating by ICR</b>	
Outcomes	Not Applicable
GEO Outcomes	Not Applicable
Risk to Development Outcome	Not Applicable
Risk to GEO Outcome	Not Applicable
Bank Performance	Satisfactory

Borrower Performance	Unsatisfactory
----------------------	----------------

<b>D. Sector and Theme Codes</b>	
<b>El Salvador Environmental Services Project - P064910</b>	
	<b>Original</b>
<b>Sector Code (as % of total Bank financing)</b>	
Agricultural extension and research	15
Central government administration	10
General agriculture, fishing and forestry sector	15
Payment systems, securities clearance and settlement	60
<b>Theme Code (Primary/Secondary)</b>	
Biodiversity	Primary
Environmental policies and institutions	Primary
Land administration and management	Primary
Participation and civic engagement	Secondary

<b>GEF - El Salvador Environmental Services Project - P070352</b>	
	<b>Original</b>
<b>Sector Code (as % of total Bank financing)</b>	
Agricultural extension and research	15
Central government administration	10
General agriculture, fishing and forestry sector	15
Payment systems, securities clearance and settlement	60
<b>Theme Code (Primary/Secondary)</b>	
Biodiversity	Primary
Environmental policies and institutions	Primary
Land administration and management	Primary
Participation and civic engagement	Secondary

<b>E. Bank Staff</b>		
<b>El Salvador Environmental Services Project - P064910</b>		
<b>Positions</b>	<b>At ICR</b>	<b>At Approval</b>
Vice President:	Pamela Cox	Pamela Cox
Country Director:	Jessica Poppele	Jessica Poppele
Sector Manager:	Abel Mejia	Abel Mejia
Project Team Leader:	Mark A. Austin	Mark A. Austin
NCO Team Leader:	Anna Corsi	
NCO Primary Author:	Anna Corsi	

<b>GEF - El Salvador Environmental Services Project - P070352</b>		
<b>Positions</b>	<b>At ICR</b>	<b>At Approval</b>
Vice President:	Pamela Cox	Pamela Cox
Country Director:	Jane Armitage	Jane Armitage
Sector Manager:	Abel Mejia	Abel Mejia
Project Team Leader:	Mark A. Austin	Mark A. Austin
NCO Team Leader:	Anna Corsi	
NCO Primary Author:	Anna Corsi	

## **F. Ratings of Project Performance in ISRs**

<b>No.</b>	<b>Date ISR Archived</b>	<b>DO</b>	<b>GEO</b>	<b>IP</b>	<b>Actual Disbursements (USD millions)</b>	
					<b>Project 1</b>	<b>Project 2</b>
1	12/30/2005	S	S	S	0.00	0.00
2	06/28/2006	U	U	U	0.00	0.00
3	12/18/2006	HU	HU	HU	0.00	0.00

**1. Context, Project Development Objectives, and Design** (*drawing from PAD, briefly describe the country and sector background, rationale for Bank assistance, development objectives, components, costs and funding, implementation arrangements, risk analysis, and quality at entry*):

**Country and Sector Background.** El Salvador suffers severe environmental deterioration both in urban and rural areas. Current land use practices have significant negative repercussions for El Salvador's agriculture sector, natural resource base, and environment, including (i) loss of biodiversity, critical ecosystems, and natural habitats, (ii) severe land and forest degradation, and (iii) poor water resource management. Rural development and poverty alleviation through improved natural resources management are priorities for the Government of El Salvador, which is consolidating the regulatory and legal framework for environmental management and developing a national environmental policy and strategy. A core element of this strategy is to develop environmental service markets to encourage landowners to make the desired land use changes.

The project concept was formulated under the Flores administration (1999-2004), whose "Alliance for the Future" program envisioned decentralized and participatory environmental management. The environment became an even higher priority under President Saca. His eleven-point *Pais Seguro* plan names two issues that were directly supported by the project (Agricultural Development: Expanding the Chain of Value; and Environment: Legacy for Future Generations) and includes short-term implementation of a Payment for Environmental Services (PES) system as one of its goals.

The Environmental Services Project aimed to create PES mechanisms to provide incentives for sustainable land use to hillside farmers and other land users in at least two pilot areas. It would have also created a framework for application of PES approaches that could have been applied to other areas on a decentralized basis, responding to local needs and conditions in particular watersheds. The development of PES programs for El Salvador was based on lessons learned from the considerable experience the World Bank has in the design, implementation, and support of PES programs in developing countries (especially in Costa Rica, Colombia, and Nicaragua), and recommendations from work published by the World Bank, FAO, Forest Trends, and the Institute for International Environment and Development (IIED). No other institution has the same depth of experience in implementing PES approaches.

GEF support was warranted because the project would have helped (i) conserve globally significant biodiversity, including critically endangered endemic species, (ii) enhance the Salvadoran sections of the MBC, (iii) pilot PES as a sustainable, long-term conservation instrument that could have been scaled up and replicated in El Salvador and served as a model for other countries, (iv) research links between land use change and environmental services; and (v) increase carbon sequestration and knowledge about bio-carbon sinks.

**Project Development Objective.** The project aimed to (i) establish legal, institutional, and financial arrangements to pilot mechanisms of payment for environmental services, (ii) document links between land use changes and water services improvements and

biodiversity conservation, (iii) define good practices to replicate, scale up, and sustain PES programs; and (iv) strengthen the capacity of the Ministry of Agriculture (MAG), the Ministry of Environment and Natural Resources (MARN), community associations, and NGOs to support long-term development of environmental service markets in El Salvador.

The **global environment objective** of the project was to enhance and protect biodiversity by preserving important forest and protected ecosystems. This would have been done by piloting a market-based system to contract environmental services. Such a system would have protected and expanded forest cover and biodiversity-friendly land uses in biological corridors and the buffer zones of protected areas, and reduced perverse land use incentives that negatively affect biodiversity and wildlife in general.

These objectives would have been achieved by (i) establishing institutional and financial arrangements to pilot a program of payment for environmental services that would have helped protect globally important biodiversity through conservation and sustainable use of high priority ecosystems; and (ii) strengthening the capacity of national institutions (MAG, MARN), municipalities, community associations, NGOs, and academic institutions to support long-term development of environmental service markets in El Salvador.

**Project Components.** The total project cost was US\$14.5 million, of which the World Bank would finance US\$5.0 million, the Government of El Salvador US\$2.3 million, the GEF US\$5.0 million, and others (beneficiaries) US\$2.2 million. The project had three main components:

Component 1: Design and Implement a Program of Payments for Environmental Services (62% of total project cost) was aimed to design and implement an environmental services fund, create several pilot mechanisms to implement the approach in two to five priority watersheds, and develop procedures to replicate the approach more widely. Payments were to be provided for activities such as agro-forestry, forest management and conservation, reforestation, afforestation, and sustainable agricultural production that generate valuable environmental benefits such as improving water quality, regulating groundwater and surface flows, maintaining or enhancing biodiversity, and increasing carbon sequestration. Particular attention would have been given to biodiversity corridors, critical ecosystems, and buffer zones for protected areas. GEF resources would have helped ensure that incentives promoted global as well as local and national objectives.

Component 2: Institutional Strengthening (21% of total project cost) was aimed at strengthening the capacity of all market participants, including national institutions (MAG, MARN), market intermediaries, community associations, and NGOs to support long-term development of environmental service markets. This coincided with the government's strategy to promote intersectoral approaches and strengthen civil society participation in environmental management. MARN was to carry out activities aimed at creating an enabling environment for the development of a PES system, identifying

funding sources for the program, and consolidating the National Environmental Services Fund (FONASA).

Component 3: Project Management and Monitoring and Evaluation (17% of total project cost) was focused on project management mechanisms including planning and monitoring and evaluation (M&E). It would have helped new and existing entities and mechanisms in the national government conduct project coordination and supervision and strengthen the effectiveness and quality of project operations. In addition, a robust mechanism would have been put in place to monitor and evaluate (a) project milestones and indicators, (b) environmental services contract compliance, (c) beneficiary perceptions of project impacts, (d) site-specific land use changes, impacts, and environmental services produced, including baseline assessments for each site and contract, and (e) pilot testing of other land use changes to establish and clarify links to hydrologic, sediment, and other environmental services. A key element of this component was establishing the mechanisms, learning process, and knowledge base to replicate the approach in other areas.

**Implementation Arrangements.** The Ministry of Environment and Natural Resources (MARN) was the institution responsible for executing the project and for all technical and fiduciary aspects, overall management and supervision of the grant/loan, and monitoring and evaluation. Direct implementation was to be provided by a Project Coordination Unit (PCU) within MARN's Department of Natural Resources. During the first year of implementation MARN, through the PCU, was to establish the National Environmental Services Fund (FONASA) within the existing Environmental Fund of El Salvador (FONAES) to execute most activities in Components 1 and 2. The PCU was to gradually transfer its responsibilities to FONASA as the Fund developed institutional capacity so that by the end of the project the PCU could have been dissolved without disrupting the PES system. Other institutional actors in the project included NGOs (acting as PES intermediaries), community associations, and universities.

The project was to coordinate with the Second El Salvador Land Administration Project (IBRD) and the partially blended El Salvador Land Administration and Protected Areas Consolidation Project (GEF), which focused on defining tenure for all private and public lands in El Salvador, and strengthening two key priority protected areas and regularizing the status of existing communities within them. Together these projects would have piloted a set of complementary mechanisms for MARN to establish its 15 Conservation Areas - one for the core protected areas through the land administration GEF and the other for buffer zones through the PES project.

**Risks.** A number of critical risks were identified during the appraisal of the project, including political pressure to shape the PES system to achieve non-environmental goals, lack of political will or economic/financial incentives for key stakeholders to help develop and participate in efforts to replicate and/or scale up the project's piloted PES markets to a national level, and the lack of capacity of national institutions, community associations, NGOs, and academic institutions to support long-term development of environmental service markets. None of these risks were rated as high. Corresponding

mitigation measures were designed, including arrangements to ensure that payments under any individual PES mechanism would only be made for land uses that are expected to generate environmental services, taking an incremental approach to developing a PES system by focusing on the building blocks of an institutional framework, and providing the necessary support and capacity building activities to each institutional actor.

## **2. Post-Approval Experience and Reasons for Cancellation**

*(main events leading to cancellation, steps taken to resolve problems, exogenous factors, identification of causes and responsibility if project failed, implications of failure):*

The factor leading to the cancellation of the Environmental Services Project was the government's failure to gain consensus and obtain Congressional approval by a simple and subsequently a qualified (two thirds) majority required for approval of external borrowing and for project effectiveness.

The project was approved by the World Bank Board on June 2, 2005, about a year after President Saca took office and ten months prior to legislative elections. In El Salvador, it is the role of the legislative branch to approve the government's annual budget, including the approval of all external loans and credits. Loan signing by the government is conditioned on the prior legislative approval by the simple majority (50 percent + 1 vote). In the case of loans, final ratification by the qualified majority (two thirds of Congress) is required for the project to become effective.

The legislative agenda in the last months before the March 2006 legislative elections was dominated by priority key reforms requiring a qualified majority in an already politically divided Congress. Thus, due to other political priorities, the project loan and GEF agreements were not taken up for discussion in the outgoing Congress. The new Congress took office in April 2006. The newly elected Congress was even more divided than the previous one, rendering approval by the qualified majority impossible without support from the main opposition party. In this difficult political situation, the project counterpart (MARN, MEF, and *Secretaría Técnica*) worked with the Congress and relevant project actors to have the project submitted for discussion and approved, and in parallel kept working to meet all other project effectiveness conditions.

The Bank team maintained regular contact with the Resident Representative in San Salvador and the CMU team to ensure a coherent strategy for presenting this and several other projects in El Salvador to Congress after the country's elections. A number of missions were carried in late 2005 and during 2006 to closely work with the counterpart (including the Government and members of Congress from all parties) in an effort to ensure project approval and ratification by Congress within the eighteen-month deadline from the Bank Board approval. The Country Director and Representative met on several occasions with members of the opposition to present the objectives of this and other Bank loans pending Congressional approval and answer their questions. They also gave several press interviews to explain the importance of the project for growth and poverty reduction. The dialogue with the new Congress was deepened during the visit to

Washington D.C. on July 12, 2006 of a high level Congress delegation, which included members of the opposition. The agenda for the visit was planned jointly with the IDB (who faces the same problems in getting Congressional approval of their loans) and with the IMF, and included discussions of El Salvador's macroeconomic and fiscal situation, debt service capability, as well as detailed presentations on all pending loans and evaluations of prior Bank loans.

In October 2006, the loan and GEF agreements were presented to the Congress. However, the Congress did not take them up for discussion. The loan and the GEF agreements were not signed because the Congress failed to approve them within eighteen months of Board approval (December 2, 2006). As a result, on December 4, 2006 the Loan Agreement and the GEF Agreement were withdrawn.

**3. Assessment of Bank Performance** (*lending process/ensuring Quality at Entry, supervision and implementation assistance role, compliance with Bank policies, justification for rating*):

Rating: Rating: Satisfactory

The Bank performance is rated satisfactory. The project was very consistent with the priorities of the Government as highlighted in the national environmental policy and strategy and the *País Seguro* program, and the CAS, all of which had a strong focus on combating poor agriculture practices and environmental degradation, improving land uses and water resources management, and promoting decentralization and participation in environmental management. The project was designed following a demand driven approach, and in coordination with other donors interested in supporting complementary operations in the country. During project preparation, the Bank's project team worked closely with the staff of MARN, on the basis of diagnostics which analyzed the lessons learned from the state-of-the art system in Costa Rica. The overall risk of the project was assessed as modest during project preparation, and a set of mitigating measures were designed. Despite the efforts by the Bank's project and Country Management teams to maintain a continuous and open dialogue with the Government and the Congress to facilitate approval and ratification, due to the political deadlock, the Bank was unable to avoid the cancellation of the project.

**4. Assessment of Borrower Performance** (*government and implementing agency performance, compliance with covenants, justification for rating*):

Rating: Rating: Unsatisfactory

The Borrower's performance is rated unsatisfactory. Despite the fact that there was a high degree of institutional ownership on the part of MARN, which also contributed to the effort of managing the difficult political process and the dialogue with the new Congress, the Government failed to have the loan approved and ratified by Congress in the eighteen months following project effectiveness.

## **5. Lessons Learned** *(both project-specific and of wide general application):*

In countries such as El Salvador where loans have to be approved by a simple majority and then ratified by a qualified (two thirds) majority of Congress, and the Congress is deeply divided, the Bank needs to recognize that loans may not be approved, despite every effort to meet with opposition leaders, explain the purposes of the projects, answer questions, provide information on previous operations, as well as information on the macroeconomic, fiscal and debt situation. The risks of political gridlock and consequent failure to approve external loans were explicitly recognized in the FY05-FY08 CAS. There is a long history of political polarization in El Salvador and ratification and effectiveness of previous loans had been delayed for almost two years under the previous CAS. However, President Saca took office in June 2004 on a platform that emphasized consensus building with the opposition and consultations and outreach to civil society and the private sector. A Presidential Commission was created to promote consensus on critical issues that required national long term commitment and support across party lines. During the first year, this approach to consensus building appeared to be bearing fruit, and the government was successful in gaining support in the Assembly for key initiatives, for example on combating crime and violence.

The FY05-FY08 CAS which was discussed by the Bank's Board of Executive Directors in early 2005 tried to reduce the risk of substantial delays in loan approval in two ways. For the DPL series, through which the bulk of lending was expected to be channeled, the Government expected that the concurrent submission of the DPLs and the annual budget to the Assembly would give it the leverage needed for prompt loan ratification. For investment loans, the Government's plan to bunch operations early in its tenure was expected to facilitate timely ratification. Therefore, during 2005 the Bank moved quickly to prepare a package of new operations, including a program of Development Policy Loans and selective investment operations for Land Administration (Board approval March 2005), Environmental Services (June 2005), Social Protection (October 2005) and Secondary Education (November 2005). The first DPL was approved by the Bank's Board in February 2005 and was approved by the National Assembly in August 2005, with the second DPL approved by the Board in December 2005. However, political polarization in the country deteriorated steadily. The new Congress that took office in April 2006 was even more divided and has operated in an atmosphere of deep distrust and confrontation between the different parties. Intensive efforts to build support for approval of external loans (including loans from the World Bank, IDB and Central American Bank for Economic Integration) were not successful despite the involvement of the LCR Vice President and Director, the President of IDB and senior management of CABEI. As of early 2007, two Bank loans and three IDB loans have been cancelled, and three more Bank loans face cancellation in the next three months.

Preparation of new operations planned under the CAS has been put on hold. Bank assistance has been reduced to Regional AAA (e.g. on crime and violence, land administration, energy), selective country capacity building on debt management, financial sector regulation, monitoring and evaluation for CCTs and workshops and conferences to disseminate findings of Bank work on relevant development topics such as remittances, informality, governance and anti-corruption, fiscal policy, etc. In addition,

project teams are continuing to supervise implementation of the two projects left in the portfolio. The Bank's representative continues to meet regularly and share information with all the parties in the National Assembly and to work with other partners and stakeholders in trying to promote national dialogue on development issues.

## Annex 1. Bank Lending and Implementation Support/Supervision Processes

### (a) Task Team members

Names	Title	Unit	Responsibility/ Specialty
<b>Lending</b>			
Mark Austin	Sr Operations Officer	LCSAR	Team Leader
Alejandro M. Deeb	E T Consultant	LCSSEN	
Dinesh Aryal	Operations Officer	LCSSEN	
Edgar Ortiz	Consultant	LCSAR	
Fabienne Mroczka	Financial Management Analyst	LCSFM	
George Campos Ledec	Lead Ecologist	LCSSEN	
Jean-Claude Balcet	Sr Agric. Economist	LCSAR	
Luis R. Prada Villalobos	Sr Procurement Spec.	LCSPT	
Peter M. Brandriss	Senior Program Assistant	LCSSD	
Stefano P. Pagiola	Sr Environmental Econ.	ENV	
Paula Freitas	Operations Analyst	LCSSEN	
Gunars Platais	Sr Environmental Specialist	LCSSEN	
Juan Martinez	Social Specialist	LCSSES	
Fabiola Altimari	Counsel	LEGLA	
Carolina Sanchez	Team Assistant	LCSSES	
Ann Jeannette Glauber	Environmental Specialist	LCSSEN	
<b>Supervision/ICR</b>			
Mark Austin	Sr Operations Officer	LCSAR	Team Leader
John Kellenberg	Sector Leader	LCSSD	

### (b) Staff Time and Cost

Stage of Project Cycle	Staff Time and Cost (Bank Budget Only)	
	No. of staff weeks	USD Thousands (including travel and consultant costs)
<b>Lending</b>		
0099		3.34
0000		86.85
0001		40.21
0002		41.82
0003		37.23
0004		53.59
0005		276.86
0006		-0.20
0007		0.00
<b>Total:</b>		539.70

<b>Supervision/ICR</b>		
0005		0.00
0006		61.69
0007		14.33
<b>Total:</b>		76.02

## **Annex 2. List of Supporting Documents**

1. Project Concept Note
2. Project Appraisal Document
3. Project Information Document
4. Integrated Safeguards Data Sheet.