

STRATEGY FOR THE SUSTAINABLE DEVELOPMENT OF THE NORTHERN ZONE OF EL SALVADOR

SUMMARY OF THE PROPOSAL FOR FINANCIAL SUPPORT FROM THE MILLENNIUM CHALLENGE CORPORATION MAY 2006

1. Introduction

The Northern Zone of El Salvador comprises one-third of the national territory, concentrates the poorest municipalities, lacks connectivity within the zone and with the rest of the country, and, for a variety of reasons, has been a historically abandoned area. However, the Northern Zone is the country's main source of energy, water, and biodiversity, which makes its sustainable development vital for the entire country.

El Salvador has proposed to the Millennium Challenge Corporation (MCC) a five-year Program to achieve poverty reduction and economic growth through activities focused on the country's Northern Zone. While the activities have a regional focus, the impact of the Program will be national in scope.

El Salvador is recognized for having achieved, in recent years, a series of reforms oriented towards democracy, economic freedom, and social investment. Since the beginning of his term, President Saca has made a series of efforts to ensure that El Salvador became eligible for MCA assistance by meeting MCC criteria on ruling justly, investing in the people, and promoting economic freedom.

The proposal that has been submitted to the MCC builds on a consultative process led by the National Commission for Development (CND), established in 1997 to lead a participatory development planning process for El Salvador. With broad participation from local governments, private enterprise and civil society, the CND helped shape a broadly shared vision for the development of five regions of the country, including the Northern Zone, and incorporated that vision in 2004 in a Shared National Development Strategy.

The Government of El Salvador (GOES) has prepared an investment plan that responds to the strategy for development for the Northern Zone. The proposal summarized in this document requests non reimbursable financial support from the MCA to help finance that investment plan and seeks to have a significant impact in our country's human development, productive development, and connectivity, as well as on the protection and restoration of our environment. It is an complete and coherent proposal with components that will guarantee the transformation of the Northern Zone.

The proposal recognizes the region's potential for economic growth and poverty reduction, its unique contribution as a source of natural resources essential to a healthy environment, and the importance to the entire nation of integrating this vital region into the mainstream of sustainable economic and social development.

This document includes a summary of the proposed Program and the rationale behind its design, as well as a description of the consultation process that has guided the evolution of the proposal.

2. Program Description and Rationale

2.1. Strategy to Achieve Growth and Poverty Reduction

2.1.1. National Strategy and Targets for Growth and Poverty Reduction

President Saca's "Secure Country 2004-2009" Plan (see the El Salvador MCA website, www.mca.gob.sv) focuses on establishing an enabling environment of sound macroeconomic policies and free trade to promote rapid and sustained private sector-led growth, places great emphasis on pro-poor policies for more inclusive growth, and is closely aligned with the principles that underlie the MCA. This policy is being given effect through several initiatives, including: the free trade agreement between the United States, Central American countries, and the Dominican Republic (CAFTA-DR) and the new seaport in La Unión.

Additionally, El Salvador is working towards meeting the Millennium Development Goals by redefining and strengthening the country's social safety net, including launching a major social program called *Red Solidaria*, and taking significant measures to achieve universal primary education, reduce child mortality, improve access to water and sanitation and expand rural electrification. The MCA Program will play a crucial role in the Government's strategy to promote growth and reduce extreme poverty.

2.1.2. Constrains to Faster Growth and Poverty Reduction

El Salvador has made substantial progress in improving its economic and social conditions and building its democratic institutions in the last 15 years; nonetheless, part of its population remains in poverty, without access to good jobs or basic social services. The 1980s civil strife had a significant negative impact on the country's economy and poverty indicators. By the time it ended in 1992, about two-thirds of the Salvadoran population was living in poverty. Rural areas, particularly in the northern region of the country, were most affected.

Since 1989, major stabilization and structural adjustment programs, an export-led growth strategy, privatization of publicly owned companies and the dollarization of the economy have restored economic growth and reduced poverty. However, the current rate of growth (2.8 percent in 2005) remains insufficient to have a wide and significant impact.

El Salvador's productive structure has changed significantly in the last two decades. Traditional agricultural exports (coffee, cotton, sugar) have declined in importance) as the contributions of services and industry have increased. However, many Salvadorans (40 percent of total population) live in rural areas and depend on agriculture for their livelihood. Most agricultural land is devoted to basic grains, with two-thirds of producers cultivating very small plots of less than 2 hectares. Only about one-half of maize production is marketed, which illustrates the continuing high level of subsistence rather than commercial agriculture. This subsistence agriculture is characterized by low productivity, low value added, inaccessibility of markets, and lack of effective support in terms of infrastructure, research, technical assistance and finance.

El Salvador's major constraints to growth and poverty reduction are low human capital formation and poor infrastructure. World Bank economists have concluded that, to increase its growth prospects, El Salvador should invest in *infrastructure* and *education*, and continue to maintain the *economy open to trade*. The MCA Program responds directly to the World Bank's analysis and guidance with its interrelated components of human development, productive development and connectivity.

2.1.3. Strategic Goal: Sustainable Development of the Northern Zone

The strategic goal of the proposed MCA Program will be accomplished by fostering human development and productive development in this region and increasing its connectivity with the rest of the country and with the neighboring countries of Central America. The direct and immediate beneficiaries will be the

Widespread unsustainable patterns of land use for subsistence agriculture in the Northern Zone are perpetuating a vicious circle of severe environmental degradation, reduced productivity of agriculture, deepening poverty, and the extension to additional land of inappropriate and unsustainable practices. Breaking this vicious circle will be essential to reduce poverty in the north and to preserve and restore the fragile environmental resources that are essential to biodiversity and access to water and energy throughout El Salvador. It is not an exaggeration to say that sustainable development of the Northern Zone will be essential for the sustainable development of the entire nation.

2.2. Objectives and Outcomes of the Northern Zone Investment Plan

The CND strategy for development of the Northern Zone involved six processes that emerged from the extensive consultations carried out in the last six years: development of territories as centers of economic activity; conservation of the Lempa River basin; construction of a northern transnational highway and a related network of connecting roads; integration of the frontier with Honduras; construction of competitive cities; and strengthening municipal associations and governance. These processes encompassed three major themes: (1) developing productive potential; (2) strengthening human development; and (3) increasing connectivity.

The Government of El Salvador has responded to the Commission's strategy with a Northern Zone Investment Plan that includes reliance on support from MCA. This investment plan is intended to convert the shared vision that over the past eight years has shaped a strategy for development of the Northern Zone into a practical reality. The plan's three components, corresponding to the major themes of the shared strategy, are the basis for the proposal of El Salvador for assistance from the Millennium Challenge Account. The three components are:

Human Development, which includes programs to increase knowledge and skills and to expand access to basic social infrastructure.

Productive Development, which will provide support to micro, small, and medium sized producers to expand their markets and increase their production and employment.

Connectivity, which seeks to achieve connectivity within the Northern Zone, with the rest of the country, and with the entire region.

These components will be given effect through a combination of financing from the MCA and from other sources. Some of the activities are already underway but require additional financing in order to be carried out in a timely and effective manner. All three components incorporate five crosscutting themes of transcendental importance for the sustainable development of the Northern Zone of El Salvador:

The Environment, because economic growth and environmental protection are mutually reinforcing goals. The level of attention and focus on the environment reflects understanding of the critical role a national's natural resource base and its rest responsible management in the long-term well being of its people. Environmental management has been carefully considered in each component of the Investment Plan in order to emphasize the importance of this aspect of achieving sustainable economic growth.

This emphasis has been reinforced in the ongoing consultation process and in the design of the Investment Plan. The Human Development component includes activities such as sanitation and rural electrification that will improve both living and environmental conditions. The Productive Development component will encourage environmentally friendly production that preserves and restores the natural resource base. The Connectivity Component will make maximum use of existing roads, thereby diminishing environmental impact.

Territorial development, because attention to diverse territorial capacities can contribute importantly to economic growth and poverty reduction. A comprehensive approach to territorial development will take advantage of the country's diversity and stimulate internal and external investment and reduce imbalances between urban and rural areas.

Each component of the Plan is intended to stimulate opportunities for the inhabitants of the Northern Zone. Making best use of each territory's particular advantages fosters a dynamic environment where social and economic relations take place, where inputs are transformed into outputs, and where the population is responsible for the sustainability of limited resources for coming generations.

The CND has accumulated a significant body of knowledge regarding territorial development, the harmonization between national and local development, decentralization, and a coherent approach in the short, medium, and long term. This experience is reflected in the Plan, and in the commitment of GOES, CND, and other institutions to assure that territorial approaches will help to achieve economic growth and poverty reduction. Particularly important will be the role of CND in the coordination with local governments to implement territorial development approaches.

Gender equality, because of the disproportionate number of women in the Northern Zone, including poor women and heads of households. This phenomenon is explained in part by the migration of the male population in search of work opportunities and as a result of the 1980's armed conflict. Gender integration will be incorporated into all components, taking into consideration, where appropriate, the analysis of beneficiaries to reduce and eliminate obstacles to participation in productive and human development activities. The new census which GOES is currently conducting will provide invaluable information on women's status in the country.

Transparency, because it is crucial to assure the credibility of the program with the people of El Salvador and with the cooperating entities, including the MCC. It is important that the public be kept informed in a permanent, timely, and transparent manner. Transparency has been a prominent feature in the preparation of the Investment Plan (as evidenced in the consultative process) and will continue to be stressed in the implementation phase. There will be constant information supplied through printed, broadcast, and electronic media relevant to activities and operations.

Participation, because, in addition to being a requirement of the MCC, it proved its value in the consultative process for improving the quality of the plan and its embrace by the people who will be directly affected. The main purpose of the consultative process was to seek consensus among the Salvadoran population to make sure that this is a country program and that it will bring the greatest benefit possible to the Northern Zone in particular and to El Salvador in general. A more detailed description of the consultative process is provided in Section 3.

Given their knowledge of the possibilities, and limitations that affect their communities, local governments, community associations, and other stakeholders are key in the development and implementation of the Plan. They can be a link with the people and make sure that benefits are directed towards the reduction of poverty, creation of local employment and economic development at local levels.

They can also provide support, along with their communities, in the execution of basic infrastructure projects, associability of local entrepreneurs, identification of priorities, strengthening of economic structures and rationalizing investment oriented to the maintenance of roads.

During the development of activities considered in the Plan, the participation of local governments and other local players is crucial, not only for implementation, but especially to ensure future financial, social, and environmental sustainability while developing the adequate local appropriation by the local communities and their recognition that the results will improve their quality of life.

The three components of the Northern Zone Investment Plan are mutually complementary and, together, form an integrated strategy for the region's sustainable development.

2.2.1. Strengthening Human Development throughout the Northern Zone

This component is the focus of two new Government programs – *Red Solidaria* and the National Education Plan 2021. *Red Solidaria* includes a program of conditional cash transfers for the most disadvantaged families living in the 100 poorest municipalities, 53 of which are in the Northern Zone. The National Education Plan 2021 follows the objectives established by Education for All (Dakar 2004), including the commitment to equal access to schooling for boys and girls.

Two aspects of human development have particular relevance to this proposal: increasing knowledge and skills and expanding access to basic social infrastructure. To meet the National Educational Plan goal of strengthening technical education, MCA financing is proposed for the initial construction, equipping and expansion of two post-secondary technological education institutes and for scholarships for secondary and post-secondary technical education for disadvantaged students. MCA, GOES and other donor financing will also be used for short-term, informal skills development for inhabitants of the Northern Zone to enable them to take advantage of new economic opportunities. The Investment Plan also includes basic infrastructure investments in (i) potable water and sanitation; (ii) rural electrification; and (iii) community infrastructure.

2.2.2. Developing the Region's Productive Potential

This component includes measures to help micro, small, and medium sized producers expand their markets and increase their production and employment, maximizing the region's economic potential while preserving the environment. The support will be market-oriented and focus on creating and strengthening productive chains for products and services that have strong potential to create employment, increase incomes and conserve and, where possible, restore natural resources.

To finance this component the GOES will establish a specific program to support micro, small and medium businesses in the Northern Zone. This program, which will also include financing from the MCA, will offer: (i) business services, (ii) business financing, and (iii) productive infrastructure. The private sector will play the crucial role in the productive development of the Northern Zone. In addition, productive development of the Northern Zone will benefit from an ongoing program of land title regularization supported by the World Bank and from a coordinated effort with Honduras and Guatemala to improve the management of the Upper Lempa River Basin. Also relevant is El Salvador's 2005 tourism law, which provides tax incentives for investment in this sector, and the recently announced National Tourism Plan 2014.

2.2.3. Increasing Connectivity within the Region, with the Rest of the Country, and with Neighboring Countries

This plan includes the development of a highway system that will achieve connectivity within the Northern Zone, and between this zone and the rest of the country, as well as with the other countries of Central America. Two major activities are contemplated for the next five years: the transnational northern

highway, and a structural cohesion network of connecting roads. Funding for this major effort will depend largely on MCA. The Government will also contribute part of the necessary financing, with support from the IDB.

2.2.4. Summary of Northern Zone Investment Plan

Table 1 presents a summary of the proposed contributions of the MCA. The proposal is subject to approval by the MCC and the final outcome of the negotiations about the content and the amount of the resulting Program cannot be predicted.

Northern Zone Investment Plan (US\$ Millions)

Component	MCA Financ.* 2007-2011	GOES** 2005- 2011	International Support	Total
I. Human Development Includes formal and informal education and basic social infrastructure investment in water and sanitation, rural electrification and community infrastructure.	106.91	131.63	139.12	377.66
II. Productive Development*** Includes technical assistance services for business development, infrastructure and productive equipment, and investment and credit programs.	75.47	190.37	73.03	338.88
III. Connectivity Includes the construction of the Northern Transnational Highway (US\$ 138.2) and a strategic network of rural roads (US\$ 95.4).	233.55	50.44	46.77	330.76
IV. Program MCA				
Technical Assistance (to ensure quality of investment)	0.1			0.1
Monitoring and Evaluation (measurement of indicators)	4.6			4.6
Audit System (ensure transparency)	3.8			3.8
Institutional Strengthening (guarantee efficiency)	3.2			3.2
Consultation and Citizen Participation	3.0			3.0
Program Execution	10.8			10.8
Total	441.43	372.44	258.93	1,072.80

* Funding is subject to discussion and approval by the MCC.

** Data base don budget trends and projections.

*** Does not include US\$ 658 millions, corresponding to the construction of 2 hydroelectric dams in the Northern Zone.

2.3. Millennium Challenge Account Contributions to the Northern Zone Investment Plan

The Millennium Challenge Account presents a unique opportunity to translate the Plan into reality in the coming years and achieve truly transformational development. This section describes how the Millennium Challenge Account will allow the Investment Plan to be successfully implemented.

2.3.1. Logical Framework

The expected outcome of the MCA Program is significantly reduced poverty through economic growth. There will be a substantially increased number of people with skills and improved access to basic services and community infrastructure. There will be new investment in value-added productive chains that will be attracted to the region, creating employment and economic growth. And the construction of a transnational highway and network of rural roads will connect the region with the rest of the country and with neighboring countries. In addition to outcomes within the Northern Zone, the Program will have important consequences for national unity, conservation of valuable natural resources, and greater competitiveness of the Salvadoran economy in domestic, regional and international markets. Greater equality of opportunity within El Salvador will contribute to diminished pressures of urban migration,

reduced loss of skilled individuals to international migration, and, as demonstrated in the World Bank's *World Development Report 2006*, greater social cohesion and more rapid and sustainable economic development.

The Program includes three components which correspond to the three specific objectives of the MCA Program: to *strengthen human development*, to *foster productive investment*, and to *improve road connectivity*. The links from Program activities to expected outcomes and goals are laid out in the proposal in a logical framework, demonstrating that, together, the three components constitute integrated elements of a coherent development program of regional and national importance. The detailed descriptions and justifications for these program elements are presented in the following section.

2.3.2. Description and Justification of Program Components

2.3.2.1. Human Development

A. Knowledge and Skills Development

1. Formal Technical Education

The Ministry of Education's MEGATEC Network initiative complements increased investment in primary and secondary education in El Salvador. The MEGATEC Network of institutions is the principal GOES initiative to expand and strengthen technical education, corresponding to the productive development requirements in the various regions of the country. Including in the MCA Program post-secondary Technological Institutes located at Cabañas and Chalatenango and the strengthening of secondary technical schools located in the Northern Zone will assure the region's participation in this national initiative. Expanding and strengthening the MEGATEC Network in the Northern Zone will increase the supply of technically qualified individuals within the region to meet the needs of a growing and diversifying economy.

The formal technical education activity will begin with a study to assure that the curricula of the institutes are responsive to the demands of the labor market for technical skills, and will also inform the design of specifications for the construction and improvement and the equipping of the Technological Institutes in Cabañas and Chalatenango, and the improvement of the capacities of ten additional middle technical institutes throughout the Northern Zone. Construction at Cabañas and Chalatenango will be carried out under the management of the Social Investment Fund for Local Development (FISDL) with technical guidance from the Ministry of Education. In accordance with the model of private administration of technical education followed successfully in El Salvador since 1991, the *Universidad Católica de Occidente* (UNICO), an accredited educational institution founded in 1982, will administer the Cabañas Institute and The *Fundación ÁGAPE*, a not-for-profit institution founded in 1978 and which currently administers the Chalatenango Institute, will continue to administer that institute.

Students with good academic qualifications who cannot afford the MEGATEC programs will be able to seek scholarships, to be awarded by the institutions responsible for administration of the institutes, with financing managed by the Multisectoral Investment Bank (BMI). The Ministry of Education will take the lead in continuing the scholarship program after the MCA Program ends in 2011, including support from cooperating agencies, civil society organizations and the private sector. At the same time, increased incomes should enable more families to be able to afford technical education for their children without the need for financial assistance.

The beneficiaries of technical education will be young people in the Northern Zone who complete secondary education and are accepted for admission into a two-year program of superior technical education at one of the two Technological Institutes, as well as those who enroll after primary school in a

three-year program of medium technical education at one of the middle technical institutes in the Northern Zone. Admission criteria will specifically take into account the importance of assuring gender equity in the availability of educational opportunity. It is expected that 180 students will enroll in each of the two Technological Institutes in superior technical education programs in the academic year 2008, and that this number will gradually increase to 1,000 total enrollments in each institute by 2011. With respect to the 15 middle technical institutes, it is estimated that 527 will enroll in the academic year 2008, growing to 3,162 total enrollments by 2011.

Costs to MCA will be exclusively for the construction and improvements to the two Technological Institutes and for scholarships.

2. Informal Skills Development

Informal training opportunities will complement the longer-term technical education provided by the MEGATEC Network initiative described above, by making available short-term business training needed to launch productive business ventures, increase the capacity of the region's micro, small and medium businesses, and facilitate associations of businesses to gain economies of scale and create productive chains. It will also provide short-term, market-based training for unskilled and low-skilled workers in the Northern Zone who are seeking to make the transition to employment in modern production. BMI will manage this activity through grants to not-for-profit institutions.

The beneficiaries of this activity will be individuals in the Northern Zone who seek to improve their incomes through the inauguration or development of a micro, small or medium business or through employment in a position requiring a higher level of skill. Criteria for participation will place emphasis on including women and disadvantaged groups. It is estimated that under this activity 9,716 individuals will receive training in 2007, and that this number will increase significantly and then phase down to 10,751 participants in 2011.

The program will draw upon existing organizational structures and networks of BMI, the Salvadoran Institute for Professional Training, and the Secretariat for Youth that are integrated into local communities. The design is relevant to both financial and social sustainability.

It is estimated that about 62,900 individuals will receive training by the end of the MCA Program, and that training recipients will experience an increase in income.

B. Basic Social Infrastructure

This activity, which will be managed by the Social Investment Fund for Local Development (FISDL), concentrates on three areas of social infrastructure important for human development: water and sanitation, electricity, and community infrastructure.

1. Water and Sanitation

The objective of this activity is to expand the availability of water and sanitation systems to the communities of the Northern Zone, thereby reducing the incidence of water-borne illnesses and contributing to the ability of a healthier population to participate in educational and productive economic activity.

FISDL will provide technical assistance, studies, and infrastructure for the benefit of communities in the Northern Zone that are identified as experiencing significant levels of poverty and lacking adequate water and sanitation services.

Approximately 60,000 inhabitants in the Northern Zone will benefit from having access to potable water and sanitation services. Benefits include reduced incidence of illness, reduced health care costs, diminished time to obtain water, reduced costs for water, and reduced harm to the environment. A less direct, but no less important benefit is the enhanced capacity for participatory governance that follows from the training, technical assistance and encouragement for the exercise of local responsibility for managing municipal water systems. In addition, some of the same beneficiaries of the water and sanitation systems in the Northern Zone will benefit from the installation of 100 water collection basins.

Sustainability of the benefits achieved by this activity is assured by the participatory approach to each project as well as an emphasis on environmental protection and conservation of natural resources and a focus on the participation of women which have been shown to contribute to the sustainability of FISDL-supported water and sanitation systems in the past.

2. Rural Electrification

FISDL will also be in charge of providing access to electricity for the presently unserved households in the Northern Zone, by providing subsidies to private providers of electrical service. Once the connections are in place, operators will be obliged to operate, maintain and replace the rural systems in exchange for the income generated by tariffs.

In this way, electrical services will be provided to the estimated 47,287 households in the Northern Zone that presently do not have access to electricity. The extension of electrical service to 100 percent of households in the Northern Zone will improve hygiene levels, literacy, and economic opportunities. The GOES annually finances a subsidy for residential users who consume less than 100 kilowatts per month which will assure the sustainability of this initiative. Eighty-five percent of the total cost of this objective will be covered by MCA financed subsidies and the rest from GOES funds.

3. Community Infrastructure

This activity will contribute to the sustainable health, security and well being of the people in the Northern Zone; facilitate access to markets, jobs, and basic health and education facilities; strengthen local capacities for decentralized regional development and help communities protect the environment. FISDL will finance technical assistance, studies and small community infrastructure for the benefit of communities in the Northern Zone that are identified on the Poverty Map as experiencing significant levels of poverty. The same criteria used in the case of water and sanitation services, will be used to select beneficiary communities for this activity.

Improved infrastructure at the community level will have dramatic impacts on the quality of life in the Northern Zone and is directly relevant to the second (Productive Development) and third (Connectivity) components of the MCA Program. In addition, as in the case of water and sanitation, by fostering community participation, encouraging an active role for women, demanding local accountability, and strengthening local governance FISDL contributes to the capacity for economic and social progress and advances productive territorial development. These considerations are major guarantors of the sustainability of the MCA Program's benefits.

2.3.2.2. Productive Development

This component includes measures to help micro, small and medium producers in the Northern Zone to expand their markets and increase their production and employment. The focus will be on productive chains for products and services that have strong potential and support for associations of businesses that can increase productivity and efficiency and achieve economies of scale. There will be a strong preference for activities that will make the best use of land, water and other natural resources, thus

contributing to environmental preservation and restoration. Assistance will be market driven and not confined to particular sectors. However, implementation will be informed by research and consultation that have identified the following sectors as promising areas: dairy products and meat, fruits (and related bee and honey production), vegetables, forestry, tourism, and artisan products. Extensive research, including studies by USAID, IICA and other international entities, has confirmed the suitability of these sectors for the Northern Zone.

Assistance for productive development will be provided through three interrelated kinds of support: business services (*PRONORTE Servicios*), business financing (*PRONORTE Finanzas*) and productive infrastructure and equipment (*PRONORTE Infraestructura*). The first two activities will be managed by BMI, and the third will be managed by FISDL. Programs providing similar kinds of support for productive development, such as an agricultural diversification program supported by USAID and a fruit production program supported by IICA, have been carried out successfully in El Salvador

A. Business Services.

Through **PRONORTE Servicios**, BMI will provide both pre-investment and post-investment technical assistance to micro, small and medium entrepreneurs to support productive development, technological adaptation, association, connectivity, and ability to enter markets and meet their requirements. These services will help improve the capacity of entrepreneurs to meet the challenge of increasing competitiveness and production and take advantage of the opportunities offered by CAFTA-DR. The recipients of services will be required to pay a part of the cost, with charges determined in part on the basis of the recipient's size as a micro, small or medium business.

BMI will contract with universities, NGOs and commercial providers of technical assistance through competitive procedures in response to requests from eligible beneficiaries that meet established standards. BMI has considerable experience with service acquisition and contract management in this field. In the past five year it has managed technical assistance and related programs of support for productive chains based on cotton, dairy and coffee production, among others.

B. Business Finance.

Through **PRONORTE Finanzas**, BMI will provide credits, guarantees and insurance needed to build productive and sustainable businesses. Financing under this program will involve loans repayable with interest and fees for guarantees. Costs will be kept low through the blending of BMI and MCA financing, with longer terms for low cost loans for permanent crops such as fruit trees and forestry, including through expansion of the forestry bond program presently managed by BMI. BMI will provide financial support through established intermediaries, including micro-finance NGOs, commercial and state-owned banks, entities that have experience working with the borrowers and with whom BMI has established relationships. BMI will make a special effort to provide financial support for technological innovations that can help to modernize production and increase productivity.

C. Productive Infrastructure and Equipment.

Through **PRONORTE Infraestructura**, FISDL will provide for the installation of public services and common infrastructure and equipment necessary to the successful operation of micro, small and medium businesses in the Northern Zone, fostering associativity among beneficiaries. Decisions will reflect BMI-supported diagnosis to study feasibility, determine needs and analyze costs and benefits.

D. Implementation Process.

BMI will implement the productive component through a proven four-step methodology:

1. **Preparatory Steps:** A specialized entity will be contracted to develop a package of standardized services to be provided for each chain, develop a database of national and international service providers, and promote awareness of the Program.
2. **Diagnosis and Implementation Plan:** Each interested firm that presents a qualified request for support will be interviewed to determine an appropriate plan. National or international companies will be contracted for the development of baseline diagnosis that will provide the basis for the implementation of the productive activities and will be used for the bidding process to contract technical assistance providers.
3. **Services Delivery:** Services and products will be delivered through national or international technical assistance providers.
4. **Coordination:** BMI will coordinate and verify the execution of each beneficiary's action plan, managing relations between all the service providers and with the Program management entity.

E. Beneficiaries

The direct beneficiaries of these three forms of support will be individuals and organizations that constitute micro, small and medium enterprises in the Northern Zone, as defined by the National Commission for Micro, Small and Medium Enterprise (CONAMYPE). Additional criteria for eligibility include the economic, managerial and technical soundness of the proposed business activity (including the presence of clusters of compatible business and access to markets and services), the beneficiary's credit history, and the extent to which the proposed business activity reflects the transcendental themes that the Program seeks to advance. A special effort will be made to encourage and support investments that will make best use of the land so as to actually improve the environment.

It is estimated that over the course of the Program's five-year duration, services will be provided under this component to 11,000 direct beneficiaries, including 4,500 women. In addition to direct beneficiaries, the estimate of the number of individuals who will benefit from the resulting increased economic activity in the Northern Zone will exceed 55,000.

The sustainability of these investments will be guaranteed in a number of ways: the change in productive activity will allow producers to obtain better access to markets, more value added products, environmentally friendly practices, and closer access to consumers; upon completion of the program, technical assistance will be assumed by entities created or reinforced as a result of the associativity encouraged by the program; and the human capital formation will allow producers to enter into new activities with more knowledge. Investments in environmentally friendly productive activities will be made so as to guarantee the maintenance of natural resources.

2.3.2.3. Connectivity: Northern Transnational Highway and Connecting Roads

This component will support the development of a Northern Transnational Highway and a structural cohesion network of rural roads. Funding for this major effort will depend largely on the MCA. The Government will also contribute part of the necessary financing, with support from the IDB. The construction will follow existing routes to the extent possible; more than 80 percent of the work will involve rehabilitation, paving and other improvements, rather than the construction of entirely new roads. When completed, the two-lane Northern Transnational Highway will extend from Guatemala in the west to Honduras in the east, and will connect with roads to southern El Salvador as well as to the new Pacific Ocean port at La Union and the Caribbean ports in Guatemala (Puerto Barrios) and Honduras (Puerto Cortez).

The proposed road system will achieve connectivity within the Northern Zone, and between this zone and the rest of the country, as well as with the other countries of Central America. Eliminating the isolation

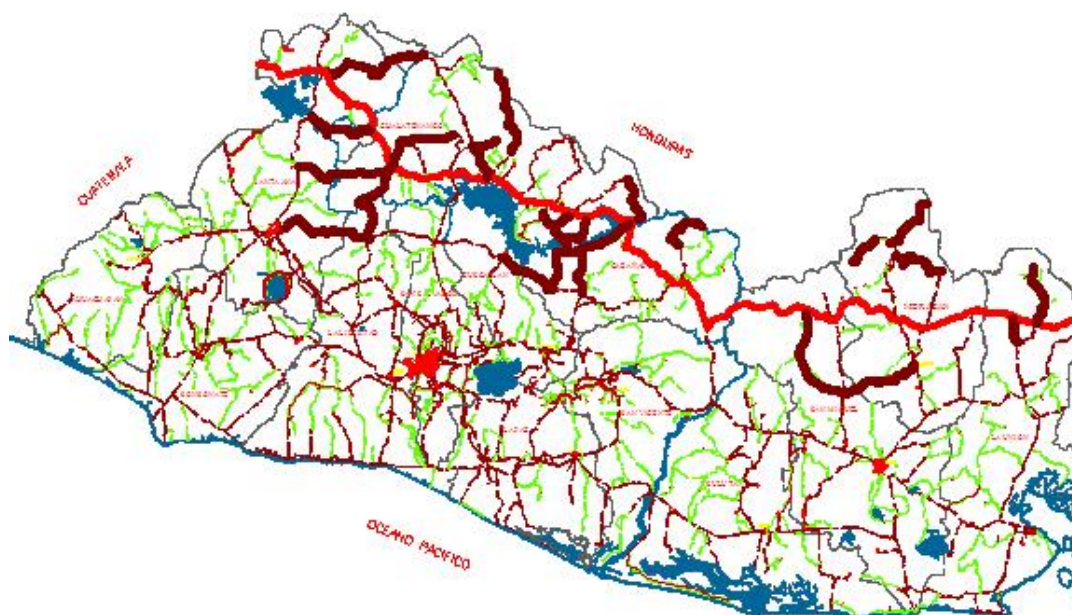
that has long impeded development in the Northern Zone and stimulating human and productive development there is essential to the success of El Salvador's national development strategy. The roads will not only reduce the operational cost of the vehicles and travel time, but will also: connect centers of housing and productive development of the Northern Zone, encourage productive land use, foster incipient development activities, and facilitate access to health and education services.

The activities of this component include:

- **The Northern Transnational Highway (CA-3):** Consisting of the rehabilitation, opening, expansion and paving of 290 kms. of the CA:3 Highway, which starts at the border point with Guatemala, called La Virgen, and ends in the Northeast of the department of La Unión, bordering with Honduras, a length of about 350 kilometers.
- **The Structural Cohesion Network:** The improvement and paving of 525 kms. of primarily dirt roads (includes roads financed by MCA and other sources) will connect vast rural areas in the North with the Northern Transnational Highway, and with the existing paved road network.
- **Conservation Management:** The sustainability of investments in roads will be guaranteed through the Road Conservation Fund (FOVIAL), an autonomous institution, which manages receipts from a tax on fuel dedicated to road maintenance.

The routes within the road system of the Northern Zone can be seen in the following map:

Map 3: Northern Zone Road System



The execution of the Connectivity Component will be carried out through the Vice-Ministry of Public Works (VMOP), a technical instance that is in charge of the planning, construction, rehabilitation, extension, expansion and maintenance of El Salvador's road infrastructure. VMOP's management of this component will include support for hiring of consultants and construction and supervision companies; developing the pre-investment work; and the execution of road projects.

The proposed Road System of the Northern Zone will cross 63 municipalities belonging to 8 departments. In addition to having a positive rate of return, the Highway will provide other benefits such as a drop in the incidence of respiratory illnesses due to the decrease of dust, a decline in school absenteeism, and an increase in public transportation supply.

Once the construction is completed, the Ministry of Public Works will develop the actions and policies for coordination with the Road Conservation Fund (FOVIAL), for maintenance in good condition of the connectivity investment,. Environmental sustainability will be guaranteed by the Environmental Law which requires a Study of Environmental Impact and an Environmental Permit from the Ministry of the Environment and Natural Resources (MARN). This law agrees with the environmental guideline and directions of international financial organizations and MCC requirements.

3. Consultative Process

The MCA Program is derived from an extensive consultation process led by the Commission for National Development (CND). Beginning in 1998 CND involved community associations, small producer associations, cooperatives, non-governmental organizations, environmental committees, private enterprise, local governments and political parties in a continuing dialogue intended to help shape a vision for the development of El Salvador and its several regions. This consultation involved 57 workshops and 14 departmental assemblies. From these efforts emerged the CND's Northern Zone Development Strategy and the GOES Northern Zone Investment Plan. In accordance with its institutional mandate, CND is continuing a permanent consultation process with key stakeholders at both the regional and national levels.

During the latter half of 2005, as El Salvador was considering the possibility of an MCA Program, the CND and the Government organized a number of additional meetings with local mayors, the private sector, academic experts, environmental groups, international donors and multilateral development organizations, sectoral specialists and the general public. As a result of this history of citizen participation, the principal elements of the MCA Program already enjoyed broad support by the time the MCC found El Salvador to be eligible for MCA assistance in November 2005.

From January to May of 2006, the Government carried out a specific consultation process for the MCA Program through the CND, which has produced a number of observations that were taken into account in the formulation of this proposal. The CND organized, conducted, documented and reported on public meetings and the contributions of participants in a manner that was fully responsive to the guidance of the MCC. The consultation plan, which is intended to continue with all interested parties in and outside the Northern Zone, throughout the development and implementation of the MCA Program, assured that consultations were timely, participatory and meaningful. The plan includes:

- A structured schedule of meetings on general and specific themes with the general public, subject-matter experts, Northern Zone residents, potential investors, nongovernmental organizations, local and national government representatives, and international cooperation organizations.
- An Internet site for the MCA-El Salvador Program (www.mca.gob.sv), administered by the Office of the Executive Coordinator for the MCA;
- Dissemination of a summary of the proposed Program as it evolved through the Internet and other media;
- Project level consultations with stakeholders and requests for feedback; and
- Hundreds of other *ad hoc* consultations with stakeholders.

The schedule of the consultations that commenced in July 2005 in anticipation of the possibility of MCA assistance, has included approximately 50 formal meetings and countless informal discussions, inquiries and comments. A summary of the consultation process and its main conclusions can be accessed through the Program's Internet site (www.mca.gob.sv).

Once the MCA Program is finalized, the GOES and CND will undertake a comprehensive communications effort to assure that the public is informed about the Program. Stakeholder participation and citizen oversight during the implementation of the Program will be promoted by continued public

communication and the direct participation of the civil society and private sector representatives in the MCA advisory body.

4. Implementation Arrangements and Accountability

The implementation arrangements for the Program are based on the need to ensure that resources are used in the most efficient and transparent way that will achieve the objectives of the proposed Program. These institutions have demonstrated their capacity to manage efficiently and responsibly the functions entrusted to them. At the same time, it is essential to the Program's coherence and effectiveness that its implementation be subject to rigorous oversight and scrupulous financial management.

4.1. Sustainability Strategy

Financial sustainability: In each area of the MCA Program, special care is being taken to identify appropriate mechanisms to ensure financial sustainability, including appropriate institutional arrangements for sustainable operation and maintenance; and the identification of an adequate source to cover the full estimated cost.

Social sustainability: The active participation of all stakeholders in the development and implementation of Program activities will be important for social sustainability.

Environmental sustainability: The Program incorporates, as a crosscutting theme the preservation and restoration of the environment and the reversal of deterioration in the natural resource base.

Particular measures to assure the sustainability of activities incorporated in the three Program components are summarized in Section 2.

5. Government Representative

The Government of El Salvador representative for negotiation of the Compact Agreement is Eduardo Zablah-Touché, Technical Secretary of the Presidency. Roberto F. Simán is the Executive Coordinator and heads the technical team for development of the Compact Proposal. Mr. Simán is the designated point of contact for the Government with regard to the MCA Program. His address is Casa Presidencial, San Salvador, El Salvador, C.A. or contactenos@mca.gob.sv. For additional information please visit the MCA El Salvador website at www.mca.gob.sv.