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Honduras 2007-2010***

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ABBREVIATIONS

CABEI	Central American Bank for Economic Integration
CAFTA-DR	Dominican Republic-Central America-United States Free Trade Agreement
CBTPA	Caribbean Basin Trade Partnership Act
CCLIP	Conditional Credit Line for Investment Projects
CPE	Country Program Evaluation
DEI	Dirección Ejecutiva de Ingresos [Honduras Revenue Agency]
EFA	External financial audit
EIU	Economist Intelligence Unit
ENEE	Empresa Nacional de Energía Eléctrica
FHIS	Honduran Social Investment Fund
FSO	Fund for Special Operations
GDP	Gross domestic product
HIPC	Heavily Indebted Poor Countries
IMF	International Monetary Fund
Lps.	Lempiras
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Reduction Initiative
MIF	Multilateral Investment Fund
NGO	Nongovernmental organization
OC	Ordinary Capital
ODA	Official Development Assistance
OVE	Office of Evaluation and Oversight
PBL	Policy-based loan
PDL	Performance-driven loan
PPMR	Project Performance Monitoring Report
PRS	Poverty Reduction Strategy
SEFIN	Ministry of Finance
SGJ	Ministry of the Interior and Justice
SMEs	Small and medium-sized enterprises
WTO	World Trade Organization

EXECUTIVE SUMMARY

Honduras is one of the poorest and most unequal countries in the region. Its three decades of democracy notwithstanding, the majority of the population still has little faith in the effectiveness of government and institutions. Between 2007 and 2010 the combination of crises in the global arena and at home cut revenue inflows by some 20% of GDP, but public spending was not adjusted and the bulk of savings has been captured by minority rent-seeking groups. Paradoxically, in the short term, those groups are benefiting from the precarious status quo of the majority, perpetuating the country's low development-potential balance that to some extent has been sustained by international donors' engagement and conditionalities.

As a country eligible for Fund for Special Operations (FSO) support, the resources allocatable to Honduras are determined every two years based on the performance of its economy and the Bank's Honduras portfolio. Since 2007 FSO resources have been blended with Ordinary Capital (OC) resources in a fixed proportion depending on country debt sustainability. By 2007, thanks to successive debt cancellations equivalent to 75% of loans outstanding, Honduras had become one of the lowest debt risk FSO-eligible countries and thus received the highest OC blend component (70%). This sharply raised the funding cost to the country but more than tripled its resource availabilities (from about US\$60 million annually to over US\$200 million).

Over the period reviewed here, the country faced growing demand for liquidity, due to the international financial crisis, which revealed the limitations of the instruments available to FSO-eligible countries. On the one hand, Honduras was unable to access emergency credit lines at a reasonable cost, prompting it to promote instead the approval of infrastructure operations.¹ On the other, the impossibility of carrying over approvals within a two-year period deprived programming of flexibility and required approval of a special waiver so that 2009 resources could be approved in 2010. Lastly, the lack of flexibility in the FSO to support policy-based reforms could limit the Bank's effectiveness in a context that is potentially favorable to structural reforms.²

In the Bank's program (2007-2010), which coincides with the presidential term in Honduras, the country set 120 development objectives in its work with the Bank. Important though these goals were, in practice they exceeded both the country's delivery capacity and the Bank's monitoring capacity. The portfolio reviewed for this report came to US\$1,171.5 million, mostly because of the exceptionally large 2010 approvals figure (55% of the period total). Despite the interruption in activity owing to the 2009 political crisis, the Bank did commit the entire expected allocation to Honduras.

The *relevance* of the Bank's program was weak. Even though the country and the Bank both had identified "*reducing poverty and indigence*" as the overarching development challenge, institutional shortcomings made it impossible to translate that shared objective into priorities and specific resource allotments. The broad scope and discontinuities in the country's development plans also limited the relevance of interventions. The Bank, for its part, distributed its lending across 18 sectors and was not able to reverse the historical

trend of portfolio fragmentation. Efforts were made to maximize resource absorption but there is no evidence of any sectoral allocation model based on actual portfolio performance and relative priorities.

The *coherence* of the resulting program was low. The Bank had difficulty deploying products suited to the magnitude of the challenge created by the country's weak institutional base. Operating with more than 20 relatively isolated executing units, with staff remuneration schemes differing from national civil service scales, made projects less vulnerable to turnover in ministerial personnel but accomplished little in terms of long-term institutional strengthening. Given the fiduciary difficulties of operating in Honduras, the Bank, and to some extent the country, emphasized physical infrastructure operations over investments in institutional and social development.

Efficiency was low, particularly in the implementation dimension. Chronic shortcomings in management capacity translated into lengthy delivery times and high implementation costs—which already had been high prior to the political crisis and considerably exceeded Bank averages, by 50% and 700%, respectively. These times and costs are associated with the fiduciary burden of working in a country where over 75% of project audit opinions contain observations, and with the small size of the operations—roughly a fifth of the Bank average.

There was an improvement in the country strategy's *evaluability* but not in the evaluability of individual projects. The absence of baselines, ex post evaluations, and project outcome indicators and/or targets, along with imprecisely defined objectives, makes it impossible to discern operations' contributions. Moreover, because of monitoring and evaluation system weaknesses no causal relationship can be established between *country progress* and *Bank actions*, so the *effectiveness* of the Bank's country program cannot be measured, and it is difficult to extract lessons learned.

Competitiveness loans accounted for 72% of new approvals, despite the large proportion of undisbursed operations. In the road sector, for instance, there had been repeated slippages because of bidding processes, securing of rights of way, and construction work, yet in 2008-2009 the Bank approved another two loans, which have yet to start disbursing. In the *fiscal balance* area, the Bank provided support for tax administration modernization, but tax revenue intakes remained relatively unchanged. To help manage treasury requirements the Bank provided policy-based loans that supplied the needs of the moment but produced no sustainable policies to reduce future imbalances. Only 6% of the lending was for *institutional capacity building* by way of specific programs.

In the *social development* sphere, given the slow pace of disbursements, only 3 of the 13 loans reviewed in this report had been approved after 2007. In *education*, the Bank was the only cooperation partner to work with secondary education; though coverage did rise, there is no evidence of education quality improvements. In the *health* sector, the Bank approved a performance-driven program loan that disbursed very slowly because of difficulties in accounting for expenditures. The Bank continued its support for conditional cash transfer programs, piloting different benefit designs, conditions to be fulfilled by families, and payment and verification systems. In part owing to its political visibility the

program underwent more than one redesign. Though advances were made on best-practice exploration, the program's outcomes have yet to be evaluated.

The recommendations in this CPE aim to optimize, in the medium term, what can already be described as a solid country-Bank relationship, while helping the country address its most immediate challenges. To this end, the Bank must pursue opportunities to continue strengthening three key functions in its dealings with the country: (i) programming; (ii) execution; and (iii) monitoring and evaluation.

INTRODUCTION

This Country Program Evaluation (CPE) was produced by the Office of Evaluation and Oversight (OVE) using a template that has been employed previously in Honduras and in the Bank's other borrowing member countries, to form an independent, comprehensive, long-range view of *Bank-country relations* to inform development of the Bank's strategy with Honduras going forward.

The CPE drew on extensive interaction with key country officials and resource persons, not all of whom are directly involved in activities with the Bank.³ Honduran government and Bank Management representatives provided excellent collaboration with the evaluation team. In OVE's view this helped advance this evaluation's ultimate objective, which is to enhance the service the Bank delivers to the country.

Although this evaluation technically closed on 31 December 2010, much of the contextual information refers to the pre-2010 period under the previous administration.⁴ The portfolio being reviewed totaled US\$1,171.5 million and includes all operations approved from 2007 to 2010 (US\$659.5 million), as well as loans approved prior to 2006 for which over 50% of the proceeds were still pending disbursement.

The CPE assessed the 2007-2010 program's *relevance* to country and Bank priorities. It rated the programming exercise's *anticipation performance* and the *coherence* of the resulting program, with regard to types of products used, feasibility of the outputs and outcomes sought, and division of work with other actors. Lastly, the CPE assessed the program's delivery *efficiency* and its *effectiveness* in achieving the development objectives. In all dimensions examined the authors have sought, to the extent possible, to separate out the effects of the transition created by the 2009 political crisis.

In the course of its evaluation OVE sought out Bank studies and monitoring data, but since that information generally was insufficient to depict progress toward the country-proposed development objectives, the evaluation team also used secondary data along with qualitative evidence of the Bank's work around the country's four fundamental development challenges: how to achieve self-sustaining macroeconomic balance; how to foster diversified, competitive productive activity; how to meet pressing social needs and build up human capital; and how to enhance institutional transparency and effectiveness.

The CPE is divided into five chapters, structured around the aforementioned topics to facilitate and inform the programmatic dialogue between the Bank's Management and the country authorities. Chapter I looks at the backdrop for Honduras's main development challenges. Chapter II examines the programming agreed upon by the Bank and the country. Chapter III reviews the performance of the programmed activities and Chapter IV reports on progress toward the program's proposed development objectives and on the Bank's contribution. Chapter V sets out conclusions and recommendations for the Bank's strategy with Honduras going forward.

I. HONDURAS: CONTEXT AND DEVELOPMENT CHALLENGES

A. Overview

- 1.1 **Honduras is one of the poorest and most unequal countries in the region.** Honduras's US\$3,841 PPP-adjusted per capita GDP makes it the region's fourth poorest country, after Haiti, Guyana, and Nicaragua.⁵ Sixty-six percent of its people live below the poverty line and two thirds of the poor (45% of the total population) are subsisting in extreme poverty.⁶ Honduras's income distribution likewise is one of the most unequal⁷ and, unlike the rest of the region, its inequality gap widened even during chapters of economic growth (such as in 2000-2006).⁸
- 1.2 **The Honduran economy is small, open, and relatively undiversified.** Honduras is the region's sixth smallest economy.⁹ With a trade openness index of 130% of GDP it is one of the region's most open economies,¹⁰ but its product range is quite narrow and its export markets still undiversified.¹¹ The United States still is Honduras's biggest trading partner, accounting for roughly 40% of its exports and imports.¹² Five low-value-added products make up close to half the country's total export sales.¹³
- 1.3 **Honduras's historical regional backdrop is one of conflict and instability.** Though Honduras may have been less exposed to the armed conflicts that Central America experienced in the 1970s and 1980s it was not immune to their influence. Two features distinguish Honduras from its neighbors: its rugged mountainous terrain and a bicoastal economy with differing interests on either side.¹⁴ On the Pacific side, Tegucigalpa and its area of influence are the nation's political and administrative hub. The Atlantic coast region is the most dynamic exporting zone, propelled by the banana industry boom of the early twentieth century and, more recently, a growing export processing (*maquila*) industry.¹⁵
- 1.4 **Honduras receives considerable foreign aid flows, which frequently are stepped up to help it contend with natural disasters.** Over the past decade, official development assistance to Honduras averaged 6% of GDP and these inflows increased 3.7% annually, on average, almost three times faster than the regional mean.¹⁶ Indeed, virtually all public investment in the country was supported by external aid (83% in 2008).¹⁷ From 1990 forward Honduras obtained numerous debt reschedulings and debt relief, each time on more concessional terms. This process was accentuated following Hurricane Mitch in 1998 and culminated in the bulk of the country's external public debt being forgiven under the HIPC, MDRI, and IDB debt relief (2007) initiatives.¹⁸
- 1.5 **Honduras is marked by high population growth and robust migration rates.**¹⁹ Thirty percent of Honduras's urban population and half its rural population are underemployed.²⁰ This has fueled in-migration and associated increases in numbers of people living in slum housing conditions, as well as out-migration.²¹ Following Hurricane Mitch and the United States' designation of Temporary Protection Status

for Honduras, more than 200,000 Hondurans left the country—equivalent to 10% of the economically active population in 2000.²² Workers’ remittances now are the country’s leading source of foreign currency inflows, equivalent to roughly 20% of GDP.²³

B. The macroeconomy

- 1.6 **The hallmark of the period covered by the previous CPE (2000-2006) was relatively fast, stable growth, which marked a change from previous decades.** Between 2000 and 2006 Honduras’s economic growth outperformed the Central America and region figures and growth rates were relatively stable for the first time since 1960.²⁴ Since 2000, Honduran growth has correlated more closely to U.S. growth performance, echoing the progressive integration of trade that culminated in the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) together with the growing weight of remittances sent home by Honduran emigrants, 95% of whom live in the United States.²⁵ From 2002 forward the Maduro administration enacted a package of reforms to boost tax revenues, contain public spending, and improve regulation.²⁶
- 1.7 **The period reviewed here (2007-2010) was very different, as the Honduran economy weathered external and domestic shocks that cut foreign currency inflows by some 20% of GDP.** The global financial crisis, which was first felt in Honduras in March 2009, affected the country’s two main sources of foreign exchange: international remittances and exports, especially from the *maquila* processing industry.²⁷ Remittances dropped from their pre-2007 level of 21% of GDP to 17% of GDP in 2009. The falloff in exports (coupled with an increase in imports) widened the trade deficit from its pre-2007 level of 15% of GDP to 25% of GDP up until 2009.²⁸ Meanwhile, the domestic political crisis sparked in June 2009 all but halted funding inflows from donor countries and institutions, the IDB among them.²⁹
- 1.8 **Nevertheless, public spending continued to rise steadily across the review period, from 19% of GDP pre-2007 to 23% in 2010.**³⁰ In 2007, following a chapter of fiscal prudence (2002-2006), a new agreement reached with the teachers’ union (PASCE) again pushed up the central government wage bill, which climbed from 8% of GDP pre-2007 to 11% in 2010.³¹ In early 2009 other sectors also secured minimum-wage increases ranging from 19% to 62%, with adjustment formulas that likewise impacted the public finances.³² The wage bill as a proportion of total expenditure (about 50%) is far higher than the mean in countries in Central America (18%) or comparable-income countries in the region (31%) or Latin America (28%).³³ Payroll costs make up more than three quarters of the largest ministries’ expenditure, with little connection between compensation and performance.³⁴
- 1.9 **Tax revenue intakes held at around 16% of GDP, still with marked vertical and horizontal inequity.**³⁵ The country’s regressive taxation structure—75% of

tax receipts come from indirect taxes—is exacerbated by a series of opaque tax exemptions.³⁶ Approximately 300 individuals and corporate bodies are tax-exempt by executive order and there are some 35 specific exemption laws on the books.³⁷ Estimates put the forgone tax revenues at 6% to 7% of GDP—a proportion that has been on the rise since 2000.³⁸ There are exemptions for (i) *certain goods*, such as fossil fuels, which benefit mostly private power generators; (ii) *certain businesses*, such as fast-food chains; and (iii) *members of certain unions*, such as teachers, whose tax-exempt status was enshrined in Honduras's sixteenth Constitution (1982).³⁹

- 1.10 **Public-enterprise deficits and social security system contingent liabilities were continuing concerns.**⁴⁰ The national power utility (Empresa Nacional de Energía Eléctrica—ENEE) is the heaviest drag on the public finances, with high but decreasing deficits.⁴¹ This situation is accentuated by heavy system losses, a growing reliance on oil, large electricity subsidies not targeted to the poorest, and costly private power purchase contracts (PPAs).⁴² The national telecommunication company (Honudtel) has seen its earnings shrink, a result of the loss of the lucrative international monopoly and “grey” telecom traffic.⁴³ The budget of Honduras's five pension administrations equals 5.6% of GDP, but three of the largest plans are actuarially unviable.⁴⁴
- 1.11 **The government moved to an expansionary monetary policy that led to appreciation of the real exchange rate.** Between June 2008 and June 2009 the *policy rate* was cut from 8.5% to 3.5%, while the Central Bank increased lending and rediscounting.⁴⁵ Domestic borrowing accelerated starting the last year of the Zelaya administration, doubling the 2007-2008 figures.⁴⁶ Following the June 2009 crisis the domestic debt stock swelled, from 6% of GDP to 11% in June 2010, just under half of it Central Bank funded.⁴⁷ After the government effectively pegged the lempira to the dollar (October 2005) the real exchange rate appreciated 17%.⁴⁸ The balance of payments deteriorated until 2008, recovering only in 2009 as a result of the crisis.⁴⁹ The new administration has taken steps to halt any further deterioration of the macroeconomic accounts.⁵⁰ In 2010, recovery of the Honduran economy translated into an inflow of capital that restored reserves to their pre-crisis levels.

Table 1.1. Honduras. Main macroeconomic indicators (2001-2010)⁵¹

		Source	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP	Nominal GDP (US\$ m)	Central Bank	7.438,3	7.632,5	8.046,9	8.667,9	9.724,6	10.917,5	12.392,4	13.975,7	14.314,5	15.340,0
	Nominal GDP (Lps m)	Central Bank	118.415,7	129.166,6	142.817,8	161.507,5	183.748,7	206.288,0	233.567,2	262.416,9	267.851,3	290.990,6
	Real GDP growth (%)	Central Bank	2,7%	3,8%	4,5%	6,2%	6,1%	6,6%	6,2%	4,2%	-2,1%	2,8%
Expenses / GDP (current prices)	Private consumption	Central Bank	41,6	45,9	51,1	57,9	67,1	77,7	77,8	79,9	80,6	79,6
	Government consumption	Central Bank	8,4	9,4	10,3	11,8	13,8	15,0	16,6	17,1	18,5	18,2
	Gross fixed capital formation	Central Bank	13,7	13,5	15,9	21,2	22,2	27,3	32,2	33,7	22,5	23,4
	Exports of goods and services	Central Bank	26,0	29,2	33,1	40,4	46,4	49,5	53,5	51,3	40,8	43,9
	Imports of goods and services	Central Bank	32,7	36,1	41,7	53,3	61,0	68,1	81,6	84,4	59,7	64,6
Population	Population (m)	Central Bank	6,5	6,7	6,9	7,0	7,2	7,4	7,5	7,7	7,9	8,0
Current account (US\$ m)	Trade balance	Central Bank	-729,3	-636,7	-1.020,1	-1.293,3	-1.496,6	-2.026,7	-3.104,1	-4.254,6	-2.474,6	-2.807,6
	Exports of goods (FOB)	Central Bank	3.422,7	3.744,9	3.754,0	4.533,9	5.048,0	5.276,6	5.783,6	6.198,5	4.824,6	5.741,9
	Imports of goods (FOB)	Central Bank	4.151,9	4.381,6	4.774,1	5.827,2	6.544,6	7.303,3	8.887,7	10.453,1	7.299,3	8.549,5
	Balance of services	Central Bank	-206,6	-190,0	-162,1	-204,1	-229,2	-290,7	-288,1	-326,2	-149,9	-309,7
	Balance on investment income	Central Bank	-257,8	-301,2	-361,8	-446,3	-459,6	-536,8	-395,2	-520,6	-530,1	-598,0
	Balance on transfers	Central Bank	715,0	846,3	991,2	1.265,3	1.895,1	2.450,3	2.671,3	2.973,4	2.639,0	2.760,5
Prices	Balance on current account	Central Bank	-478,7	-281,6	-552,8	-678,4	-290,3	-403,9	-1.116,1	-2.127,9	-515,6	-954,8
	Consumer price index	Central Bank	8,8	8,1	6,8	9,2	7,7	5,3	8,9	10,8	3,0	6,5
Remittances	Remittances / GDP (%)	Central Bank	7,5%	9,7%	10,2%	12,8%	18,2%	21,3%	20,8%	20,2%	17,4%	16,8%

C. Institutions and governance

1.12 Since democracy was reinstated in 1982 the National Party and Liberal Party have alternated in government, against a backdrop of weak institutions and a steady drop in public credibility.⁵² The first decade of that new chapter was marked by domestic conflicts in the region. Democracy came to full fruition in Honduras only after armed forces reform during the Reina administration.⁵³ Nevertheless, in 2008 cross-region surveys Honduras still came out third weakest in support for democracy (50%) and most supportive of a disruption of the democratic institutional order: 45% of respondents said they would not mind a nondemocratic government if it could solve the country's economic problems.⁵⁴ Hondurans also were among the most skeptical about prospects for change, whether sought via the ballot box or public protests.⁵⁵ Against this backdrop, electoral participation has fallen steadily, from 85% in 1985 to 55% in 2005 and 50% in 2009. Nonetheless, this last election did record the highest number of votes cast since 1982.⁵⁶

Box 1.1. The 2009 political crisis

The 2009 political crisis that ultimately forced President Manuel Zelaya out of office on 28 June was sparked by a dispute between the President, the Honduran Congress, and the Supreme Court over the legality of a national poll the President proposed to hold, in conjunction with the election of a new President, to determine in the 29 November elections whether to call a constituent assembly.

On 24 June, the Honduran Congress passed the law regulating such polls, but prohibited referendums from being held within 180 days before or after elections. It also made the Supreme Electoral Tribunal (TSE) the entity with sole responsibility for organizing, running, and supervising polls. However the President went ahead with preparations for the June poll and ordered the military to distribute ballot boxes and other materials for it. When that order was refused, the President dismissed the head of the army, prompting the resignation of the navy and air force commanders. The TSE, in turn, declared the poll illegal and the Supreme Court ordered the arrest of the President (Special Communiqué, Supreme Court, 29 June 2009).

On 28 June soldiers stormed the President's residence and flew him out of the country. The international community, including the Organization of American States (OAS) and the European Union, called for President Zelaya's reinstatement. That did not happen: Roberto Micheletti took office as interim president and national elections were held on 29 November 2009 as scheduled before June 2009. Porfirio Lobo Sosa of the National Party was elected and took office on 27 January 2010. As of December 2010 Honduras remained suspended from full membership in the OAS.

1.13 **Hondurans have little faith in the justice system, crime and violence rates are very high, and there are few avenues for public input or scrutiny.** Honduras ranks seventh lowest in the region for citizen participation and faith in the justice system.⁵⁷ Its homicide rate is one of the highest in the world (60.9 per 100,000 population in 2008), double the region average.⁵⁸ Violence is not the only scourge: crimes against property are frequent as well.⁵⁹ In 2000 the main concern had been criminal gangs, but today violent crimes are more likely to be drug-related, operating out of geographic enclaves.⁶⁰

1.14 **The Honduran State is contending with major governance challenges, exacerbated by a decentralization process launched in the 1990s but yet to be completed.** Honduras ranks fifth lowest in the region for government effectiveness (34th percentile worldwide) and seventh lowest for regulatory quality (45th percentile worldwide), and comes in third worst for control of corruption (21st percentile worldwide).⁶¹ A 1990 Municipalities Law assigned responsibilities to that tier of government but did not fix serious management and control shortcomings.⁶² In 2009, central government spending still made up 87% of all public expenditure.⁶³ The new development plan upholds the commitment to decentralization of the State.

D. Competitiveness and production sectors

1.15 **Honduras has the region's lowest productivity index, aggravated by the poor quality of capital formation.** Honduras's 30% total factor productivity (TFP) index puts it below the region average (50%) and the performance of such countries as Costa Rica (75%), El Salvador (60%), and Nicaragua (45%).⁶⁴ The nominal investment rate is high but investment is concentrated in nontradable sectors like construction.⁶⁵ Furthermore, investment, including foreign direct investment, depends heavily on ad hoc tax exemptions.⁶⁶ The environment also creates high

- private-sector inefficiencies: Honduras ranks third-last in the region for ease of doing business, one notable impediment being difficulties in enforcing contracts.⁶⁷
- 1.16 **Honduran businesses—especially small and mid-sized ones—find it much harder to get credit than their counterparts elsewhere in the region.** Nearly 20% of firms identified lack of access to credit as the main obstacle—far exceeding the 12% for the region as a whole.⁶⁸ What's more, Honduran banks supply only 11% of businesses' capital investment finance and 16% of their working capital finance—the lowest ratios in the region.⁶⁹ Intragroup finance accounts for most production finance;⁷⁰ the result is a few dozen established financially self-sufficient groups that have come to wield influence on industry sector competition and political dialogue.⁷¹
- 1.17 **Another serious impediment is a shortfall of reliable infrastructure.** On the matter of electric energy, for instance, the costly private power purchase agreements (PPAs) negotiated in the 1990s have diminished the system's reserve capacity (estimated at just 5%) and hence its reliability.⁷² Similarly, in other infrastructure subsectors like roads, "*the predominant model ... was build, ignore, and rebuild;*" roadwork has been contracted out to a handful of local groups selected using uncompetitive procurement methods.⁷³
- 1.18 **Trade preferences accorded to Honduras helped grow an export processing (*maquila*) industry that has created few linkages.** The 2006 CAFTA-DR agreement expanded on the benefits the country had obtained under the 2000 Caribbean Basin Trade Partnership Act (CBTPA), removing origin restrictions for inputs. In 2007 Honduras's *maquila* industry contributed 7% of GDP or 40% of industrial output.⁷⁴ When the World Trade Organization (WTO) ended textile quotas in 2005 Honduras came up against even stronger competition from Asian producers, who were better positioned from the standpoint of labor and electricity costs.⁷⁵ Though the *maquila* industry is starting to diversify⁷⁶ it still is generating few linkages and is based on trade distortions that the WTO wants to see ended.⁷⁷
- 1.19 **Honduras enjoys natural advantages for traditional crops like coffee and for other nontraditional products and services.** Between 1997 and 2007 the export share of coffee and bananas dropped from 38.3% to 27.3% as such niche products as melons, tilapia, shrimp, and lobster gained importance. However, traditional exports are picking up again with the recent Honduras-European Union trade agreement which will mean broader access for bananas and *maquila* textile products.⁷⁸ The Honduran tourism industry is already bringing in the equivalent of 4.5% of GDP in foreign exchange⁷⁹ but there are a number of impediments to its growth in visitor numbers and daily spending, among them crime and violence rates, infrastructure shortfalls, and environmental sustainability concerns.⁸⁰
- E. Social development**
- 1.20 **Honduran poverty rates still are high, recent increases having neutralized some of the past gains.**⁸¹ Between 2001 and 2006 the national poverty rate had

- come down approximately 5.5 percentage points. The 3.5 percentage point increase in 2006-2009 reversed that downtrend.⁸² Poverty—especially extreme poverty—is severe in six departments (*departamentos*) with predominantly rural subsistence economies.⁸³ Most of the nation’s indigenous population, particularly the Lenca community, lives in these departments that border with Guatemala and El Salvador. Their economic mainstay is coffee growing, on plots of land too small to enable them to plow earnings back into their operations (70% of these *minifundios* are smaller than five hectares).⁸⁴
- 1.21 **Honduras has achieved a high primary school enrollment ratio but still has shortcomings in education quality and secondary education.**⁸⁵ The country’s 91% primary enrollment rate compares favorably to region figures, but its secondary enrollment rate is just 36%. As for quality, the limited evidence available puts Honduras below the regional mean,⁸⁶ and a strong teachers’ union is generally opposed to active quality management.⁸⁷ The challenge is even greater in rural areas because of access difficulties and thin population density.⁸⁸
- 1.22 **Despite some recent improvements, the Honduran health system still faces serious challenges, aggravated by an unstable institutional environment.**⁸⁹ Though the infant mortality rate edged down from 28 per 1,000 births to 25 between 2005 and 2009, it remains one of the region’s highest.⁹⁰ The maternal mortality rate improved as well (a drop from 160 per 100,000 births to 110) but still is the region’s second-highest, after Haiti. Though mortality rates have improved in urban areas, lowering the rural rates remains a challenge, to come up with culturally sensitive intervention models for indigenous communities.⁹¹ Another serious public health challenge is to consolidate gains in combating HIV-AIDS, which also affects Garifuna communities disproportionately.⁹²
- 1.23 **At the donor community’s prompting, Honduras is keeping social spending high, but because the expenditure is inefficient the gains have been modest.**⁹³ A huge increase in public social spending between 1998 and 2005, from 6% of GDP to 11%, brought the poverty rate down only 2 to 3 percentage points.⁹⁴ Today Honduran public expenditure on education and health is among the region’s highest as a proportion of GDP (8% and 4% respectively) but the country ranks second from the bottom for public spending efficiency.⁹⁵ The consolidated public sector wage bill (13% of GDP in 2006, nearly double the 7.2% Central American mean) is a fundamental factor here.⁹⁶ Transparency, cost overruns, and weak controls both in personnel management and in procurement are other serious concerns,⁹⁷ as is regressivity in expenditure in some spheres.⁹⁸
- F. Outlook**
- 1.24 **Honduras is engaged in a process of reconciliation and consolidation of democracy.** The current “national unity” government has been able to bring members of opposition factions into a number of ministerial and executive posts, but the expectations of some of these political actors have made it difficult to

coordinate actions and deliver the government's new "National Vision" agenda. This agenda gives the country the opportunity to consolidate its public policies, while promoting structural reforms.

- 1.25 **The international community is playing a key role in this process.** The 2009 crisis reaffirmed that a democratic institutional base is a *sine qua non* for development-agency engagement in Honduras. In October 2010, with firm support from the Bank, Honduras concluded a Standby Arrangement with the International Monetary Fund (IMF) setting out a matrix of policy measures intended to "*restore macroeconomic stability and strengthen public finances.*"⁹⁹ Among the pledged reforms are a civil service law and a review of tax exemptions, public enterprises, and pension administrations.¹⁰⁰ Among the risks to the economic recovery cited is a worsening of the external environment driven by slower U.S. economic recovery, oil price increases, appreciation of the real exchange rate, or strong mismatches in a fixed exchange rate environment.¹⁰¹ Even in downside scenarios the IMF is not anticipating debt sustainability issues: the debt-to-GDP ratio is not expected to exceed 30% in 2015.¹⁰²
- 1.26 **Supporting Honduras at a time of evolving challenges and trade prospects.** Though the aging of the emigrant population, already evident in a slowing of remittances since 2007, could be accentuated in the future, the still-considerable level of remittances offers complementary opportunities.¹⁰³ Honduras still is facing a series of challenges to make its economy competitive, among them the potential energy crisis as the economy gets back on a growth path,¹⁰⁴ and to keep its people safe.¹⁰⁵ On the trade side, pacts with the United States and the European Union are creating a strategic opportunity for Honduras but this will require improvements in the country's road and port infrastructure and in regulation, financing, and advisory support for export firms.¹⁰⁶

II. DEVELOPMENT OF THE COUNTRY PROGRAM

- 2.1 **This chapter assesses the Bank's programming exercise for its work with Honduras.** The evaluation looks at: (i) *relevance*, defined as the extent to which the Bank's strategy and program objectives addressed the country's needs as charted in government development plans and priorities; (ii) *coherence*, which assesses the fit of the Bank's products and its coordination with the work of other cooperation partners; and (iii) the strategy's *anticipation performance*, to gauge how closely the programming exercise anticipated the activities ultimately delivered and thereby enabled sound resource planning. It should be noted that much of the review period was affected by the turbulent local political process. To the extent possible, the CPE has sought to isolate the potential impacts of this, although it is clear that exceptional circumstances directly influenced the Bank's relationship with the country, hampering implementation of the country program.

A. Relevance

- 2.2 **This evaluation covers the 2007-2010 cycle (the “review period”) for which the Bank had framed a country strategy with Honduras.**¹⁰⁷ The country strategy encapsulated a dialogue and consensus process with the country. Its objective was to “*help consolidate an inclusive economic growth process that promotes poverty reduction, improves the population’s living conditions, and generates opportunities for the most underprivileged sectors.*” Four focus areas were selected for Bank support: (i) “*improve the investment climate;*” (ii) “*boost competitiveness;*” (iii) “*promote the development of human capital,*” and (iv) “*strengthen the institutional framework and risk management.*”¹⁰⁸
- 2.3 **When the country strategy was developed in 2007 the Honduran economy had been expanding but that growth had not yet translated into substantive improvements in living standards for the majority of the population.** The country strategy predicted a continuing “*expanding economic cycle*” if the country held to its economic policy course.¹⁰⁹ Despite its growth performance and ongoing implementation of a Poverty Reduction Strategy (PRS) launched in 2001 Honduras had yet to make significant inroads against poverty and inequality. In its previous Honduras Country Program Evaluation (CPE) covering 2001-2006, OVE had indicated that “*the evidence [showed] a modest decrease in income poverty, but little decrease in consumption-based poverty and a widening in measures of inequality.*” In practice, this predicted expansionary phase of the cycle was interrupted by the international financial crisis, which primarily affected the program’s anticipation performance.¹¹⁰
- 2.4 **Both the country and the Bank had identified “*reducing poverty and extreme poverty through economic growth*” as Honduras’s fundamental development challenge.** The Poverty Reduction Strategy—at the time the country’s prime planning tool—came out of the HIPC Initiative, in the context of commitments to the donor community. The PRS’s core objective was to “*reduce poverty significantly and sustainably, based on accelerated and sustained economic growth whose benefits are distributed more equitably through greater access by poor people to the factors of production.*” The Bank’s diagnostic assessment was identical. That assessment implicitly assumes the spillover effect of the economic growth.
- 2.5 **In the end, however, that shared objective did not translate into specific priorities and resource allocations.** The 2001 PRS and subsequent updates became the country’s de facto development blueprint, with 15 broad goals and about 140 indicators. Although the PRS was approved with broad consensus, the operating plans derived therefrom to pursue those goals were missing the instruments and consensus needed to direct activities toward broad priorities such as growth.¹¹¹ Moreover, there was little connection between PRS objectives and structural budget changes. For instance, approximately 40% of PRS resources went toward current payroll expenditure, and 70% of that to teachers.¹¹²

- 2.6 **The broad scope and discontinuity of the Poverty Reduction Strategy also limited the relevance of potential Bank interventions.** The PRS update, which began in 2006 and brought the number of indicators up to almost 200, was inconclusive. This affected the relative relevance of the Bank's interventions, which had to contend also with the risk of losing currency during their unusually long execution. The incoming administration in 2010 pursued legislative passage of a new planning tool, the “*National Vision: 2010-2038*” agenda.¹¹³ This 28-year roadmap with its 23 national targets and 62 goals was approved unanimously. With a different emphasis and structure than the PRS, it has the opportunity become locked in as government policy as its targets are effectively implemented and the main national stakeholders demonstrate their commitment.¹¹⁴
- 2.7 **Though the Bank’s portfolio was not able to reverse its historical trend and lending was scattered across 18 sectors, much more funding went to infrastructure projects than to institutional and social development investments.**¹¹⁵ Echoing the previous programming cycle (2002-2005), the Bank’s strategy focus was the competitiveness pillar, which accounted for 72% of approvals by amount, the bulk of it for infrastructure projects. The competitiveness portfolio rose from 36% of the total at the start of 2007 to 56% by end-2010. Continuing the previous-cycle pattern, the relative weight of the social development and institutional framework pillars continued to trend down (from 45% to 29% and from 14% to 6%, respectively, between 2007 and 2010). The fiscal balance pillar saw its relative weight increase from 5% to 9%, the result of programmatic budget-support loan approvals.¹¹⁶ Part of this emphasis on infrastructure was due to the decision to approve operations in sectors with higher job-creation potential, given the international crisis.
- 2.8 **Though this priority-setting approach did focus on anticipated sectoral absorption capacity, in practice it was not optimal for the program’s relevance.** Key elements such as an understanding of country needs and relative priorities, or past operational performance and the Bank’s sector experience, were not duly taken into account when distributing resources.¹¹⁷ For instance, had those elements been taken into consideration, road and port infrastructure would have come in for 10% of approvals, but in actuality they accounted for close to 50%.¹¹⁸ There were disparities as well in areas that came in for PBL funding, such as the fiscal balance support, financial system, and social investment operations.¹¹⁹
- 2.9 **On the operational side, the country strategy also had proposed to rationalize the Bank’s portfolio to make it easier to administer and supervise.** The country strategy had stated that “[this] portfolio is one of the Bank’s largest in both number of operations and sector coverage. Thus, it is complex to supervise,” terming this “a recurring consideration shared by the [previous] country strategy evaluation and the portfolio review reports.” According to the strategy paper, “the number of active loan operations is expected to drop gradually from 32 operations in execution in late 2007 to 25 at the end of the strategy implementation period.”¹²⁰

B. Coherence of the program

- 2.10 **The Bank’s Honduras portfolio included a complex mix of finance products.¹²¹** The portfolio reviewed for this evaluation consists of 24 traditional investment loans totaling US\$742 million, five multiphase loans for US\$107 million, two supplementary loans for US\$65 million, a US\$22 million global multiple works loan, four programmatic loans for US\$129 million, a US\$20 million conditional credit line for investment projects (CCLIP), a US\$17 million performance-driven loan (PDL), six nonsovereign guaranteed loans totaling US\$46 million, one MIF loan for US\$5 million, and 10 MIF and 47 technical-cooperation grants totaling US\$28 million.¹²²
- 2.11 **The country strategy had called for a sequencing of products, depending on sector and fiduciary capacity strengthening.** The country strategy had envisaged investment loans and technical assistance followed by policy and programmatic loans.¹²³ According to the strategy paper, “*Once progress has been made in these areas, the necessary consensus has been reached regarding sector reforms, and the macroeconomic framework has been strengthened—with the backing of the ... program [the Honduran government was negotiating] with the IMF [in 2007]—[it may be possible to] channel resources with other instruments.*” In November 2010, after Honduras concluded a new IMF arrangement, the Bank approved the cycle’s first two policy loans.¹²⁴ This observed the anticipated sequence but without evidence of prior sectoral or fiduciary capacity strengthening.
- 2.12 **Following successive rounds of debt relief Honduras’s debt-to-GDP ratio came down, but the Bank continued to be one of its lead lenders, with US\$659 million in approvals between 2007 and 2010.** In 2007 the Bank forgave US\$1.367 billion in face value Honduran debt (principal and interest).¹²⁵ Between 2005 and 2009 the country’s IDB debt dropped from 14.2% of GDP to 3.2%.¹²⁶ Nevertheless, the IDB and World Bank still were the largest holders of Honduran public debt.¹²⁷ During the 2008-2009 chapter of instability Honduran private commercial banks and Venezuela became major suppliers of funding.¹²⁸
- 2.13 **The country strategy had underscored the importance of donor coordination, but in practice the Bank’s and other donors’ activities were not effectively coordinated.¹²⁹** According to the strategy paper, “*the Bank [would] continue to play a lead role to coordinate international cooperation actions in Honduras by organizing consultative group meetings and participating actively in the G-16 [Donor Coordination Group].*” Sectoral donor roundtables were in fact set up to coordinate analytical and operations work but the results have been mixed.¹³⁰ In a 2010 evaluation the G-16 found that the government, donors themselves, and the sectoral approach all presented constraints for effective use of resources.¹³¹
- 2.14 **Like the IDB, the World Bank programmed in line with the country PRS and then redirected resources toward infrastructure projects.** The four pillars of the World Bank’s Country Assistance Strategy (CAS) for Honduras were similar to the

IDB's.¹³² Between 2007 and 2009 the World Bank approved US\$248 million in loans for Honduras: 36% for road infrastructure, 20% for agriculture, 17% for energy, 16% for water supply and sanitation, 7% for education, and 4% for natural disaster mitigation. Following a 2008 evaluation of the CAS, funds originally intended for policy support were redirected toward investment projects.¹³³ In 2010, after operations were reestablished, the World Bank approved US\$146 million for Honduras.

- 2.15 **Meanwhile, the Central American Bank for Economic Integration (CABEI) became Honduras's lead lender, expanding its traditional infrastructure support to other areas of opportunity.** CABEI lent US\$461 million to Honduras in 2007-2009, the bulk of it for road infrastructure (57%) and port infrastructure (34%). One highlight was US\$130 million in flexible financing for a project to expand and upgrade section I of Highway CA-5, in which the IDB also is participating. In 2010 CABEI approved US\$336 million, notably a US\$280 million multisector emergency program for fiscal strengthening and social equity.¹³⁴

Box 2.2. Effectiveness of International Cooperation in Honduras (G-16 Report)¹³⁵

On the government side there is no strategic-budget framework to align aid and measure performance. This creates a dichotomy in the use of aid funding rather than ensuring that aid flows complement domestic monies. The lack of leadership and ensuing procedural duplication pushes up costs. Personnel changes in each administration limit the capacity-building impact of aid.

On the donor side the various agencies' procedures and models are not aligned to the international policy guidelines worked out in Paris and Accra. In the G-16 the organization structures of cooperation limit the capacity to raise technical priorities to the political level and the needed impact thus is not achieved. Owing to its weak institutional base the country is making limited use of new international aid delivery models that seek to strengthen country ownership.

At the sector level, specific programs were more successful, coordinating and setting their own agendas. When approaches were broader or issues were cross-cutting the tendency was to move away from the roundtables and take up these issues bilaterally with different government agencies or departments that often had differing views.

C. Anticipation performance

- 2.16 **The resources available to Honduras are determined by its Fund for Special Operations (FSO) allocation and the FSO/Ordinary Capital (OC) blend level.**¹³⁶ FSO resources are allocated every two years based on the FSO-eligible countries' economic and portfolio performance. Since 2007 FSO resources have been blended with OC resources in a fixed proportion depending on a country's debt sustainability. Perceived as the lowest-risk FSO country, Honduras receives a 30% FSO/70% OC blend.¹³⁷ Introducing OC resources increased the funding available to Honduras by 54% but the cost equivalent increased more than fivefold.¹³⁸
- 2.17 **The country strategy had envisaged a US\$431.6 million base-case lending scenario for 2007-2010; actual allocations came to US\$607.2 million.**¹³⁹ The

base-case sovereign-guaranteed lending scenario envisaged US\$97.1 million in annual approvals in 2007-2008 and US\$118.7 million annually for 2009-2010.¹⁴⁰ The country strategy had posited two scenarios for 2009-2010, corresponding to changes in FSO allocations depending on how institutional conditions evolved.¹⁴¹ As a result of a substantial improvement in its 2009-2010 FSO allocation Honduras received US\$201.1 million and US\$211.9 million in those years, nearly double the country strategy's high lending scenario. Nonetheless, it was noted that "the Bank has no provision for emergency assistance for D2 countries, nor do these countries have access to OC in a period of crisis and high financing demand."¹⁴²

- 2.18 **Even with the interruption in approvals owing to the political crisis, the total allocated funding was committed in approved loans.** The Bank approved US\$102.1 million for Honduras in 2007, US\$97.1 million in 2008,¹⁴³ and US\$69 million in 2009 despite the interruption in activity.¹⁴⁴ Since it was not possible to have carry-overs within the FSO allocation period, a special waiver was sought so that US\$132.1 million not used in 2009 could be approved in 2010.¹⁴⁵ Unused resources at end-2010, however, were to be returned to the FSO. With the extraordinary US\$343 million in 2010 approvals, all the allocated resources were committed.
- 2.19 **The 2007-2010 program's approvals anticipation rate was 73% and its programming anticipation rate was 69%.**¹⁴⁶ Eleven of the 15 investment loans programmed in the country strategy ultimately were approved (73% approvals anticipation rate); 11 of the 16 approvals had been proposed in the country strategy (69% programming anticipation rate).¹⁴⁷ All five of the approvals not envisaged in the country strategy were in 2010.¹⁴⁸
- 2.20 **The country strategy had provided core indicators with which to track the objectives set, which made it more evaluable than previous-cycle strategies.** A logical framework provided in the country strategy set out the development objectives along with proposed Bank actions. As metrics of progress toward those objectives the strategy paper provided 17 indicators: 53% were outcome indicators, 100% had stated targets, 94% had a baseline, and 18% had milestones. This made for an ex ante evaluability index of 0.66 for the country strategy reviewed here, a significant improvement over the previous one (0.35).

III. DELIVERY OF THE COUNTRY PROGRAM

- 3.1 **This chapter assesses the preparation and implementation of operations that came out of the programming exercise.** It discusses the portfolio that OVE examined and looks at how *efficiently* the operations were prepared and delivered. The *operations' evaluability* and *implementation issues* are particular focuses of the review.

A. Portfolio reviewed

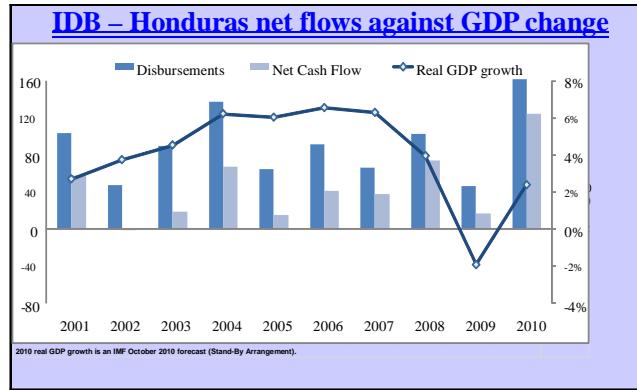
3.2 **The portfolio reviewed for this evaluation comes to US\$1,171.5 million.** It consists of all 2007-2010 loan approvals (US\$659.5 million) plus 24 previous approvals (from 1999-2006) that had over 50% of their proceeds left to disburse during the review period. The undisbursed balance of those operations at the start of 2007 was US\$512 million.¹⁴⁹

Table 3.1. Approvals by sector and undisbursed balances (US\$ million)¹⁵⁰

Sector	Undis. bal. prev. ops.	Approvals				Approv. 2007- 2010	Total port- folio	Disb. 2007- 2010	Canc. 2007- 2010	Undisb. balance Dec. 2010
		2007	2008	2009	2010					
INVESTMENT CLIMATE (FISCAL BALANCE)	26.5	-	29.0	0.5	46.5	76.0	102.5	54.5	-	48.0
Fiscal balance	26.5	-	29.0	0.5	46.5	76.0	102.5	54.5	-	48.0
COMPETITIVENESS	186.1	110.4	61.5	75.8	228.1	475.8	661.9	179.9	25.9	456.2
Road infrastructure	46.5	75.0	20.6	50.1	31.5	177.2	223.7	36.5	-	187.2
Port infrastructure	-	-	0.5	-	145.0	145.5	145.5	0.3	-	145.2
Financial system	8.0	4.9	8.9	6.3	51.2	71.2	79.2	58.7	5.0	15.5
Tourism	32.6	-	-	-	-	-	32.6	17.1	-	15.5
Electric energy	61.3	0.5	29.3	0.3	-	30.0	91.4	37.9	9.9	43.5
Agric. and rural development	15.5	28.9	-	-	-	28.9	44.4	5.5	11.0	28.0
Environment and natural disasters	22.2	0.6	1.4	19.0	0.4	21.3	43.5	23.3	-	20.3
Science and technology	-	-	-	-	0.0	0.0	0.0	0.0	-	0.0
Support for competitiveness	-	0.6	0.9	0.1	-	1.6	1.6	0.6	-	1.0
SOCIAL DEVELOPMENT	229.5	0.9	20.2	0.3	84.6	106.0	335.5	127.7	23.7	184.1
Education	28.8	0.4	-	0.3	-	0.6	29.5	12.4	10.0	7.0
Social investment	88.8	0.5	20.2	-	56.4	77.1	165.9	78.0	-	88.0
Health	16.6	-	-	-	28.2	28.2	44.7	8.3	-	36.4
Housing and utilities	95.3	-	-	0.1	-	0.1	95.4	29.0	13.7	52.7
INSTITUTIONAL FRAMEWORK	69.9	0.0	0.2	-	1.5	1.4	71.3	25.4	31.4	14.5
Justice system	23.6	-	0.2	-	-	0.2	23.7	20.2	-	3.5
Citizen security	14.9	-	-	-	-	-	14.9	5.2	-	9.7
Public management and municipal development	31.4	0.0	-	-	1.3	1.3	32.7	0.0	31.4	1.3
Transparency and anticorruption	-	-	-	-	0.3	-	-	-	-	-
TOTAL	512.0	111.3	110.9	76.6	360.7	659.5	1,171.5	387.5	81.0	703.0

3.3 **Following the delivery of debt relief the sum total of Honduras loans in repayment dropped 63%.** The debt cancelled in 2007 represented over 75% of loans in repayment at end-2006. Between 2007 and 2010 Honduras repaid an average of US\$43 million a year in principal, interest, and fees. New disbursements outpaced repayments, averaging US\$98 million annually. Because of its high 2010 approvals the Bank ultimately delivered some US\$200 million in net funding to the country over the review period.

- 3.4 **Net Bank-country flows were positive but mostly procyclical during the review period.¹⁵¹** Between 2003 and 2008, against a backdrop of 6% annual GDP growth, net flows to Honduras were positive, peaking at US\$74.8 million in 2008. In 2009, with a political crisis unfolding and a 2.1% drop in GDP, the net positive flow shrank to just US\$17.5 million. In 2010, with the increase in lending, the net positive flow rose to US\$124.5 million.



- 3.5 **Owing to the large 2010 approvals figure the undisbursed portfolio increased 26% over 2007.¹⁵²** The Bank's new lending between 2007 and 2010 averaged US\$159 million a year; disbursements averaged US\$98 million a year, cancellations US\$24 million a year. This took the undisbursed total from US\$564 million in 2007 to US\$711 million at end-2010, mostly the result of the 2010 approvals, since by December 2009 the undisbursed loan balance had dropped 9% from the 2007 figure.

B. Efficiency of operations

1. Preparation and execution times

- 3.6 **Preparation and approval times for Honduras loans are comparable to the Bank average.** On average it took 29 months to prepare Honduras investment loans, slightly longer than the 26-month Bank average. A comparison of preparation times with other countries that, like Honduras, require parliamentary ratification of loans shows the Honduras times to be among the shortest. Investment projects in Honduras, specifically, averaged four months from signature to ratification, shorter than the five-month Bank average.

- 3.7 **However, even before the June 2009 crisis Honduras projects had one of the Bank's slowest implementation rates.** On average it took 68 months to execute investment loans, 58% longer than the Bank average. There were major disbursement timetable slippages (actual versus scheduled) in loans in every sector. Though some of these holdups can be ascribed to the halt in activities owing to the June 2009 political crisis, many projects had already been reporting schedule slippages that averaged 17.8 months.¹⁵³

2. Costs

- 3.8 **Loan preparation costs in Honduras were high, making it one of the costliest countries for Bank lending.** Preparation costs in Honduras came to US\$5,190 per million in approvals, more than double the US\$2,100 Bank average.¹⁵⁴

Nevertheless, average preparation costs were down 37% from the 2003-2006 figure of US\$8,199 per million in approvals—similar to the Bankwide drop (34%).¹⁵⁵

- 3.9 **Implementation costs were high even before the 2009 political crisis—over seven times the Bank average.** Honduras had the fourth highest implementation costs per million disbursed.¹⁵⁶ These costs already were high prior to the crisis, at around US\$16,000. The 30% rise in Honduras costs contrasts with a Bank average drop of 13% from 2003-2006 numbers. One factor in Honduras's high costs is the size of the loans (US\$17.8 million versus the Bank average of US\$71.6 million), which magnifies the relative weight of the fixed and transactional costs implicit in approval and implementation processes.¹⁵⁷

C. **Reported project implementation issues**

- 3.10 **There were evaluability constraints in over 85% of the operations since they were missing indicators to properly describe their outputs and development objectives.**¹⁵⁸ The at-entry evaluability index of the operations reviewed was 40%, owing to missing indicators, targets, and milestones. Baselines had been provided for just 38% of the indicators identified and targets for 69%. Logical framework quality varied considerably among the projects. The confusing of outputs and outcomes was common (39% of projects). The large number of qualitative targets was an obstacle as well: since their attainment typically was evaluated by the parties involved, the assessment was more subjective.
- 3.11 **The evident implementation issues notwithstanding, 2007 was the first year in which the number of Honduras project PPMRs reporting issues surpassed (slightly) the Bank average.**¹⁵⁹ The most frequently cited issue was *institutional capacity shortcomings in executing units*, which was reported for 15% of operations in 2007-2009, up from 11% during the previous cycle (2001-2006). Instability, reflected as *lack of ownership*, and the *effects of policy changes on executing units* were the next most frequently reported issues (for 11% and 8% of projects, respectively). Next came *national policy changes*, reported for 9% of projects in 2007-2009 (up from 2% in 2001-2006). There also were inconsistencies between the portfolio and the resident specialist complement in the Country Office. Specifically, for much of the period, there were no resident specialists in the sectors that made up the bulk of the portfolio (e.g. energy, transportation, water and sanitation).¹⁶⁰
- 3.12 **The Bank continued to operate via multiple executing units with remuneration schemes differing from national civil service scales.** Over the period 2007-2010 the Bank worked with 22 executing units, 15 of them in central government agencies, 2 in municipal governments, 4 in the private sector, and 1 nongovernmental organization. Over half these units executed a single Bank loan each. Information on compensation of personnel attached to these units is not readily accessible, but OVE's analysis suggests that, on average, they earned far more than national civil servants: double for an executive position within a

ministry, 10 times more for technical personnel, or 15 times more for administrative support personnel.¹⁶¹

- 3.13 **While this did reduce projects' vulnerability to staff turnover in government agencies it diminished their contribution to institutional development.** In an environment of weak institutions and great political volatility this model of executing units not integrated into ministerial structures made project execution less vulnerable to frequent turnover of ministry personnel, but as OVE had observed in the previous CPE, "*There is no evidence that the implementation by the PEU is producing institutional strength that is portable across the borders of the PEU.*"¹⁶²
- 3.14 **The Bank was operating in a country environment in which, even before the political crisis, projects had had the Bank's highest proportion of unfavorable external financial audit (EFA) opinions.**¹⁶³ On average, projects' audit opinions contained observations across two thirds of their implementation span and 50% of the projects came in for observations three or more years in a row.¹⁶⁴ Operations receiving unfavorable EFA opinions as a proportion of the total jumped from 54% in 2006 to 84% in 2008. Though more rigorous audits might be behind this increase it speaks also to the high fiduciary risk of operating in Honduras, which tallies also with the increase in number of sanctions imposed by the Office of Institutional Integrity.¹⁶⁵

D. Interruption of activities as a result of the political crisis

- 3.15 **The period examined here was marked by a political crisis sparked in June 2009 which prompted a formal interruption of operations with Honduras.** On the operations side this "pause" meant interrupting Honduras loan approvals and disbursements from June 2009 to March 2010. Apart from implementation time and cost increases this interruption created serious project delivery challenges. In some cases this situation led to the partial or complete dissolving of executing units, irregular use of revolving funds in part or in full, loss of project data, and expense settlement problems.
- 3.16 **Nevertheless, during this halt the Bank kept up its presence in Honduras and then quickly reactivated its support.** The Bank kept its in-country specialists in place and worked internally to reactivate active and pipeline loans. In 2010, once operations resumed, the Bank approved a record US\$363.7 million in lending, 99% of it during the last four months of that year.¹⁶⁶ The Bank also was a key actor in the IMF arrangement the country concluded in October 2010.¹⁶⁷
- 3.17 **The crisis also explains in part the scant progress achieved toward the recommendations made by OVE in the previous Country Program Evaluation.** In April 2007 OVE presented its 2001-2006 Honduras Country Program Evaluation to the Board of Executive Directors, setting out recommendations for the Bank in three areas: (i) work with the country and development partners to sharpen the Poverty Reduction Strategy; (ii) integrate its program with the country; and (iii) move forward with results-based management,

quantifying the effectiveness of its interventions. For a variety of reasons not entirely attributable to the Bank there is no evidence that progress has been made toward any of these recommendations.¹⁶⁸

IV. RESULTS OF THE BANK'S PROGRAM

- 4.1 **In its work with the Bank, Honduras had proposed 120 development objectives for the period examined here but virtually all of them (96%) went untracked.** Data are missing for every strategy focus, particularly social and institutional development. Using alternate data sources OVE reconstructed progress on about one third of the proposed objectives. Owing to shortcomings in monitoring and evaluation systems no causal relationship can be established between *country progress* and *Bank actions*. Consequently, in this chapter we report only progress made toward each objective and actions by sector.¹⁶⁹

Table 4.1. Summary of operations and progress toward development objectives¹⁷⁰

Country strategy focus	Objectives proposed by the IDB	IDB operations		Country progress			
		Portfolio evaluated (US\$ million)	% disbursed	Insufficient data	Significant improvements	Some improvement	Limited progress
Fiscal balance	10	102.5	14%	60%	0%	10%	30%
Competitiveness	50	661.9	46%	68%	2%	22%	8%
Social development	44	335.5	33%	73%	9%	11%	7%
Institutional framework	16	71.3	6%	75%	0%	0%	25%
Total / Average	120	1,171	100%	70%	4.2%	14.2%	11.7%

A. Fiscal balance

- 4.2 **The proposed objectives pertained to tax revenue collection and public expenditure management; the results were mixed.** Between 2007 and 2009 the number of registered taxpayers soared (up 178%) as did the number of audits of businesses (up 235%) but tax revenue intakes held at around 16% of GDP, with a slight uptrend.¹⁷¹ The Bank also had proposed to help enhance expenditure planning, effectiveness, and transparency, but there is no evidence of results on those fronts. In brief, the Bank did not track any of the 10 development objectives in this focus area (perhaps owing to the IMF's leadership in this sphere).¹⁷² OVE was able to reconstruct series for only three of the objectives.

- 4.3 **The Bank had been supporting Honduras's efforts to modernize public finance management with a 2004 loan, which at the start of 2007 was still over 70% undisbursed.** The aim of this US\$15 million loan (HO-0208) was to improve public expenditure management and facilitate implementation of the Poverty Reduction Strategy (PRS).¹⁷³ Coordination problems between the Program Administration Unit (PAU) and the separate components' executing units slowed disbursement of this loan until 2007 when the PAU was restructured.¹⁷⁴ Most of the program's outputs were reported as having been delivered, including the new

Integrated Financial Management System (IFMS), through which close to 50% of aggregate public sector spending is being executed.¹⁷⁵ On the minus side, the information system for the PRS (US\$1 million) is out of date, no longer a government priority.¹⁷⁶

- 4.4 **In 2006 and 2010 the Bank approved two PBLs for US\$60.8 million to supply current financing requirements, and in 2009 a US\$28.6 million loan for a Fiscal and Municipal Management Program.** The 2006 US\$15 million Public Management Reform Program PBL (HO-0223) was intended to put through gradual reforms in the management of public funds.¹⁷⁷ Highlights of its achievements are the new Honduras Revenue Agency (DEI) organizational structure, a Unified Customs Code, and technical standards for financial management subsystems.¹⁷⁸ The 2010 PBL for a Fiscal Reform Program (HO-L1030, US\$45.8 million) provided support for tax system and public enterprise modernization.¹⁷⁹ The first US\$22.9 million tranche disbursed almost immediately, enabling the country to access other budget supports.¹⁸⁰ The Fiscal and Municipal Management Program approved in 2009 (HO-L1015) aimed to extend tax, customs, and financial management systems to the municipal level.¹⁸¹

B. Competitiveness

- 4.5 **Competitiveness-enhancing loans accounted for just over 40% of the country program objectives but came in for 72% of Bank lending by amount.** Fifty development objectives had been set: 16 in the electric power sector, 11 in the roads sector, 10 in the tourism sector, 10 for environmental protection or management, two for rural development, and one in the financial sector. The Bank did not track any of these objectives; OVE was able to reconstruct series for 15 of them. In short, of the US\$658 million it had approved in 24 competitiveness loans the Bank disbursed US\$169 million (25%).¹⁸²

Box 4.1. Competitiveness: Main development objective outcomes

In the **electric power sector**, 80% of Honduran households had electricity service in 2010, up from 69% in 2007. The increase in generating capacity was more modest (2.8%) and power rates did not cover its high costs. Power transmission and distribution losses rose 4.3%.¹⁸³ In the **roads sector**, the total paved network increased 2% annually, with a focus on arterial road corridors, but the country's road system continued to be severely undermaintained. There had been proposals also to reduce road accident rates, traffic congestion, and travel costs and times and to improve transport conditions (freight and passengers), but there is no evidence of results in those areas.

The **tourism industry** grew at the equivalent of 7% annually. The direct jobs and foreign currency generated by the sector increased 7% and 10% respectively. However, Honduras has yet to clearly position itself as a tourist destination. There is no evidence of its having consolidated or diversified its tourism offerings or of systematic mobilizing of private investment, which were other proposed objectives. As for the **rural development** objectives, exports climbed almost 6% between 2007 and 2009, but these increases have more to do with external conditions than with consolidating an inclusive agroexporting model. In the **financial sector**, consumer credit increased sharply, producer credit modestly.

1. Electric sector

- 4.6 **The Bank had been delivering support for the Honduran power sector with a regional loan approved in 2001, which at the start of 2007 was still less than 50% disbursed owing to design and procurement issues.** The objective of the US\$50 million regional loan for the Central American Electric Interconnection System (SIEPAC) (CA-0035) was to develop a Central American wholesale power market. The project finally was completed in July 2010, held up by design changes and delays in securing easements.¹⁸⁴ An additional US\$89 million in financing (22% of the original cost) was sought to cover engineering, supervision, administration, and financial cost overruns.¹⁸⁵
- 4.7 **Further support was provided in 2004 with a US\$35 million loan for a Rural Electrification and Energy Sector Support Program (HO-0224), which at the start of 2007 was still almost 99% undisbursed.** This loan, intended to increase rural electricity coverage, called for investments in four parts of the country to bring power to 27,000 new customers.¹⁸⁶ Other components assisted the national power utility (ENEE) with dispatch center modernization, loss reduction, and strengthening of the Social Electrification Office. As part of the debt forgiveness process US\$9.9 million of the loan was cancelled (76% corresponding to rural electrification).¹⁸⁷ Six years after the project's approval 95% of its active funding was still undisbursed.¹⁸⁸ Among the reasons for this slow pace are management turnover, an institutional crisis, and procurement and control problems.¹⁸⁹ The delays also made it harder to coordinate complementary investments of other donors.¹⁹⁰
- 4.8 **Despite the problems being experienced in the other ongoing operations, in 2008 the Bank approved a US\$28.5 million loan for another Energy Sector Support Program.** This program (HO-L1019) aims to boost transmission grid capacity to make the system more reliable, reduce technical losses, and help supply the mounting demand for electricity. The corporate restructuring of ENEE is another objective.¹⁹¹ The loan took two years to become disbursement-eligible and is to include a second phase (HO-L1039) that is being coordinated with parallel World Bank and CABEI operations. As of December 2010 the program funding was 15% disbursed.

2. Road and port infrastructure

- 4.9 **The natural disaster vulnerability of Honduras's roads and the fact that they are tangible focuses for investment attracted much donor support.**¹⁹² In 2004 the Bank had approved a regional integration project, Improvement of the Puebla-Panama Plan Atlantic Corridor (HO-0207), which at the start of 2007 was over 80% undisbursed. The US\$57 million project financed works along 50 kilometers of Highway CA-5 Norte.¹⁹³ Other donors were funding the other sections of the highway using more flexible rules (CABEI) or different designs (Millennium Account).¹⁹⁴ The project was held up by delays in securing rights-of-way and

quarrying permits.¹⁹⁵ Nevertheless, in 2007 the Bank approved a US\$35 million supplementary loan, only a small fraction of which has been disbursed.¹⁹⁶

- 4.10 **Loans for new roads projects approved in 2008 and 2009, totaling US\$70 million, had not yet begun disbursing at end-2010.**¹⁹⁷ The 2008 loan for US\$20 million is funding the Infrastructure Program for the San Pedro Sula Logistics Corridor (HO-L1018) to “*improve road access to the city of San Pedro Sula, the country’s industrial hub, in the context of the program for ... improvement of the CA-5 Norte Highway.*” Delays in obtaining rights-of-way have held up this project as well; construction is set to begin in September 2011.¹⁹⁸ In 2009 the Bank approved the US\$50 million Tegucigalpa–Puerto Castilla Agricultural Corridor Road Program (HO-L1033) to improve freight and passenger transportation conditions along the Gualaco–Puerto Castilla agricultural corridor.
- 4.11 **In 2010 the Bank approved US\$175 million for port infrastructure and urban transportation programs, which have not yet begun executing.** The US\$135 million Puerto Cortés Expansion and Modernization Program (HO-L1037) aims to increase that port’s efficiency and capacity by expanding infrastructure and facilities and strengthening the national port authority (Empresa Nacional de Puertos—ENP). A parallel US\$10 million loan was approved for Puerto Cortés Customs Modernization (HO-L1055). Also in 2010, the Bank approved a US\$30 million loan for a Public Transportation Program for the Central District (Tegucigalpa-Comayaguela) (HO-L1061).

3. Other competitiveness spheres

- 4.12 **The Bank’s finance-sector engagement was in the form of a PBL, its private-sector windows, and technical assistance.**¹⁹⁹ In November 2010 the Bank approved a US\$40 million programmatic loan for Strengthening the Financial Security Network and Improving Access to Financing (HO-L1065),²⁰⁰ which disbursed in full in 2010. The regulatory framework was aligned to international best practices and foundations were laid to give SMEs and vulnerable groups better access to financial services.²⁰¹ In addition, the Bank approved five nonsovereign guaranteed loans totaling US\$32 million, one US\$5 million MIF loan, and seven MIF and two technical-cooperation grants totaling US\$11.9 million.²⁰²
- 4.13 **The US\$27.8 million loan for the Natural Resources Management in Priority Watersheds (“Marena”) Program (HO-0179)—approved in 2001 but less than 50% disbursed at the start of 2007—was intended to further sustainable rural development.**²⁰³ This loan financed 753 projects on 694,743 hectares to benefit 42,604 families.²⁰⁴ Though there were some interagency coordination problems and administrative complications to obtain production inputs for the projects,²⁰⁵ the final evaluation found that over a four-year span the program had positively impacted the value of agricultural production (between US\$263 and US\$331 per household).²⁰⁶ A second investment-scaleup phase was planned but no mechanisms

for transition between the phases were built into the design to ensure that the benefits would be lasting.²⁰⁷

- 4.14 **Continuing its support for rural development, in 2007 the Bank approved a US\$27.1 million loan for the Rural Business Development Program (ProNegocios), which is virtually undisbursed.**²⁰⁸ The object of this program (HO-L1010) was to raise the income of poor and extremely poor rural households by means of activities in three components: (i) support for rural business services; (ii) financing of business plans, and (iii) support for complementary policies and programs. The project has experienced problems in fulfilling technical requirements such as development of the beneficiary baseline and design of the communication strategy.²⁰⁹

Box 4.2. IDB engagement in specific sectors (tourism and environment)

As sector-specific support, the Bank supplied US\$35 million in funding for a National Sustainable Tourism Program. This project (HO-0195) approved in 2005 proposed to consolidate and diversify the range of Honduras's tourism offerings and strengthen links between tourist circuits to enhance the country's positioning. The public investment component was to fund works such as an airport in the Copan archeological park (US\$7.4 million) but that project has been shelved.²¹⁰ The bulk of the funding (80%) in the private investment component was for works associated with a private resort complex (the Los Micos project) but it executed slowly owing to problems in synchronizing the private investment and securing municipal permits.²¹¹ Another component created a Tourism Development Fund (US\$3 million) for small tourism-associated businesses; it too experienced difficulties involving the outside manager selected.²¹²

At the start of 2007 the Bay Islands Environmental Management Program, approved in 2003 and likewise designed to promote sustainable tourism, still was more than 80% undisbursed. The aims of the Bank's US\$12 million loan (HO-0198) were to help consolidate a regional environmental management and sustainable tourism scheme (US\$3.7 million), expand sanitation services (US\$6.7 million), and strengthen municipal management capacity and land use planning (US\$2.5 million). Though the program experienced serious problems, particularly in the sustainability dimension, a Law regarding Designation of Protected Areas was enacted and the water and sanitation works built under the program have the potential to serve 18,088 people (82.15% of the target population).

At the start of 2007 the Sustainable Forest Development Program approved in 2002 was still almost 90% undisbursed. The Pro-Bosque program (HO-0218), which aimed to increase the economic, social, and environmental benefits of the forest sector, had three components: (i) policy and institutional framework (US\$6.1 million), (ii) local public management to support forest development (US\$11 million), and (iii) productive projects (US\$4.2 million). The 2007 cancellation of US\$10.95 million of the funding as part of the debt relief process eliminated the entire productive-projects component but the program was not reformulated, on grounds that "*the development objectives were not affected.*"²¹³

C. Social development

- 4.15 **The social sector accounted for one third of the country program's development objectives and of its lending.** The 44 social development objectives that had been set break out as follows: 9 for education, 6 for health, 10 for housing and utilities, and 19 for social investment systems. The Bank tracked 4 of the objectives; OVE was able to reconstruct series for a further 4. In brief, 10 of the 13 social sector loans had been approved before 2007 and two of the three 2007-2010 loans were approved in late 2010 and thus have not begun disbursing.²¹⁴ In

sum, as of December 2010, US\$127 million of the total US\$332 million social-sector portfolio (38%) had been disbursed.²¹⁵

Box 4.3. Social development: Main development objective outcomes

In the **education** sphere, spending rose significantly but education quality, secondary school enrollment rates, and workforce entry are ongoing challenges. In the **health, social investment systems, and housing and utilities** focus areas, too much information is missing to be able to gauge progress toward the development objectives. Nevertheless, if we look at the aggregate level, extreme poverty rates did come down by 3% annually and there have been annual declines of about 1% in maternal and infant mortality rates.

1. Education and health

- 4.16 ***Education.*** While most cooperation partners focused on preschool and primary education the Bank identified secondary education as the country's major education sector challenge.²¹⁶ In 2004 the Bank had approved a Secondary Education and Job Training Program (HO-0202). The first of its two subprograms (US\$25 million) was designed to increase secondary education coverage and quality in the third cycle (ages 12 to 14) and fourth cycle (ages 15 to 18) by building schools and upgrading existing ones.²¹⁷ Four flexible education delivery formats also were planned for those two cycles, as an alternative for areas with the most severe shortages of conventional education services.²¹⁸ The second subprogram (US\$6.4 million) provided skills training and job placement support to help young people into the workforce.
- 4.17 Each of the two subprograms had its own executing unit, with little coordination between the two, and each targeted a different age group.²¹⁹ US\$10 million of the loan was cancelled as part of the debt forgiveness process. The midterm review of the flexible education format subprogram executed by the Education Ministry (the only subprogram for which such a review has been done) found that none of these flexible avenues improved academic performance.²²⁰ For the job training subprogram, executed by the Ministry of Labor and Social Security in partnership with the private sector, there are descriptive statistics about young people who have found jobs in the *maquila* and services sectors but no data as yet about the quality or continuity of this employment.²²¹
- 4.18 ***Health.*** In 2005 the Bank had approved a performance-driven loan (PDL) for a health sector program. Most of that operation's objectives had been delivered even before the loan started disbursing in 2007. The US\$16.6 million PDL had sought to increase institutional deliveries, prenatal and post-partum checkups, the use of family planning, and numbers of children vaccinated.²²² The program's first external audit (2007) found that virtually all the targets—even the ones set for the last two tranches—had been attained early.²²³ However, by end-2009 only about 20% of the advance had been disbursed and it had not yet been accounted for.

4.19 **This performance-driven lending product (PDL) turned out not to be well suited to the capacity-deficient health sector.** The major issue was the PDL requirement not just to deliver specified results but to account for the respective investments. Splitting technical and administrative tasks between two executing agencies did not fix the problem.²²⁴ The first tranche of the loan was disbursed in 2010, and the year closed with 50% of its proceeds disbursed. Among its results is delivery of a basic basket of health services benefiting some 70,000 people.²²⁵ In addition, the infant mortality rate would have dropped in the four departments served by the program, from 46 to 36 deaths were 1,000 live births.²²⁶ That same year the program was reformulated (US\$6.7 million) to complement the US\$27.5 million new investment loan for the Program to Strengthen Decentralized Management and Supply of Health Services (HO-L1059).²²⁷

2. Social investment

4.20 **A conditional cash transfer program approved in 2004 (Comprehensive Social Safety Net Program) was still 95% undisbursed at the start of 2007.** The US\$20 million program (HO-0222) envisaged three types of transfers: a nutrition/health allowance, an incentive for institutional deliveries, and a school attendance allowance. Lessons learned in the midterm review of the previous loan (HO-0132) were taken into account in designing the new program which was more sharply targeted, focusing on the poorest 164 villages in 24 municipalities in Lempira, La Paz, Intibucá, and Santa Bárbara. The amount of the transfers was increased and the target 22,000 households were reached. The groundwork was started to incorporate a further 23,000 households.²²⁸ Given the shortage of services in the targeted locations, NGOs were used to facilitate health service delivery.²²⁹

4.21 **These cash transfers were interrupted owing to delays in securing ratification of the following operation and the June 2009 halt of disbursements.** In 2008 the Bank approved a conditional credit line for investment projects (CCLIP) (HO-X1012, first loan HO-L1032) to continue the conditional transfers, scaling up coverage in the same four departments.²³⁰ The operation distinguished between “initial” interventions for villages that did not have certified services available and “integrated” interventions similar to those of the previous loan.²³¹ Approved in March 2009, the loan did not receive congressional ratification until after the June 2009 change in government, so the interventions were interrupted starting in March 2009 when the funds of loan HO-0222 ran out.

4.22 **In parallel with the conditional cash transfer program the Bank had approved a policy-based loan (PBL) in 2006 to consolidate the country’s social protection system under a “Solidarity Social Safety Net” scheme closely associated with the Executive Branch.** Loan HO-L1009 for US\$27.9 million created a “Solidarity Safety Net Program monitoring and evaluation system [to] identify and monitor outcomes and impacts of programs in beneficiary groups.”²³² The loan’s first tranche was disbursed in 2007.²³³ A second-tranche release condition was the formal establishment and structuring of the “Solidarity Safety Net” and updating of

the Poverty Reduction Strategy (PRS) information system.²³⁴ This condition was deemed to have been fulfilled under the assumption that the Ministry of Social Development incorporated the objectives of the “Solidarity Safety Net.”²³⁵

4.23 **As the Bank had been supporting a series of conditional cash transfer programs since 1995, it was able to pilot best practices.** These included changes in benefits, conditions to be fulfilled by families to receive the allowances, payment and verification systems, and supply- and demand-side interventions. Standard-setting for beneficiary selection (poverty map) and payment transparency (concurrent audits) were two highlights. However, there was instability on the institutional side (as the Solidarity Social Safety Net lost prominence, for instance) and the personnel side (changes in the executing unit).²³⁶ Though these programs had evaluation designs, assessments of their impact have been done only in part (HO-0132) or have been complicated by external factors (HO-0222).²³⁷

4.24 **A 2003 poverty reduction program anchored in local capacity building likewise was more than 80% undisbursed at the start of 2007.** This Poverty Reduction and Local Development Program (HO-0220, US\$35 million) was a continuation of the US\$25 million 2000 HO-0161 operation.²³⁸ The second-phase aim was to “*help create a policy framework for municipal and local development ... in the area of poverty reduction.*”²³⁹ The program’s implementation progress was termed unsatisfactory and it was classed as high-risk.²⁴⁰ The Honduran Social Investment Fund (FHIS) itself—a preferred Bank executing agency in decades past—acknowledged the “*weak institutional performance*” and the risk “*for the program and for the institution itself.*”²⁴¹ In 2010 the Bank approved a US\$55 million loan for the second operation for Comprehensive Support for the Social Safety Net Program (HO-L1042), which will expand coverage of the new government “Bono 10,000” program and strengthen the offices and agencies that administer it.²⁴²

Box 4.4. Bank participation in development of autochthonous peoples

A US\$11.7 million loan provided support for Comprehensive Development of Autochthonous Peoples (DIPA).²⁴³ This 2006 project (HO-0197) was designed to build up human and productive capital in Honduras’s native communities to further their development.²⁴⁴ The Ministry of the Interior and Justice (SGJ), as the national government agency in charge of indigenous communities policy, was executing agency for the program’s legislative, regulatory, and human capital formation facets.²⁴⁵ The ministry encountered serious difficulties owing to staff turnover and the interruption of Bank disbursements.²⁴⁶ An ad hoc executing unit was set up in the FHIS to implement the productive capacity development segment of the program.²⁴⁷ As of December 2010 US\$8.6 million of this project was still undisbursed, a result of a change in the methodology for entrepreneurial project design and execution and then a reduction in investment funding.²⁴⁸ At the more strategic level of Bank action, there was a lack of attention to the strategy on gender, social exclusion, and marginalization in the country strategy, which had been mandated in the Country Paper Guidelines (document GN-2020-6, paragraph 3.22).

3. Housing and utilities

- 4.25 **Water supply and sanitation.** Over the past 10 years the Bank lent US\$74.7 million under three projects, which experienced serious implementation issues.²⁴⁹ Its 2002 loan for water and sewer systems in San Pedro Sula (HO-0211, US\$13.7 million) had proposed to fund investments by the concessionaire. By December 2008 the project had not started disbursing and was cancelled. Two other programs—the 1999 Water Supply and Sanitation Investment Program (HO-0072, US\$31 million) and 2006 Supplemental Water Supply and Sanitation Investment Program (HO-0174, US\$30 million)—sought to “ensure efficient and effective water and sanitation services” for municipalities that had undertaken to modernize the way those utility services are delivered.²⁵⁰
- 4.26 As of end-2010, 11 years after its approval, loan HO-0072 was 83% disbursed, after a succession of executing-unit changes and unequal competition with the World Bank.²⁵¹ The physical works component had not become disbursement-eligible until 2003 when the new Framework Law was enacted.²⁵² Meanwhile, the World Bank’s water and sanitation sector modernization loan (PROMOSA), which pursued very similar objectives but had a different executing unit (Finance Ministry) and different rules (concessional access to funds), had reduced the demand for financing on the municipalities’ part.²⁵³ The IDB loan was reworked in 2008 to align it to the World Bank approach, and ultimately was reallocated to fund emergency works projects. As of December 2010, loan HO-0174 of 2006 was still 97% undisbursed.²⁵⁴
- 4.27 **Housing.** The Bank provided support through one loan to help fill the country’s severe housing shortage.²⁵⁵ In 2006 the Bank approved a loan for a Low-income Housing Program (HO-L1007) to improve housing conditions by means of individual subsidies (US\$20.2 million) and group subsidies (US\$5.6 million).²⁵⁶ Implementation responsibilities were shared between two executing units that experienced continuous problems.²⁵⁷ There have been slippages caused by cost underestimates, the program’s reformulation, and the 2009 interruption of activity.²⁵⁸ As of December 2010, the loan was 40% disbursed.²⁵⁹

D. Institutional capacity

- 4.28 Programs specifically designed to build up institutional capacity made up 6% of the portfolio reviewed here, but 80% of the other loans also had institution-strengthening components.²⁶⁰ Four loans approved before 2007—one for the justice system, one for citizen security, two for municipal management—focused specifically on institutional improvements. Another 20 active loans had institutional development components totaling US\$133.4 million in funding—about US\$5.3 million per loan. In all, the country strategy had set 16 development objectives for institutional development. These were not tracked by the Bank but OVE was able to reconstruct series for five of them.

- 4.29 **In 2002 the Bank had approved the Justice System Modernization Program to deepen reforms begun in an earlier operation.²⁶¹** This US\$30 million loan (HO-0210) financed infrastructure needed to improve case processing through the courts and the stability of the judicial career and public defender's office. An Interagency Digital Records System (SEDI) was set up under the component to develop an integrated information network between the Ministry for Public Safety, the Ministerio Público, and the Supreme Court.²⁶² There were some isolated procurement delays and construction cost overruns. As of December 2010, only 11% of the loan proceeds remained undisbursed and almost all the new facilities are now operational.²⁶³
- 4.30 **In 2003 the Bank approved a US\$20 million loan to enhance Citizen Security in the Sula Valley Region (HO-0205).²⁶⁴** One of the operation's components had a preventive focus (with social and sports activities); others provided support for at-risk youth in the form of formal education, health services, and job training. Funds were budgeted as well to create a Public Safety Information System (SISC) with georeferenced primary data produced by the police, the public prosecutor's office, and forensic services.²⁶⁵ As originally designed the program focused on the influence of gangs, which in 2000 was the prevailing violent-crime pattern.²⁶⁶ Today violent crimes are much more likely to be drug-related and cases of killing for hire are on the rise.²⁶⁷
- 4.31 **The program experienced timetable slippages and US\$6 million of its funding was used to repair damage caused by the October 2008 storm.²⁶⁸** By June 2008, 58 months after reaching disbursement eligibility, the program's funding was 36% disbursed and it was classed as high-risk, citing particularly "very marked political sectarianism" and fiduciary issues.²⁶⁹ At the start of 2010 *there was no information about what the project had accomplished or about funds available or committed, owing to changes in executing unit management.*²⁷⁰ Given this situation the executing unit indicated its intention to "*propose to the Bank an orderly closeout of the program.*"²⁷¹ When the pause in activity ended, the Bank and the executing agency agreed on a series of measures for the operation's orderly closeout in 2011.²⁷²

V. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

- 5.1 **Honduras has one of the region's most severe inequality gaps.** Close to half (45%) of its population is subsisting in extreme poverty and another 21% falls below the poverty line. Half the rural economically active population (EAP) and 30% of the urban workforce are effectively unemployed; this has fueled migration from the countryside to the cities and swelled urban slum populations. In addition, in the wake of Hurricane Mitch more than 200,000 people—the equivalent of 10% of the nation's EAP—left the country, most of them for the United States.

- 5.2 **The Honduran economy is small and very vulnerable to shocks.** The shocks the country suffered over the span examined here (2007-2010) cut capital inflows by the equivalent of 20% of GDP. The international crisis shrank Honduras's two main sources of foreign exchange (especially because of the correlation to U.S. economic performance): *remittances* and *exports*. The 2009 political crisis then halted *funding flows from international organizations*, the IDB among them. And as a natural-disaster-prone country Honduras lives with the latent risk of catastrophic losses.
- 5.3 **Adjustments to public spending in light of these shocks, however, has been slow.** For the most part, savings have been neutralized. For instance the funds freed up by successive debt relief packages delivered to Honduras have been taken up by interest groups, including the teachers' union. Paradoxically, this satisfied donor requirements but meant that a country that, in GDP-proportion terms, leads the region in spending on education (8% of GDP) and health (4% of GDP) ranks second from the bottom for spending efficiency.
- 5.4 **Such rent-seeking behavior extends to the tax revenue collection sphere.** Since Honduran banks finance only 11% of productive investments (the region's lowest ratio), a small number of financially self-sufficient groups have gained influence on industry sector competition and politics. In this environment, tax revenue collection has remained low (16% of GDP) and regressive, partly because of the preponderance of indirect taxes but also because a series of opaque tax exemptions make for the equivalent of 7% of GDP in forgone revenues.
- 5.5 **Government procurement processes with limited participation by international bidders are another concern.** A case in point is the State power utility, which is running significant deficits owing to costly contracts with private generating companies and generalized electricity subsidies. Likewise, in other subsectors such as roads, the prevailing model has been "*build, ignore, and rebuild,*"²⁷³ and roadwork is contracted out in processes with limited participation. Transparency is another serious concern: cost overruns, weak controls, and acceptance of obsolete materials are common occurrences.
- 5.6 **Meanwhile, since 1982 exclusion has been accentuated and the majority has little faith in the effectiveness of government and institutions.** Support for a disruption of the democratic institutional order is higher in Honduras than anywhere else in the region: close to 40% of Hondurans polled say they would support a nondemocratic government if it resolved economic problems. Overall, the State faces huge governance challenges, with a severe deterioration in delivery of core mandates like security and environmental protection. For instance, with drug-related crime on the rise, Honduras's homicide rate is one of the world's highest, as is its deforestation rate.
- 5.7 **The portfolio evaluated for this report came to US\$1,171.5 million.** This included 2007-2010 operations approvals (US\$659.5 million) plus loans approved in 1999-2006 that had over 50% of their proceeds left to disburse in 2007-2010

- (US\$512 million). Because of the high 2010 approvals figure the Bank ended up delivering close to US\$200 million in net funding to Honduras in 2007-2010. The undisbursed loan balance was up 26% from 2007.
- 5.8 **The Bank’s 2007-2010 program was spread across many sectors and its evaluability was low, particularly for individual operations.** The Bank’s Honduras country strategy and the loans that came out of it had proposed an ambitious set of 120 development objectives scattered across virtually all sectors. Though the country strategy had proposed to rationalize the portfolio, in actuality it still envisaged some 35 operations to be delivered by 22 different executing agencies. Nevertheless, the country strategy’s evaluability index did improve—66%, versus 35% in the previous strategy—though the overall evaluability of individual projects was just 40%, as too many core indicators were missing.
- 5.9 **The resulting program’s relevance was weak.** Though the country and the Bank both had identified “*reducing poverty and indigence levels*” as the country’s fundamental development challenge, its weak institutional base to translate that aim into specific priorities and actual budget lines diminished the program’s relevance. This, coupled with myriad, complex, and shifting development agendas, limited the relevance of the Bank-funded projects and programs, making all of them virtually “*equally important*.”
- 5.10 **The virtual preallocation of resources via the FSO mechanism increased the resulting country program’s approvals anticipation rate and programming anticipation rate.** The resources available to Honduras are determined by its FSO allocation and the FSO/OC blend level. The introduction of OC resources in 2007 increased the funding available to Honduras by 54% but raised its cost. Even with the interruption of approvals owing to the political crisis, Management’s notable effort made possible the extraordinary US\$343 million in 2010 approvals, thereby committing the full country allocation for the two-year period. The country program had an *approvals anticipation rate* of 73% and a *programming anticipation rate* of 69%.
- 5.11 **There were issues with the program’s coherence.** Because of fiduciary constraints in operating in Honduras the Bank, and to some extent the country, emphasized physical infrastructure finance, but without parallel and commensurate sustainable institutional development. Support for longstanding Bank work focuses such as the social sector could not be sustained owing to difficulties in executing the allotted funding. In practice, the lack of a programming process that incorporated the relevant characteristics of the sector (such as real absorption capacity) limited the Bank’s effectiveness.
- 5.12 **Efficiency, and delivery efficiency in particular, was low.** Even before the crisis Honduras was one of the countries with the slowest delivery performance and highest delivery costs, surpassing the Bank averages by more than 50% and 700% respectively, owing to the fiduciary burden (procedures required to work in a

country where over 75% of project financial audit opinions contain observations) and the small size of operations (about a fifth of the Bank average). The Bank continued to work with relatively isolated executing units and with personnel compensation schemes that differed from national civil service scales. Though this made projects less vulnerable to staff turnover, it did little for institutional development.

- 5.13 **The review period was marked by a political crisis which halted operations with the country from June 2009 to March 2010.** This pause in activity increased times and costs and created serious implementation challenges. Nevertheless, during this interruption the Bank kept up its presence in the country and then quickly reactivated its support. The crisis also explains in part the scant progress achieved toward the recommendations made by OVE in the previous Country Program Evaluation.
- 5.14 **The effectiveness of the Bank's program is not evaluable, so it is difficult to extract learnings for its country work going forward.** Over 85% of the projects presented evaluability constraints, which is one reason why the Bank still has been unable to institute management by results. Effectiveness impediments, such as policy changes, institutional capacity weaknesses, and missing or inadequate monitoring systems, were reported year after year. Lastly, though some specific lessons can be drawn in each area *there is no evidence that the Bank has formally built these learnings into the mechanics of its engagement with Honduras.*

Box 5.1. Outcomes of the Bank's program

For its fiscal balance support focus the Bank's program had set 10 development objectives, on which the country achieved little progress. The Bank did not track any of these objectives. With data from the IMF, which had a lead role in this sphere, OVE was able to reconstruct series for three of them. The Bank provided support for tax administration modernization but tax revenue intakes held steady at around 16% of GDP, with a slight uptrend. To address the country's treasury requirements the Bank provided policy-based loans (PBLs) that supplied the needs of the moment but produced no viable policies to minimize future imbalances.

For the competitiveness support focus the program had set 50 development objectives, on which the country achieved only modest progress. The Bank did not track any of the 50 objectives; OVE was able to reconstruct series for 15 of them. This focus area accounted for 72% of new approvals by amount despite the large portion of previous-cycle loans that remained undisbursed. In the road sector, for instance, despite projects' lengthy delays in bidding processes, securing of rights-of-way, and construction work the Bank approved another two loans in 2008-2009 that have yet to start disbursing.

For its social development focus the program had proposed 44 development objectives. There were some gains in the coverage dimension but the challenges of quality and sustainability persist. Only 3 of the 13 loans had been approved after 2007. The Bank tracked just 4 of the objectives; OVE reconstructed series for another 8. Owing to the slow pace of disbursements only 3 of the 13 social-sector loans reviewed for this evaluation had been approved after 2007. In the education sector the Bank was the only cooperation partner to work with secondary education, and though coverage did go up there is no evidence of improvements in education quality. The disbursement performance of the Bank's health-sector PDL was low, mainly because of issues in accounting for expenditures. The Bank continued to fund conditional cash transfer programs, piloting various designs of allowances, requirements to be fulfilled by benefiting households, and payment and verification systems. These efforts furthered best-practice exploration but their outcomes have yet to be assessed.

In the institutional capacity focus area the Bank scattered its support across components attached to most of its sector loans. Fully 80% of the sector loans had institution-strengthening components, with a total of US\$133.4 million in funding. The country program had proposed 16 institutional development objectives, many more of them in specific programs—justice system and citizen security—than in the institutional components of sector loans. None of the objectives was tracked by the Bank; OVE was able to reconstruct series for five of them.

B. Recommendations

- 5.15 **The background of the country-Bank relationship is one of critical challenges limiting short-term options.** Although the country is advancing the national unity process, the effects of the severe *political fracture* that manifested itself during the 2009 crisis can still be felt. In addition, despite recent efforts, the country's long-standing endemic *institutional weakness* cannot be resolved overnight and will probably continue holding back the country's operational performance in coming years. Lastly, the serious *macroeconomic situation* caused by the international crisis and fueled by the floating debt accrued during the period of institutional instability, will continue to burden the country with unquantifiable costs and potential policy limitations.
- 5.16 **Despite these challenges, Management provided significant support to the country.** The Bank demonstrated thorough knowledge of the country's development problems, as well as the ability and willingness to significantly speed up operations. Unquestionably, the Bank has been a key partner for the country, not only financially but also as a reference for policy-making and the transfer of

- knowledge. The Bank was active in most sectors, experimenting with different work modalities, and attempting to build public investment sustainability and institutional capacity in the country.
- 5.17 **The recommendations in this CPE aim to optimize, in the medium term, what can already be described as a solid country-Bank relationship, while helping the country address its most immediate challenges.** The country's many needs and the Bank's virtual allocation of a predetermined volume of resources has resulted in a fragmented portfolio, mostly beset by persistent execution problems. The most pressing challenges must be tackled before the supply and demand dynamics can be optimized in the medium term. To this end, the Bank will have to identify opportunities to continue strengthening three key functions in its dealings with the country: (i) programming; (ii) execution; and (iii) monitoring and evaluation.
- 5.18 **Recommendation 1 - Programming: Optimize mechanisms so as to use the Bank's policy and investment instruments strategically.** As part of the country programming process, the CPE found that, if the country deems it appropriate, there would be opportunities to further expand the dialogue and use analytic tools to guide the programming exercise.
- 5.19 **Recommendation 1.A – Encourage effective spheres for dialogue.** The Bank should be ready and have the capacity in the field to respond to country requests that will open spheres of dialogue, to coordinate technical programming aspects with policy, social, and economic factors. OVE recommends that in doing so, the Bank incorporate the views of leading economic and social stakeholders, including civil society, the Congress, economic groups, and donors. The current national reconciliation process presents critical challenges, while also offering a historic opportunity to move forward in this direction.
- 5.20 **Recommendation 1.B - Ensure timely use of policy instruments.** In keeping with the country's will, the Bank must react quickly and take advantage of available windows of opportunity to initiate and support reforms in key areas such as civil service, the tax system and pension. Should the transitional cost of the needed support exceed the limit set for PBLs, the Bank will have to provide financing through other instruments with similar effects, within the framework of existing restrictions.
- 5.21 **Recommendation 1.C - Analysis in support of investment instruments.** OVE recommends that, to the extent possible, the Bank and the country agree on programming processes that consider the following characteristics for each sector: (i) the projected absorptive capacity; (ii) the anticipated volume of local coinvestment funds; (iii) the Bank's sector expertise and potential value added; (iv) the country's sector performance gap measured against a group of comparator countries; and (v) the proposed operation's expected return on investment.

- 5.22 **Recommendation 2 – Execution: Strengthen technical assistance, capacity transfer, and execution support mechanisms.** With respect to project execution, OVE recommends that the Bank will have to continue to strengthen its investment in technical support and capacity transfers. It also recommends that the Bank agree on a Framework Operating Agreement with the country as a transitional measure to address typical execution problems.
- 5.23 **Recommendation 2.A – Increase technical assistance and capacity transfers.** The Bank must ensure the country has access to a significantly higher proportion of technical assistance resources both as nonreimbursable and loan component funding, as well as direct support from the Bank's technical experts. This will call for increasing the Bank's investment in the country, not only to prepare operations but also to provide technical monitoring. The monitoring will also be crucial to help attain the long-term objective of ensuring that the lessons learned from these experiences are gradually transferred to government agencies. Lastly, the Bank and the country should program these resources in a reasonably predictable manner given their strategic importance, and ensure their year-on-year stability so as to allow sufficient time for the institutional capacity-building process to reach maturity.
- 5.24 **Recommendation 2.B - Implement a transitional operating mechanism to support project execution.** OVE recommends that the Bank and the country develop a transitional operating agreement specifying additional rules governing the interaction. OVE recommends that these rules be sufficiently specific and transparent to minimize transactional costs for repetitive decisions such as staff selection, permanence, training, promotion and compensation for professionals assigned to executing units. These rules could also include core agreements on the eligibility of expenditures, contracting and bidding procedures, or other matters seen as recurring problems in the past. OVE recommends that these additional rules be evaluated and adjusted as part of the annual portfolio review and programming exercise, and be formally incorporated in a Framework Operating Agreement with the country.
- 5.25 **Recommendation 3 – Monitoring and evaluation: strengthen monitoring and evaluations systems.** The above recommendations will require a gradual strengthening of monitoring capacities and drawing on lessons learned. OVE recommends that the Bank work with the country to create opportunities to deepen the country's statistics systems and gradually strengthen the monitoring and evaluation systems.
- 5.26 **Recommendation 3.A – Strengthen statistics systems.** To support the programming and execution mechanism improvements recommended above, the Bank will have to work with the country to find ways to support the gradual strengthening of its statistics systems. This could possibly be achieved through the National Statistics Institute (INE). Accordingly, OVE recommends that information from past experiences in areas such as the economic statistics performed with the

- Central Bank, be systematically collected and used. Finally, OVE recommends that the Bank provide constant support to strengthen this core capacity so that the country may effectively move towards results-based programmatic activities in the medium and long term, and generate technical evidence to adjust public policy.
- 5.27 **Recommendation 3.B – Use of monitoring systems.** Under SPD's guidance, the Bank is making a major effort to strengthen monitoring tools, in particular the project monitoring report (PMR). OVE recommends that the Bank, through SPD, continue working on the project performance index (PI) and the components relating to output delivery levels, cost and times, compared against pre-established targets. It further recommends that execution risks be managed actively as soon as they become apparent. Specific solutions should be proposed as part of the portfolio review exercise. Moreover, in the case of risks common to multiple operations, the solutions should also be incorporated in successive updates of the above-mentioned transitional operating regulations.
- 5.28 **Recommendation 3.C – Indicators to support the FSO allocation mechanism.** Closely monitoring the operating mechanisms derived from these recommendations could generate a more objective set of indicators to assess reforms, institutional capacity and portfolio performance for use in future allocations of FSO resources. OVE recommends that these objective indicators be used to document the country's progress in these areas, ensuring greater objectivity for the aspects considered in the periodic allocation of FSO resources to the country. It is important to learn from past lessons, especially following the recent international financial crisis when contingent instruments under suitable terms were unavailable for FSO countries. OVE recommends that this and other special country requirements be properly documented for possible future discussions about changes and adjustments to instruments available to FSO countries.

Endnotes

- ¹ According to comments from the country. See Republic of Honduras, Ministry of Finance, *Comments on the Country Program Evaluation, 2007-2010, OVE*, May 2011. It should be noted that not all international donors lack flexible instruments for providing access to liquidity during times of economic crises or natural disasters. Specifically, the World Bank has a mechanism known as the Development Policy Loan Deferred Drawdown Option (DPL DDO) that allows the borrower to defer disbursements for up to three years, renewable for an additional three years. For more information on the terms and conditions of this mechanism, see http://treasury.worldbank.org/bdm/pdf/Handouts_Finance/DDO_MajorTerms_Conditions_Aug09.pdf.
- ² At present, the ceiling on approvals for policy-based loans is under review, and the restriction on carryovers was recently eliminated.
- ³ CPE activities included two working missions to Honduras. The purpose of the first mission, which took place from 24 May to 3 June 2010, was to study the context surrounding Honduras' development challenges, as well as the Bank's country program. A broad cross-section of people involved in the design and execution of the program and in the country in general were interviewed. The interviews went beyond the issues covered in the Bank's program because the idea was to get an overview of conditions and prospects in the country, not to produce an evaluation of individual operations, which was the purpose of the second mission. Interviewees included past and present government authorities, sector specialists, and other technical experts, scholars, and opinion leaders. The purpose of the second mission, which took place from 26 July to 6 August 2010, was to analyze aspects related to implementation of portfolio projects. Interviews were conducted with staff at the executing units of portfolio projects and other project stakeholders. A list of the interviewees can be found in the Annexes.
- ⁴ Although the period covered by the Bank's program evaluation was 2007-2010, based on the availability of data and the objective of analyzing the country's medium-term development challenges and their context, pre-2007 data was also used. Data sources included the World Bank, the International Monetary Fund, the Economic Commission for Latin America and the Caribbean, the United Nations Development Programme, Latinobarómetro, the World Economic Forum, and national sources (e.g. the Finance Ministry, the National Statistics Institute, the Central Bank, the Labor, Health, and Education Ministries, etc.). In many cases, due to lack of information or the preliminary nature thereof, data running up to the end of the review period could not be included. In accordance with the country program evaluation protocol (document RE-348-3), primary and secondary data sources were used, including information from the Bank, research institutes, and think tanks, as well as from other international organizations.
- ⁵ According to World Bank data on PPP-adjusted per capita GDP (in current international dollars) (*World Development Indicators*). The figure is for 2009, the latest year for which cross-region data are available. Honduras ranks fifth-lowest for current-price GDP per capita, ahead of Haiti, Nicaragua, Guyana, and Bolivia.
- ⁶ All measures are for the official poverty headcount ratio as reported in the CEDLAS-World Bank database. The poverty headcount ratio is simply the proportion of the population living below the national poverty line. In Honduras this measure also shows the incidence of poverty, and particularly extreme poverty, to be far higher in rural areas: in 2007 the urban poverty and extreme poverty rates stood at 55% and 22% respectively; the rural figures were 66% and 53%.
- ⁷ According to the most recent available data (2006), Honduras's Gini index score was 55, putting it third for income inequality in the region that year, and higher than other Central American countries like El Salvador (46 points, 2007), Guatemala (54 points, 2006) or Nicaragua (52 points, 2005). Technically the Gini coefficient—the most commonly used yardstick of income inequality—ranges from 0 to 100 points. A Gini index score of 0 denotes an economy in which income is distributed equally across the entire population. All data are taken from *World Development Indicators* (World Bank). Looking at Gini

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changes over time: in 1991-2001 both the Honduras and region Gini averages were about 54 points. In 2002-2009 Honduras's Gini climbed to 56.5 while the region average slipped to 51.7. In other words, the regionwide Gini coefficient improved during that strong-growth chapter but Honduras's Gini worsened slightly. Gini numbers for the temporal analysis are from the SEDLAC (CEDLAS and World Bank) database which provides more data.

- ⁸ For an analysis of inequality in Latin America over time see Luis Felipe Lopez-Calva and Nora Lustig (eds.), *Declining Inequality in Latin America: A Decade of Progress?* Brookings Institution Press.
- ⁹ In 2009 absolute dollar GDP terms, Honduras is the sixth smallest of the region's 24 economies, after Guyana, Belize, Suriname, Nicaragua, and Haiti, and is slightly smaller than the Paraguayan and Jamaican economies. Looking just at its neighbors, the Honduran economy is respectively 40%, 50% and 65% the size of the economies of Guatemala, Costa Rica, and El Salvador, but more than double (232%) the size of the Nicaraguan economy. Source: World Bank, *World Development Indicators*.
- ¹⁰ The trade openness index is the ratio of exports and imports to GDP. Within the region Honduras trails only Guyana, Panama, and Belize. It also has a considerably higher trade openness index than its neighbors: in 2008 the indexes for Guatemala, El Salvador, and Nicaragua (2007) were 64%, 77%, and 100%, respectively. Source: World Bank, *WDI*.
- ¹¹ By the Herfindahl index, calculated from Honduran trade databases. The Herfindahl-Hirschman index (HHI) is a commonly used measure of market concentration, calculated as the sum of squared market shares. This core index then is normalized to lie between 0 and 1. The lower the HHI, the lower the market's concentration. In terms of product range, Honduras has Central America's highest HHI (0.064), nearly triple that of Guatemala (0.022), double that of El Salvador (0.038), and close to 30% higher than Nicaragua or Costa Rica (0.05). For destination markets, Honduras (0.21) is more concentrated than Nicaragua (0.14) or Costa Rica (0.16), on a par with Guatemala (0.21), and less concentrated than El Salvador (0.29). These can be interpreted as very high concentration levels. One change since 2000 is a slight increase in concentration in destination markets and products alike. Source: The authors, from the World Bank's World Integrated Trade Solution (WITS) database. See Figures 1.6 and 1.7. Products are beginning to be diversified: in 2010 nontraditional exports grew 12.4%, led by paper and cardboard (85.5%) and soaps (23.2%).
- ¹² In the past the U.S. share was even higher, but has been declining owing to the rise in intraregional trade and China's direct access to the U.S. textile market. In the 2001-2007 span, Honduran exports to the U.S.A. dropped from 58.8% of total export sales to 42.7%, while imports from the U.S.A. slipped from 42.1% of the total to 39.3%. Over that same period Honduras's exports to its Central American trading partners climbed from 16.4% of the total to 24.1%, while the share of imports from those countries held at about 18.9%. Source: Inter-American Development Bank, INTAL, DATAINTAL. See Figure 1.7.
- ¹³ According to 2007 data from the INTAL DATAINTAL database, coffee topped the list of the country's leading exports at 21% of the total, followed by electrical wiring (9.6%), bananas (6.5%), seafood (5.4%), and palm oil (4.6%). In the 1990s coffee sales had made up more than 30% of total exports; since 2000 they have held at around 19% of the total. Two items that have seen their percent share slip over time are wood products (Ch. 44) and knitted clothing accessories (Ch. 61). Wood products accounted for 5% to 7% of total exports up until 2003 but have since disappeared from official statistics; exports of knit fabrics peaked in 2002-2003 and declined thereafter.
- ¹⁴ Some have argued that Honduras's geographic features (poor nonvolcanic soil and a terrain that poses connectivity challenges) explain why it took the country longer than its neighbors to develop a coffee-exporting economy. That factor, along with campesinos' ready access to land, is cited as an explanation

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for less conflictive labor relations in Honduras, with the pursuit of nonviolent solutions to landless campesino disputes in the early 1970s. See John A. Booth, Christine Wade, and Thomas Walker (2010), *Understanding Central America. Global Forces, Rebellion, and Change*, Westview Press, 5th edition. Others have argued as well that the establishment of the banana industry, despite its rent-seeking behavior, contributed to this state of affairs, since it helped liberal ideas take sway in Honduras. See Darío Euraque (1996), *Reinterpreting the Banana Republic: Region and State in Honduras, 1870-1972*, University of North Carolina Press.

- ¹⁵ Some 60% of the population and the bulk of the nation's infrastructure are concentrated in the narrow strip of land between Puerto Cortés on the Atlantic coast and Choluteca on the Pacific side. According to the latest census, 62% of the population live in the departments comprising that bioceanic corridor: Valle, Choluteca, Comayagua, Francisco Morazán, Yoro, Cortés, and Atlántida, which together make up roughly one third of the country's land area.
- ¹⁶ Official development assistance (ODA) consists in disbursements of loans made on concessional terms (net of repayments of principal) and grants by official agencies of the members of the Development Assistance Committee (DAC), by multilateral organizations, and by non-DAC members to promote economic development and welfare in countries and territories on the DAC list of ODA recipients. Since the most recent data are from 2008 the figures given here for the "decade" are for the period 2000 to 2008. Over that interval Honduras was the region's fourth largest recipient of development aid per capita (US\$82), after Guyana (US\$170), Nicaragua (US\$150), and Suriname (US\$106). The Honduras per capita ODA figure is well above the regional mean of US\$10 per capita. Moreover, ODA flows to Honduras have been increasing more quickly than to the rest of the region—from US\$71 per capita in the 1990s to US\$82 per capita in the past decade, while the regional figure held virtually unchanged at US\$10 per capita. Given the great volatility of the ODA series the comparisons have been done for decade averages, then annualizing the growth rates.
- ¹⁷ ODA as a proportion of public investment. Note that this ratio is not bounded by 0 and 1, since ODA includes all concessional funding approvals for projects even if they are multiyear operations. According to the Honduran budget, 61% of sectoral public investment in 2010 will be externally funded.
- ¹⁸ The Heavily Indebted Poor Countries (HIPC) Initiative was launched in 1996 by the World Bank and the IMF to help countries with heavy external debt stocks to achieve sustainable debt levels. The Multilateral Debt Relief Initiative (MDRI) is an initiative of the IMF, IDA (World Bank), and African Development Bank (AfDB) to provide additional debt relief. The IDB signed on to the latter initiative in 2007, delivering assistance to the five HIPC countries in the region (Bolivia, Guyana, Haiti, Honduras, and Nicaragua). Honduras's debt relief process began in 1990 when the country sought Paris Club debt reschedulings; further negotiation rounds took place in 1992, 1996, and 1999 in parallel with the MDRI and HIPC initiatives. For a chronicle of debt relief to Honduras see USAID, "Debt Forgiveness for Honduras, the Process and the Results," mimeo. Available at www.usaid.gov/hn/. Mostly owing to the debt relief delivered, Honduras's debt stock shrank from 77% of GDP in 1998 to 17% of GDP in 2008, according to GDP data and World Bank *World Development Indicators* data on external public and publicly guaranteed debt. Debt relief delivered to Honduras since 2000 comes to about US\$3.68 billion, making it the second largest recipient of relief after Nicaragua. That figure being about 51% of 2000 GDP, it is evident that new borrowings up until 2008 were in line with GDP growth rates. See Table 1 in the annex and Figures 1.8 and 1.9.
- ¹⁹ Honduras's 2% annual population growth rate and its dependency ratio are among the region's highest. Though its population growth rate has been slowing in recent years, at 2% it remains one of the region's highest. Its 2007 rate of growth was the region's third highest, trailing only Belize (3.45%) and

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Guatemala (2.45%) and well ahead of the Latin American mean (1.3%), the Central American mean (1.5%), and even regional neighbors such as Nicaragua (1.3%). See Figure 1.10. The Honduran population also is one of Latin America's youngest: the country's 2007 dependency ratio (proportion of children to adults of working age) of 67% was Latin America's second highest. See Figure 1.11.

- ²⁰ Underemployment refers to the status of working-age individuals who worked for less than the normal work day (visible underemployment) or worked a full day but earned less than the statutory minimum wage (invisible underemployment). The unemployment equivalent of underemployment measures the number of full-time jobs equivalent to the work hours lost by the underemployed. The sum of the open unemployment rate and the unemployment-equivalent rate is an indicator of the severity of unemployment/underemployment in a particular country, which for purposes of this evaluation we call "effective unemployment" (see Figure 1.12). Honduras's formal unemployment rate is low (3.05% in 2007) but its high underemployment rate (38.2%) makes for a high unemployment equivalent of underemployment rate (22.8%). In other words, in 2007, fully one quarter of the population (25.85%) were "effectively unemployed," and the proportion of the population in that situation had been on the rise since 1999 (14.2%). All unemployment and underemployment data are from Observatorio del Mercado Laboral of the Honduran Ministry of Labor and Social Security (<http://www.trabajo.gob.hn/oml>) and come from the Permanent Multipurpose Household Survey (EPHPM). See Figures 1.12 and 1.14. Honduras's high informal employment rates likewise put it second highest in the region for employment vulnerability. See Figure 1.13.
- ²¹ The most recent census data on in-migration come from the 2001 population census. According to CELADE-ECLAC net migration rate calculations, only three departments had positive net migration rates between 1996 and 2000: Cortés (12.5 per 1,000), Islas de la Bahía (7.3 per 1,000) and Francisco Morazán (2.63 per 1,000). These migration patterns correlate to significantly lower poverty levels in the cities. Hand in hand with this swelling of urban populations was an increase in the proportion of the population living in slum conditions. See Figures 1.15 and 1.16. According to ECLAC data (CEPALSTATS), 34.9% of the population was living in slum conditions in 2005, up from 18.1% in 2001. See Figure 1.17.
- ²² Temporary Protection Status (TPS) allows nationals of countries that have been hit by natural disasters to remain temporarily in the United States. Honduras was designated a TPS country on 5 January 1999 and its status has been extended through 5 January 2012.
- ²³ The exact number of Hondurans in the United States is hard to estimate because much of this migration is undocumented. The 2000 U.S. Census reported a total of 280,000 Hondurans living in that country. An estimate using U.S. household census (CPS) data would put the number of Hondurans living in the U.S.A. at 497,000 in 2006. See Figure 1.18. A study based on the Honduran Statistics Bureau's Permanent Multipurpose Household Survey reports 693,000 Hondurans living in the U.S.A. in 2006 (CEMLA and MIF, 2008, *International Remittances in Honduras*, Mexico City. <http://www.cemla-remesas.org/informes/report-honduras.pdf>). These estimates suggest increases of between 75% and 145% between 2000 and 2006. According to Central Bank of Honduras remittances surveys (Banco Central de Honduras, March 2007, *Consideraciones sobre las remesas familiares enviadas a Honduras*, http://www.bch.hn/download/trabajos_investigacion/remesas.pdf) the vast majority (95%) of Honduran emigrants live in the United States. By the Central Bank figures there would have been some 530,000-730,000 Hondurans living in the U.S.A. in 2006. Remittances in 2007 came to 21% of GDP, almost triple foreign direct investment into Honduras (7.7%) or the export assembly industry (7.3%) that year. In recent years, there has been a drop in remittances, which were equivalent to 17% of GDP in 2010. See Figure 1.19.

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- ²⁴ The Honduran economy grew 5.11% in 2000-2006, outperforming Central America and Latin America (3.95% and 4% growth respectively). See Figure 1.22. Moreover, the growth rate variation coefficient over that interval was 0.29, significantly lower than the 0.60, 0.91, and 1.03 figures for the periods 1961-1974, 1975-1990, and 1990-1999, and likewise below the Latin America and Central America change rates of 0.59 and 0.31 respectively. See Figure 1.23. Note, however, that these growth rate changes are calculated from a small number of observations and thus are rough estimates.
- ²⁵ The Honduras/U.S.A. GDP growth rate correlation coefficient was 0.89 in 2000-2006 after averaging -0.16 in 1990-1999. The coefficient of correlation between the two variables takes values of -1, 0, and 1 for strong and inverse correlation, no correlation, and strong, direct covariation of the variables. The importance of migrant remittances for Honduras was underscored in OVE's second Honduras country program evaluation (OVE, 2007. *Country Program Evaluation: Honduras 2001-2006*). See especially paragraphs 1.8, 1.19, and 3.4 that highlight the role of remittances as a source of current-account deficit finance.
- ²⁶ See Figures 1.20 and 1.21 and IMF, *Honduras: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility*, January 2006. <http://www.imf.org/external/pubs/cat/longres.cfm?sk=18852.0>.
- ²⁷ Residential construction sector performance is one way to proxy the onset of the economic downturn. In Honduras, new construction permits began to drop in March 2009; in the U.S.A. the downtrend had started in June-September 2008. March 2009 was the third month in a row to show a decline in the Central Bank of Honduras year-on-year forecaster of economic activity; the political crisis erupted just three months later, in June 2009. The term "political-economic crisis" used at various points in this document refers to this near-simultaneous development of the two crises. See Figure 1.29.
- ²⁸ Not until late 2009, as Honduras weathered a crisis, was there a partial correction by way of 21%-of-GDP and 28%-of-GDP drops in exports and imports respectively.
- ²⁹ The Committee of the Whole and the Board of Executive Directors discussed an interruption in the Bank's relationship with Honduras on 7 July 2009. According to the minutes (CGA/09/23), "[t]he President mentioned the resolution the Organization of American States (OAS) had adopted on 4 July, whereby proceedings were under way to suspend Honduras as a member of the organization. He also mentioned that several parties continued to pursue diplomatic efforts to end the break in the institutional order caused by the coup d'état in that country. In view of the OAS resolution and the Bank's fiduciary obligation with respect to the proper administration of its resources and operations, the President said there would be a pause in the Bank's relations with Honduras. This meant that no new operations would be considered and no disbursements would be made from the public and private sector windows" (paragraph 2.1). As noted earlier, these international inflows came to around 6% of GDP.
- ³⁰ According to IMF estimates, *Staff Report for the 2010 Article IV Consultation*. See Figure 1.24. Debt relief—particularly the rounds from 1997 until 2001 when Honduras was admitted into the HIPC Initiative—lowered the country's interest burden by 4% of GDP. Virtually over that same span the central government wage bill rose by 4% of GDP. According to World Bank estimates, the 1997 passage of regulations governing teacher remuneration (Teachers Statute) was the main driver of the sharp increase in expenditure between 1998 and 2002. This legislation raised teachers' gross earnings by 40% in real terms over that period by: (i) indexing teachers' base salaries to the minimum wage; (ii) introducing salary allowances for seniority, geographical location, etc., and (iii) increases in the base salaries negotiated in excess of the inflation rate. See World Bank (2004), *Honduras. Development Policy Review: Accelerating Broad-Based Growth*, 8 November, p. 26. The Teachers Statute is anchored

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in Article 165 of the Honduran Constitution: “The Law guarantees active teachers job security, a standard of living in keeping with their elevated mission, and a fair retirement income. The Statute Governing the Honduran Teaching Profession shall be enacted to that end.” See Figure 1.43.

- ³¹ In 2003 the Maduro administration approved the “Central Government Employee Compensation Law” in a bid to contain the fiscal impact of the 1997 Teachers Statute (see *Honduras Public Expenditure Review* [PER], 2007). In 2006 the government exempted teachers from the remuneration law. The Social Adjustment and Education Quality Program (PASCE) approved by the government in 2007 called for wage increases and a new standardized education quality measurement system. The authors of an IDB technical note argued that this new pact was “financially unsustainable” (Gustavo Arcia and Carlos Gargiulo, March 2010, *Ánalisis de la Fuerza Laboral en Educación en Honduras*, IDB, SCL/EDU, Technical Note 7). Similarly, the World Bank predicted that the PASCE would double Honduras’s teacher wage bill (see World Bank, PER, July 2007, Washington, D.C., p. 75). Wage bill data (central government) are taken from International Monetary Fund estimates, *Staff Report for the 2010 Article IV Consultation*, 25 June 2010. See Figure 1.25.
- ³² The increase in the minimum wage is fiscally significant because the regulations (“Statutes”) governing particular professions (teachers, doctors) index remuneration to the minimum wage. The Government of Honduras notes that, during the period, the most significant growth was in three sectors: (i) the aforementioned PASCE agreement with teachers; (ii) the increase for physicians, in keeping with the inflation rate; and (iii) the increase for nurses. The figures are taken from Economist Intelligence Unit, *Country Report, Honduras*, February 2009, p. 10. The Honduran system does not set a single minimum wage; the minimum wage is set separately for each industry sector.
- ³³ The Central American countries included are Costa Rica, El Salvador, Guatemala, and Nicaragua. The comparable-income countries are those in the region with per capita GDP (PPP) below US\$5,000 in 2009. This includes the Dominican Republic, Paraguay, Nicaragua, Bolivia, and Guatemala.
- ³⁴ See Figure 1.42. With respect to distribution across the central government: the Education Ministry, for instance, accounted for 32% of central government budget spending in 2010; virtually all (99%) of that was current expenditure, and payroll comprised 75% of current expenditure. The Ministry of Health’s budget constituted 15% of total central government expenditure; 90% of its expenditure was current and 65% of that was for payroll. See SEFIN, *Presupuestos de Egresos por Institución y Comparativo por Ejercicio, Administración Central*.
- ³⁵ Tax revenues had been trending up slightly until 2008 but flattened after the 2009 crisis, which erased the gains achieved in 2007 and 2008. Data for 2001-2005 from Dirección Ejecutiva de Impuestos; additional data from Luis Eduardo Escobar, *Honduras: Espacio fiscal para la inversión social y productiva*, UNDP-Honduras.
- ³⁶ A recent IDB study (Jerónimo Roca, *Desafíos de la Política Tributaria en Honduras*, January 2009) found the main problem with the sales tax (ISV) to be the myriad exemptions that benefit higher-earnings sectors. Specifically, the report concludes that “the extent of ISV exemptions in Honduras shows, albeit indirectly, that the highest-income sectors have a very significant—and societally unwarranted—share in consumption of the exempted goods and services” (p. 6).
- ³⁷ For a detailed discussion of the tax-exempting laws and orders see Dirección Ejecutiva de Ingresos (DEI) (2007), *Sacrificio Fiscal en que ha Incurrido el Estado de Honduras a Consecuencia de Exoneraciones Tributarias y Aduaneras a Diferentes Personas Naturales y Jurídicas en el Transcurso de los Años 2001-2007*, Tegucigalpa, 26 December.

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³⁸ Forgone revenue breaks out as follows, according to the most recent estimates (2006): sales tax, 30%; import duties, 28%, and income and wealth taxes, 22%. See Luis Eduardo Escobar, “Honduras: Espacio fiscal para la inversión social y productiva”, UNDP, p. 21, and Annex II. In addition to their magnitude, these exemptions have been increasing over time (see DEI, 2007). Another study found that the proportion of exemptions to GDP jumped from 1.9% to 6.9% between 2002 and 2006. World Bank (2009), *Institutional Governance Review, Strengthening Performance Accountability in Honduras*, Vol. 1, p. 15.

³⁹ See Table 1.2, Subsidy Programs in Honduras. See World Bank, Honduras PER, 2007. See Luis Eduardo Escobar, *op. cit.*, p. 29: “There are exemptions for particular goods, as in the case of the road (fuel) tax. This exemption benefits mainly four companies, three of them power generators, which account for 75% of the tax-exempt revenue.” See Roca, *op. cit.*, p. 18, on the importance of exemptions enjoyed by teachers—that benefit being enshrined in Article 164 of the 1982 Constitution which reads: “*Primary school teachers in active service shall be exempt from every kind of tax on their salaries and on such sums to which they shall ultimately be entitled as retirement income.*” See Figure 1.53.

⁴⁰ As a point of reference, were these to ultimately become contingent liability risks, the pension administrations have a budget equivalent to 5.6% of GDP, which in the event of difficulties would have to be funded from another source. See World Bank, *Honduras PER*, 2007, Vol. II, Table 2.1, p. 9, and Economist Intelligence Unit. For instance, even before the PASCE agreement was concluded with the teachers’ union the teachers’ retirement plan was running operating deficits, and much of its capital was tied up in personal loans made to plan members at subsidized interest rates.

⁴¹ The ENEE’s financial deficits grew in 2007 and 2008 to 1.2% of GDP as global oil prices rose, but improved in 2009 (0.5% of GDP) following an electricity rate adjustment and a drop in bunker prices. The Honduran government has cut electricity subsidies as part of its program with the International Monetary Fund, while committing to adjusting electricity rates to ensure the power utility’s sustainability. According to country data, the ENEE now has a deficit on the order of 0.3% of GDP. See *Estudio de Actualización y Revisión del Sector Eléctrico*, a report prepared by Dussan Manuel for JICA in March 2010, and *Honduras: Request for a Stand-By Arrangement and an Arrangement Under the Standby Credit Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Honduras*, October 2010.

⁴² See World Bank (2007), *Honduras, Power Sector Issues and Options*, and 2010 update. A March 2010 JICA consultant report offers a similar diagnostic (Manuel Dussan, “*Estudio de Actualización y Revisión del Sector Eléctrico.*”) Electricity subsidies are poorly targeted because some go directly to urban households (*Bono 80*) and they benefit mostly intermediate-consumption households (100 to 300 MW)—the areas that have electricity service being relatively less poor. See World Bank, *Honduras Public Expenditure Review (PER)*, 2007.

⁴³ See Figure 1.48. Between 2004 and 2008 Hondutel’s operating profits plummeted from US\$126 million to US\$15 million, driven by the loss of the international market (international sales dropped from US\$141 million to US\$55 million), grey traffic that represents some US\$35 million annually, and the company’s skyrocketing operating costs—the latter owing to increases in the termination costs that Hondutel pays other mobile telephone service providers and increases in personnel from 2,934 in 2004 to 3,662 in 2008. See Tribunal Superior de Cuentas de Honduras (TSC) (2009), *Investigación Técnica Practicada al Control del Tráfico Gris en la Empresa Hondureña de Telecomunicaciones, Informe Especial 04/2007-DASII-F*, June 2009. Personnel data are from Honduran Finance Ministry, Dirección General de Instituciones Descentralizadas, *Informe de Recursos Humanos*, several years.

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- ⁴⁴ Pension plans vary widely both in size of member rolls and actuarial soundness. The contribution rates of the two largest plans by member numbers (Honduran Social Security Administration—IHSS—with 527,000 members and Honduran Teachers' Pension Administration—INPREMA—with 63,000 members) are far below actuarially sustainable rates. Two other plans, covering Universidad Nacional de Honduras employees (INPREUNAH, 5,500 members) and executive branch civil servants and employees (INJUPE, 28,000 members) need only minor adjustments to become financially sound. The other plan—the Armed Forces Pension Plan (IPM, 26,000 members)—is actuarially sound. See World Bank, Honduras PER, 2007, Table 2.13. These data refer to the size of the budget of pension institutions and, therefore, include categories such as investments.
- ⁴⁵ Negative real interest rates since 2007 have widened the private-sector deposit-lending spread. See Figures 1.26 and 1.27 and IMF Country Report No. 08/241, July 2008, and UNDP, *op. cit.* After lowering the policy rate to 3.5% in June, the central bank raised it to 4.5% between July and August 2009, where it has remained since then.
- ⁴⁶ See UNDP-Honduras, *Economía Hondureña 2009 y perspectivas 2010: datos y percepciones*, pp. 30-32.
- ⁴⁷ Just under half (48%) of this funding was from the Central Bank, 30% from commercial banks, and 20% from decentralized agencies. Meanwhile, Central Bank foreign currency reserves shrank 20% between June and December 2009. See Figures 1.30 and 1.31.
- ⁴⁸ The October 2005 cutoff is when the government effectively pegged the lempira to the dollar. Real appreciation since then was mostly because of accelerating inflation in Honduras over the period, ranging from 5% to 11%. By IMF estimates the Honduran exchange rate is 5% to 18% overvalued, depending on the calculation method. See IMF, *Staff Report for the 2010 Article IV Consultation*, p. 14.
- ⁴⁹ See Figure 1.28.
- ⁵⁰ Specifically in April 2010, a package of tax measures was approved—higher tax rates and abolishment of some exemptions—that could boost tax receipts by 1.5% to 2% of GDP. See IMF, *op. cit.*, p. 12. Details in the October IMF Stand-by Arrangement, discussed in the next section.
- ⁵¹ Most 2010 data are International Monetary Fund or Economist Intelligence Unit estimates.
- ⁵² The ratio has been approximately two Liberal Party governments to one National Party government. Liberal Party presidents since 1982 were Suazo Córdova (1982-1986), Azcona Hoyo (1986-1990), Reina Idiáquez (1994-1998), Flores Facussé (1998-2002), and Zelaya Rosales (2006-2010). National Party presidents were Callejas Romero (1990-1994), Maduro Joest (2002-2006), and Lobo Sosa (since 2010). Honduras officially has five major political parties (National Party, Liberal Party, Innovation and Unity, Christian Democrats, and Democratic Unification). However, the National Party and the Liberal Party have won approximately 90% of the vote in every election since 1982.
- ⁵³ For an analysis of the relationship between the international context and the end of military aid to Honduras see J. Mark Ruhl, "Curbing Central America's Militaries," *Journal of Democracy*, Vol. 15, No. 3, July 2004. For a discussion of Honduras's democratic transition see John A. Booth, Christine Wade, and Thomas Walker (2010), *Understanding Central America: Global Forces, Rebellion, and Change*, Westview Press, 5th edition, Chapter 8. These authors choose the 1996 armed forces reform as the moment of transition toward a civilian democracy (p. 171). Among other reforms, the Reina administration put the military police under civilian control, privatized the national telecommunications company, appointed a civilian as minister of defense, and abolished mandatory military service. Julieta Castellanos (2002), *Honduras, Relaciones Cívicas y Militares: Avances y Conflictos Vigentes*, Center for Hemispheric Defense Studies, Research in Defense and Security Studies, mimeo.

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⁵⁴ See Latinobarómetro 2008. Booth, *op. cit.*, p. 178, points up the contradiction between Honduras's progress on the formal components of democracy and the poor quality of democratic institutions, as revealed by the public's weak support for democracy. A recent World Bank study takes up this point, relating it to the slow pace of economic progress. World Bank (2009), *Institutional Governance Review, Strengthening Performance Accountability in Honduras*, Vol. 1. Nevertheless, most Hondurans did not approve of the removal of the Zelaya government: according to a 2009 Latinobarómetro poll, 61% of the population disapproved of the president's expulsion and only 39% were supportive. The more educated and older the responders, the more supportive they were toward the coup.

⁵⁵ See Figure 1.34.

⁵⁶ Own calculations based on data from the Supreme Electoral Tribunal for the presidential elections of 1985, 1989, 1993, 1997, 2001, 2005, and 2009. The number of valid votes with respect to registered voters is reported. Tallies of registered votes are not available for 1989 and 1993, so figures for these years were geometrically interpolated based on the 1985 and 1997 figures. In absolute terms, the last election (2009) recorded 7% more valid votes than the 2005 election. The drop in the percentage of electoral participation was due to a nearly 16% increase in the number of registered voters. With 2,300,056 ballots cast, the 2009 election had the highest number of votes since democracy was restored in 1982.

⁵⁷ According to World Bank data, *Worldwide Governance Indicators*.

⁵⁸ According to 2008 United Nations data for the 75 countries for which data are available for that year, the mean homicide rate worldwide was 9 per 100,000 population (UNODC, police/justice system sources); the Latin America rate was close to 30 per 100,000. Honduras's already-high violence rates have risen dramatically in recent years: according to Central American and Honduran data (Observatorio Centroamericano de la Violencia—OCAVI and Observatorio de la Violencia de Honduras), the nation's homicide rate jumped from 31 per 100,000 population in 2004 to 70 per 100,000 in 2009.

⁵⁹ According to 2006 UNDP crime-victim data, 27.7% of Hondurans polled had been the victim of a robbery and 15.8% had witnessed one. See Mario Posas (2009), *Delincuencia, inseguridad ciudadana y desarrollo humano en Honduras*, UNDP.

⁶⁰ See Posas, *op. cit.*, Booth, *op. cit.*, p. 178, and Bjorn Lomborg (ed.), *Latin American Development Priorities. Cost and Benefits*, Chapter 10. Homicides are very concentrated in the Atlantic region departments and those along the Guatemala border (Copán and Ocotepeque). Most murders now are being perpetrated by hired killers. According to Observatorio de la Violencia, the homicide rate in Cortés (San Pedro Sula), one of the most affected areas, now stands at 111 per 100,000 population.

⁶¹ World Bank, *Aggregate Governance Indicators*. 2008 data. Latin America takes in 18 countries in the region: Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Panama, Paraguay, Peru, Uruguay, and Venezuela. Honduran businesses, for instance, are the third most likely to be asked for a bribe, following Ecuador (15.9%) and Paraguay (14.2%). See Álvaro González, J. Ernesto López-Córdova, and Elio Valladares (2007), *The Incidence of Graft on Developing-Country Firms*, World Bank Policy Paper 4394, Washington, D.C.

⁶² See World Bank (2009), *Institutional Governance Review, op. cit.*, Vol. II, Ch. VI, especially on the matter of local expenditure management and control. See also Leonardo Letelier, *El Gasto Municipal en Centroamérica y República Dominicana*, Serie de Estudios Económicos y Sectoriales, Inter-American Development Bank, April 2007. The bulk of locally raised revenues comes from taxes on economic

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activity (66%). The broad consensus is that local taxes should be based on real property to avoid interjurisdictional competition.

⁶³ According to 2009 World Bank data, *Institutional Governance Review, op. cit.*, Vol. II., p. 237.

⁶⁴ Total factor productivity (TFP) is a commonly used yardstick of an economy's productivity. TFP is simply the portion of GDP that cannot be explained by the accumulation of factors of production and hence can be interpreted as being associated to changes in technology level or productivity in an economy. By convention the productivity frontier of 100 is usually the United States. See Carmen Pagés (ed.) (2010), *La era de la productividad*, Inter-American Development Bank, Washington, D.C., Chapter 1.

⁶⁵ For a long-term trend analysis of productivity see V. Hugo Juan-Ramon (1999), *Honduras's Growth Performance During 1970-1997*, IMF Policy Discussion Paper, January. This paper concludes that "Regarding investment, the *quantity* appears to be adequate, while the *quality* seems to be low" (p. 10), arguing that "Public GFCF [Gross Fixed Capital Formation] in infrastructure relative to total public GFCF is rather low for a country like Honduras, which has insufficient infrastructure" (p. 14). More recently (October 2009), Sebastián Auguste in *Competitividad y Crecimiento en Honduras*, CID/BID, reaffirms the finding of low and shrinking public infrastructure investment and growth in private construction investment, which climbed "from 4% to over 12% of GDP in approximately 20 years" (p. 38).

⁶⁶ The Dirección Ejecutiva de Ingresos document cited earlier (DEI, 2007) notes that "strong lobbies in some business sectors demanded, before making investments, tax exemptions that, cumulatively over time, have come to represent very significant amounts for an economy as impoverished as Honduras's" (p. 6). Meanwhile, foreign direct investment between 2006 and 2009 was targeted to the telecom sector (41.8%), services, including tourism (25.8%), and the *maquila* export processing industry (19.8%). See Economist Intelligence Unit (June 2010), *Honduras: Commerce Report*.

⁶⁷ Honduras compares unfavorably to the region in all indicators related to the true cost of doing business. When it comes to enforcing contracts, Honduras has the most procedural steps (45; the regional mean is 37) and comes third for the time it takes (900 days; regional mean 711) and fifth for contract enforcement cost (35.2% of the original claim; regional mean 30.1%). The figures for a comparable-income and comparable-context economy like Nicaragua are 35 steps, 540 days, and 26.8% of original claim. In the World Bank's nine "Doing Business" categories (starting a business, dealing with construction permits, employing workers, registering property, getting credit, paying taxes, trading across borders, enforcing contracts, and closing a business) Honduras comes in third to fifth most costly in every category except cross-border trading and taxes, where it outperforms the region. Moreover, it compares favorably to the region in some indicators related to formal aspects of the business environment, particularly the number of days and steps required for doing business except for ease of enforcing contracts, discussed in the text. See World Bank, *Doing Business 2010, Latin America*.

⁶⁸ The situation is far worse for small firms, with 30% of small and mid-sized businesses (less than 20 employees) identifying lack of access to credit as their main problem. In contrast, for medium and large companies, the main challenge was corruption. See *Enterprise Survey 2006*, World Bank.

⁶⁹ See World Bank, *Enterprise Survey 2006*.

⁷⁰ See Figure 1.55.

⁷¹ For example, 60% of the lucrative power generation business is controlled by two families whose businesses have ramifications into other sectors of the economy (banking, food imports,

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telecommunications, and agribusiness, among others). Three other major corporate groups have interests in banking (Banco de Occidente and Banco Atlántida) and a number of industry sectors (sugar, livestock, edible oils, construction, and media industries) and have partnered in some ventures (cement industry, banking, media). The leading figures of these groups have held public office. See Víctor Meza, Leticia Salomón, Ramón Romero, Manuel Torres Calderón, and Jorge Illescas Oliva (2007), *Honduras. Poderes Fácticos y Sistema Político*, Centro de Documentación de Honduras (CEDOH).

⁷² World Bank, *Honduras, Power Sector Issues and Options*, Washington, D.C., July 2007.

⁷³ Quoted from World Bank (2005), *Private Solutions for Infrastructure in Honduras*, p. 70. A Road Fund financed from a tax on fossil fuels was set up in a bid to remedy this situation, but it is likely to be insufficient to defray estimated maintenance costs. Moreover, it has yet to receive all the legally mandated transfers. In the case of roads, costs came in higher because of the lack of competition in maintenance tendering and high supervision costs (*ibid.*, p. 71). These practices also were brought out in a recent audit report by the Honduran General Accounting Office which states that “There is no justification for SOPTRAVI’s frequent current custom of approving contract amendments to extend completion times, mostly for road projects; this behavior in most cases has pushed project costs well above the original budgets. At first glance this suggests poor tendering planning and/or reviews.” TSC, *Informe de Auditoría de Obras Públicas*, No. 03/2010-DASP. For a discussion of the supervision dimension see World Bank (2007), *Honduras: Public Expenditure Review*, Vol. II, paragraph 7.26.

⁷⁴ Though the export processing (*maquila*) system was legally instituted in 1990 it did not gain economic importance until late in that decade.

⁷⁵ Hourly labor costs in China, for instance, are US\$0.88, compared to US\$1.48 in Honduras. Electricity costs half as much in China as in Honduras (US\$0.0507/kWh versus US\$0.1172). See Jaime Granados *et al.* (2007), *Honduras: Desafíos de la inserción en la economía internacional*, INTAL, Working Paper 31.

⁷⁶ Sales of other items such as manufactures of automotive parts and wiring harnesses are on the rise, accounting for 11% of *maquila* activity in 2008. Honduras’s advantage is its proximity to the United States, which enables it to supply the most volatile portion of U.S. demand using just-in-time arrangements, taking advantage of logistical facilities centered in Puerto Cortés. However, the *maquila* model is anchored in low wage costs and low value added, and its standalone production model reduces its potential to generate innovation or production externalities. And benefits under export free zones (where *maquila* industries operate) are based on certain tax exemptions that the WTO considers to be export subsidies, which are to be phased out starting in 2015. See IQOM (March 2009), *Análisis del impacto del CAFTA-DR: El caso de Honduras*, prepared for IDB/INT. See IDB/INT (2009), *Honduras: Nota Sectorial sobre Comercio e Integración*.

⁷⁷ According to the WTO, countries are not to offer export promotion incentives (tax or otherwise), which it considers to be international trade distorting since they accord differing treatment to exporting and non-exporting companies. What countries can introduce, to attract investment, are stimulus measures built around industry clusters that can generate investment in research, development and training or based on the location of the business or other criteria that can be applied regardless of the end-destination of the products or services. See IDB, *Nota Sectorial de Comercio Internacional*, and ICEFI (2007), *La política fiscal en la encrucijada. El caso de América Central*.

⁷⁸ See Inter-American Development Bank (2009), *Nota Sectorial Sobre Comercio e Integración*, October.

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- ⁷⁹ Visitors from Central America (50%) and North America (38%). Although the market—especially the cruise market—has been growing, average spending has flattened out. See Instituto Hondureño de Turismo, *Boletín de Estadísticas Turísticas 2004-2008*, Tegucigalpa, 2009.
- ⁸⁰ Cruise passengers as a share of total visitors increased from 38% to 43% between 2004 and 2008 but average spending per stay held steady at around US\$650, or US\$50 per day. See *Compendio Estadístico, 2009*, IHT, Honduras.
- ⁸¹ The poverty figure used (66% poverty rate, 45% extreme poverty rate) is the poverty headcount—poor people as a proportion of total population—calculated by the Honduran Statistics Bureau according to the national poverty line and corresponding to overall poverty (i.e., extreme and relative). There is no single poverty metric; poverty calculations depend on a series of assumptions applied to the household survey (e.g. imputed income) or the poverty line. These assumptions are even more crucial for countries where much of the population lives close to the poverty line; small differences in poverty line calculations bring with them substantial changes in the proportion of the poor. Other poverty line calculation methods take an international measure (US\$1.25, US\$2.50, or US\$4 PPP) or deal in relatives (50% of median household income). Since all poverty lines carry assumptions it is important to look at the sum total of indicators when drawing conclusions about poverty-level changes (see the following endnote). Another important consideration is that all these measures are estimates and thus have a sampling margin of error. As a practical approximate rule, differences smaller than half a percentage point should not be interpreted as being statistically different.
- ⁸² Once again, caution is needed when interpreting these data. As explained above, every poverty metric is constructed based on more or less plausible poverty-line assumptions. Adding to these technical difficulties in Honduras's case are a number of questions regarding Honduran Statistics Bureau (INE) official poverty calculation methods (e.g. Mauricio Diaz Burdett [n.d.], *Diez Consideraciones Técnicas sobre el Cálculo de la Medición de Pobreza*). There even have been direct references to "methodological manipulations" (FOSDEH, 2008, *Balance Crítico de la Estrategia para la Reducción de la Pobreza*, Tegucigalpa). Nevertheless, a 2008 World Bank consultancy found no "specific directional biases" in INE poverty calculations, though it did note "serious limitations" in the methodology used, among them the absence of a technical manual containing a detailed description of the methodology (see Carlos Sobrado and Irene Clavijo, 2008, *Informe sobre Revisión de la Medición de la Pobreza en Honduras*, World Bank, Poverty and Gender Unit, Latin America). To estimate the change in poverty we took the median value of four poverty headcount changes between 2001, 2006, and 2009. The following are the poverty measures: (1) extreme poverty of individuals using the 2011 INE national poverty line; (2) poverty by the US\$2.5 per day PPP standard; (3) by the US\$4 per day PPP standard; and (4) poverty measured as individuals in households receiving less than 50% of the median income (relative poverty). The 2001-2006 changes were -4.05%, -7.87%, -6.85%, and -2.54%, respectively; the 2006-2010 changes were -3.97%, 5.46%, 2.17%, and 5.08%. See Figure 1.50.
- ⁸³ The country's 20 poorest municipalities (16 of them located in the department of Lempira) have extreme poverty rates of around 90%. Sixteen of the 20 lowest-poverty municipalities are in the departments of Francisco Morazán (Tegucigalpa), Cortés (San Pedro Sula), and Islas de la Bahía, where extreme poverty rates range from 35% to 45%. All these data are taken from the most recent (2004) municipal poverty map; see Marcos Robles (2004), *Estimación de Indicadores de Pobreza y Desigualdad a Nivel Municipal en Honduras*, IDB/MECOVI, INE-Honduras. The departments of Lempira, Intibucá, La Paz, Santa Bárbara, Choluteca, and Copán are home to over 80% of Honduras's poor. The regional poverty data in this paragraph come from the most recent by-municipality poverty analysis, Marcos Robles (2004), *op. cit.* These figures differ slightly from official poverty numbers and from World Bank

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calculations (World Development Indicators) cited elsewhere in this document and thus are not directly comparable to official poverty headcount figures. In contrast, the poverty rate in the more urban departments of Cortés, Francisco Morazán, and Islas de la Bahía is 60%. Only 2.2% of the population in the seven most developed departments self-identified as belonging to an indigenous group in 2001 (the proportion was as high as 15.6% for the other departments). Close to 60% of residents of these departments are urban dwellers compared to just 22% in the others. According to poverty data available by department, the rates were 68% in the seven most developed departments and 82% in the others. These poverty data differ slightly from Honduran reported figures, from a 2004 study on poverty and inequality by municipality (Marcos Robles, 2004, *Estimación de Indicadores de Pobreza y Desigualdad a Nivel Municipal en Honduras*, IDB/MECOVI, INE-Honduras).

⁸⁴ This fact was exploited to examine the poverty impact of the coffee price crisis in Honduras and the mitigating effects of the PRAF. See Pedro Olinto, *Coping with the Coffee Crisis in Central America: The Role of Social Safety Nets in Honduras*, World Bank.

⁸⁵ See Figure 1.44.

⁸⁶ The available measure of teacher quality is the percentage of trained teachers. Honduras's 61% figure is Central America's lowest.

⁸⁷ Gustavo Arcia (2010), *op. cit.*

⁸⁸ According to the 2000 School Census, 81% of Honduran schools had fewer than six teachers. In 62.1% of the country's schools, from three to six grades shared a single classroom (World Bank, 2004, Project Performance Assessment Report, Honduras, Rural Primary Education Management Project [LN. 2804], 14 June). The multigrade school strategy is being advocated on the grounds that it improves education outcomes (World Bank, 2005, *Central America Education Strategy. An Agenda for Action*). There has been no discernable improvement in education performance in Honduras.

⁸⁹ One symptom of this weakness is the turnover among Ministers of Health; there were five from 2006-2008.

⁹⁰ Honduras's improvements in under-5 mortality have been modest relative to other countries in the region like El Salvador or Nicaragua.

⁹¹ Whereas 90% of women living in cities give birth attended by skilled health workers, only 50% of rural women have professionally attended deliveries. The drop in maternal mortality rates in the 1990s correlated to the increase in number of births attended by skilled health workers (see Marjorie A. Koblinsky [ed.], 2003, *Reducing Maternal Mortality: Learning from Bolivia, China, Egypt, Honduras, Indonesia, Jamaica, and Zimbabwe*. World Bank, Health, Nutrition, and Population Series). Though precise maternal mortality data are lacking, the 2005-2006 health survey revealed that 67% of deliveries are attended by skilled health workers (World Bank, 2009, *Institutional Governance Review*). The maternal mortality models (WDI, World Bank) depict a drop in mortality rates to 110 per 100,000 live births in 2008, a significant 50-point reduction from the 2000 measure, but Honduras still has the region's fifth highest maternal mortality rate, after Haiti, Guyana, Bolivia, and Ecuador and on a par with El Salvador. Maternal mortality rates also were disproportionately high in rural areas (see Inter-American Development Bank, 2005, "Improvement of Health Conditions in Honduras, performance-driven loan HO-L1002, Loan Proposal").

⁹² Honduras has the region's highest HIV infection rate (highest prevalence rate in 2003, 1.6%). The most affected population groups are sex workers, prison inmates, and the Afro-descendant Garifuna community (Afro-Caribbean ethnic group in the Atlantic coast region). The interaction of AIDS and

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tuberculosis has become a serious public health concern as well. See World Bank (2006), *Reducing HIV/AIDS Vulnerability in Central America: Honduras: HIV/AIDS Situation and Response to the Epidemic*.

⁹³ An article published in 2010, but based on 1990-2006 data, cites Honduras as one of the world's Millennium Development Goals (MDGs) success stories (Benjamin Leo and Julia Barmeier (2010), Who Are the MDG Trailblazers? A New MDG Progress Index. Center for Global Development, Working Paper 222). OVE, in contrast, finds Honduras's MDG performance to be not just less than stellar but trailing the region average. This tallies with other technical analyses that put Honduras's progress behind the region's (See, for instance, Maurizio Bussolo and Denis Medvedev (2006), "Millennium Development Goals for Honduras: Current Achievements and Forthcoming Challenges," paper presented at the Global Trade Analysis Project (GTAP) Conference, Addis Ababa, Ethiopia, June.)

OVE found methodological problems with the article: (i) the authors construct an ad hoc index to encapsulate performance in the different MDG target areas, but its composition is arbitrary (See, for instance, Maurizio Bussolo and Denis Medvedev (2006), "Millennium Development Goals for Honduras: Current Achievements and Forthcoming Challenges," paper presented at the Global Trade Analysis Project (GTAP) Conference, Addis Ababa, Ethiopia, June.); (ii) Honduras benefits from a high weighting of goals that—given the country's startoff status—would be less difficult to deliver (for instance, gender equality in primary education); (iii) in Honduras the baseline (1990) was a period of crisis and the end point (2006) was a strong growth chapter, so the index overrates the country's gains; and (iv) the sample compares countries at different stages of development, assuming a non-evidence-based linearity. (On this topic, see Easterly, 2009, "How the Millennium Development Goals are Unfair to Africa", *World Development*, Vol. 37, No. 1, pp. 26-35.). For a detailed analysis, see Annexes.

⁹⁴ Between 1998 and 2005 government spending on social services (education, health, and social assistance) climbed from 6% to 10.7% of GDP, though the rise in education spending (from 3.6% of GDP to 7.2%) explains most of the increase (World Bank, 2007, *Honduras, Public Expenditure Review*, Vol. II, p. 18). Poverty data are from World Bank, WDI. Though these poverty data are incomplete and available for few years, most of them indicate virtually no poverty-eradication gains in 2000-2005. We have used poverty headcount according to the national poverty line since this is the only metric available for the two dates; by that measure the decline was just from 52.5% to 50% between 1999 and 2004. No later data are available from the same source. Comparable countries like El Salvador or Guatemala posted improvements of 8 and 4 points respectively in their poverty rates with no such increases in spending. The findings hold if we use other measures of poverty: the poverty gap at US\$1.25 and US\$2 PPP allows for a comparison of 2003 and 2006 that yields similar findings and in fact a slight increase in poverty. The same patterns emerge whether we look at urban poverty (28.6% to 29.6%) or rural poverty (71.2% to 70.4%). Honduran sources (INE) show an even less encouraging trend over this period, with no substantive change either in poverty or extreme poverty. They indicate a very slight drop in the poverty rate, from 70% to 69.7%, and a slight rise in extreme poverty, from 50.2% to 50.8%. Both Honduran sources and CEDLAS/World Bank calculations from those sources show a dramatic increase in poverty in 2005-2006.

⁹⁵ IDB and World Bank estimates. Social spending efficiency is computed by measuring a country's distance to the production possibility frontier, in other words, the ability to generate outputs from inputs in the production function. See Roberto Machado (n.d.), "Gastar más o gastar mejor? La eficiencia del gasto público en los países centroamericanos y la República Dominicana," Inter-American Development Bank, mimeo. That report concludes that Honduras "has the worst performance of 19 countries, except for Paraguay ... The weakest points in public sector performance are the social areas, where Honduras

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ranks 16th [out of 19] in the areas of poverty, education, and health [...] The Honduran public sector performs best on macroeconomic stability, where it is in eighth place ..." (p. 11). One World Bank study specifically of the health and education sector using a similar technique comes up with similar findings (see World Bank, 2007, *Honduras, Public Expenditure Review*, Vol. II, Annex A). See Figures 1.39, 1.40, and 1.41.

⁹⁶ See World Bank (2007), *Honduras, Public Expenditure Review*, Vol. II, paragraph 3.26. Honduras has one of the region's highest public spending ratios to begin with; and this is all the more striking when public sector size is adjusted for per capita GDP. According to the PER findings, "the public wage bill in Honduras is unusually large." See Figure 1.42.

⁹⁷ World Bank (2007), *Honduras, Public Expenditure Review*, Vol. II. Paragraphs 6.67-6.69 discuss deficiencies in the procurement process for pharmaceuticals.

⁹⁸ For example, though the poor gain the most from primary education, university education benefits almost exclusively the wealthiest. Another example is social spending on electricity subsidies, which ends up being regressive because households need to have a certain minimum income level to get electricity service. Likewise, the implicit subsidies in the social security system are biased toward the top purchasing-power quintiles. Only the PRAF, and other more modest social programs like the School Snack Program, are more poverty-targeted. An estimated 80% of PRAF expenditure goes to the poorest 40% of households. Data are from Robert Gillingham, David Newhouse, and Irene Yackovlev (2008), *The Distributional Impact of Fiscal Policy in Honduras*, IMF Working Paper No. 168, Washington, D.C.

⁹⁹ IMF, *Honduras: Request for a Stand-By Arrangement*. IMF Country Report No. 10/322, October 2010, p. 11.

¹⁰⁰ *Ibid.*, pp. 49-51. See also Table 1.4 in the annexes, where the government proposes a matrix of future policies (Source: Republic of Honduras, Ministry of Finance, *Comments on the Country Program Evaluation, 2007-2010*, OVE, May 2011).

¹⁰¹ *Ibid.*, p. 10, and IMF, *Staff Report for the 2010 Article IV Consultation*, and EIU, *Country Report*, June 2010. The Honduran economy is predicted to grow moderately in 2010 (2% to 2.75%) and post a current-account deficit again in 2010-2011. The recovery likely will be driven by U.S. economic growth, which is expected to have a positive impact on exports, investment, and remittances.

¹⁰² In its annual Article IV review the IMF has called on Honduras to contain spending and limit the impact of the floating debt created during the transition period, which combines short repayment terms and high interest rates. The main components of the floating debt, which stands at 12,725.5 million lempiras, are wages (30.5%), goods and services (22.3%), transfers (13.4%), and direct investment (10%). Source: Republic of Honduras, Ministry of Finance, *La deuda flotante y su financiamiento: Nota técnica*, 13 May 2010.

¹⁰³ Though precise data on Honduran emigration are lacking, estimates put the ranks of emigrants at about 10% of the population. By far the majority (94%) of the migration stream has gone to the U.S.A., and this happened in a relatively short space of time following Hurricane Mitch in 1998. There also is empirical evidence in the literature that the longer emigrants live outside Honduras, the less money they send home; given that the stock of emigrants is built of migrations dating back more than 10 years, remittances likely will continue to shrink. According to the March 2007 Central Bank of Honduras (BCH) report *Consideraciones sobre las remesas familiares enviadas a Honduras*, the average immigrant has lived in the U.S.A. between 10 years (INE survey) and 15 years (BCH survey).

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See Isaku Endo *et al.* (2009), *The U.S.-Honduras Remittance Corridor. Acting on Opportunities to Increase Financial Inclusion and Foster Development of a Transnational Economy*, World Bank Working Paper No. 177. One prospect is the demand created by emigrants living in the United States for “nostalgic products” from Honduras. Another promising development avenue is investment facilities for emigrants returning to their place of origin—especially in rural parts of the country—who plan to start a business with their savings. This can involve providing information on the local economy, on such topics as prices, competition, lack of products or services, and investment opportunities. Yet another way to capture emigrants’ investment could be tax incentives such as duty-free entry of goods that emigrants take home with them or temporary tax exemptions linked to the initial investment outlays. Lastly, remittance inflows can be harnessed to direct toward productive activities. For instance, 11% of businesses in La Esperanza (Intibucá) reportedly are funded with emigrant remittances. Remittances also could be channeled to producing sectors via the financial system. Since most emigrants are from poor rural parts of the country, the development impact could be powerful.

- ¹⁰⁴ The government has taken steps to ensure the energy supply, given renewed economic growth. For the moment, it has decided to put out tenders for 250 MW of clean power generation and renew expiring PPAs. Another option that has been under discussion for some time is the Patuca hydroelectric plant: this 700 MW facility would boost installed capacity by close to 50% and could help integrate the Mosquitia area to the rest of the country and bring in foreign currency from power exports. The project’s downside is the environmental cost associated with construction of artificial dams in a protected reserve area. For a detailed discussion see the above-cited World Bank power sector study.
- ¹⁰⁵ Meanwhile, insecurity is a major concern, as homicide rates in some parts of the country reach almost civil war levels (specifically, some parts of San Pedro Sula). Bjorn Lomborg, *op. cit.*, p. 628.
- ¹⁰⁶ Advice on standards, certification, and administrative procedures. See IQOM (March 2009), *Análisis del impacto del CAFTA-DR: El caso de Honduras*, prepared for IDB/INT.
- ¹⁰⁷ Regional programming for Central America had been updated in 2005 (document GN-2126-5) when two major developments advanced the regional integration process: (i) signature of the United States-Central America-Dominican Republic free trade agreement and (ii) consolidation of the Puebla-Panama Plan. The previous update had covered the period June 2001–October 2003.
- ¹⁰⁸ In the “investment climate” domain the strategy proposed support for “strengthening the macroeconomic framework to generate a stable macroeconomic environment conducive to attracting funds,” by means of Bank assistance for Honduran government efforts to (i) enhance efficiency in public finance management and (ii) pursue fiscal reform.
- ¹⁰⁹ Potential risks noted in this regard were a slowdown of the U.S. economy and a deterioration of the fiscal situation owing to wage pressures and larger deficits of State-owned enterprises.
- ¹¹⁰ For an analysis of the program’s anticipation performance, see Chapter II, section C.
- ¹¹¹ On the magnitude of the consensus achieved, in his statement to the United Nations General Assembly, Honduras’ Minister of Foreign Relations said, in reference to the PRS, “[i]n addition to mapping out the national reconstruction plan to overcome the unprecedented damage caused by Hurricane Mitch three years ago, the Administration of President Carlos Flores, in one of the broadest public consultation processes in our country’s history, adopted the Poverty Reduction Strategy, to be implemented over a 15-year horizon. This is the first time that such a plan, based on national consensus, has been adopted in my country.” [Statement by Honduras’ Minister of Foreign Relations to the United Nations General Assembly, November 2001](#). In addition, the International Monetary Fund pointed out the participatory

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nature of this process, noting that it created a level of national buy-in that was instrumental for long-term sustainability. IMF, Honduras Poverty Reduction Paper, August 2001.

¹¹²Source: Documento Estratégico Sectorial G-16 – Mesa de Efectividad de la Ayuda, “El proceso de Efectividad de la Cooperación en Honduras.” Those same donors have provided flexibility for using resources in activities that had not been anticipated.

¹¹³As well as two “National Plans” for 2010-2022 and 2022-2034 with indicators and targets.

¹¹⁴The National Vision also aims to serve as a framework for effectively coordinating donor cooperation. The Ministry of Planning and External Cooperation was created to that end.

¹¹⁵Loans approved during the review period (2007-2010) plus previously approved loans that disbursed more than 50% of their proceeds over that span.

¹¹⁶See Table 2.3, Loan Flows by Sector, in the annexes.

¹¹⁷Appendix 4 in the Annexes section presents an exercise that shows how sectoral allocations would have varied had the variables mentioned been taken into consideration.

¹¹⁸It should be noted, however, that infrastructure projects tend to be for larger amounts, which exacerbates the weight of that sector. In any event, the approval amounts are also an indication of the importance accorded to a given sector.

¹¹⁹According to the government, the global crisis and economic slowdown caused tax receipts to fall, which spurred the government to make more active use of budget support resources. See *Comments on the Country Program Evaluation: 2007-2010* (Government of Honduras).

¹²⁰Honduras Country Strategy, paragraph 4.1.

¹²¹The portfolio examined for this report includes 2007-2010 cycle approvals plus earlier loans that disbursed mostly (over 50%) during the review period. One instrument in the complex product mix was the health-sector PDL, which has experienced delays because of difficulties in accounting for eligible expenditures. This lending product uses country accountability systems. (For an analysis of this and other Bank products see “Proposal to Reform the Bank’s Sovereign Guaranteed Lending Instruments and the Emergency Lending Category. Revised version,” document GN-2564-1.) Another example is the multiphase Natural Resources Management in Priority Watersheds program (HO-0179) which did satisfy conditions to trigger the second phase, but the program design included no mechanisms to transition from one phase to the next and ensure that the investments made and the benefits would be sustainable. For more information on these programs see Chapter IV.

¹²²A US\$1.5 million Project Preparation and Execution Facility and seven small projects totaling US\$4.4 million were not included in the portfolio.

¹²³The strategy also noted the importance of scaling up the Bank’s work with the private sector. As one important lesson learned, the strategy paper noted the “*need for more systematic and aggressive action to support various private sector segments in Honduras. More business origination efforts are called for given the scale, type of market, and risks.*” The idea was to use the Bank’s private sector windows mainly to enhance financial intermediation and make more credit and business development services available to MSMEs.

¹²⁴Program of Support for Fiscal Reform (HO-L1030, US\$45.8 million) and Strengthening the Financial Security Network and Improving Access to Financing (HO-L1065, US\$40 million).

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¹²⁵ Debt contracted before December 2004.

¹²⁶ IDB debt as a proportion of the nation's debt stock dropped from 31% in 2005 to 18% in 2009.

¹²⁷ The World Bank's share in Honduras's debt stock dropped as well, from 30% in 2005 to 20% in 2009.

¹²⁸ In 2009, Venezuelan and private creditor debt claims made up respectively 7% and 5% of the country's debt stock.

¹²⁹ Management came to a different conclusion than OVE regarding coordination with other donors. According to Management, although there was no opportunity to fulfill the Paris Declaration and the Accra Agenda, coordination efforts—made against a backdrop of political crisis—were effective in practice and decisive in preventing even greater problems.

¹³⁰ For information on the makeup of each roundtable see Table 2.5.

¹³¹ From an expenditure performance standpoint “*the sectors with the highest proportion of investment and largest share in funding expended (over 10%) were education, health, basic sanitation, transportation, and institution-strengthening. Agriculture and environment were one tier down at 5% to 10%. The other sectors were lower.*”

¹³²(i) Equitable economic growth for job creation; (ii) good governance through modernization of the State and civic participation; (iii) environmental protection and risk management; and (iv) human capital development.

¹³³Owing to the country's macroeconomic situation and delays in delivering some reforms, the Poverty Reduction Support Credit (PRSC) series originally planned for 2007 and 2008 was dropped. The funds freed up were used to scale up infrastructure investments, provide additional funding for natural disaster mitigation, and finance continuation of road and health projects that had not been proposed in the Country Assistance Strategy.

¹³⁴Central Bank of Honduras, *Resumen de deuda externa total a diciembre de 2010*. This program will assist with job creation, social protection, and emergency support projects.

¹³⁵ Consulting report, *Estado de Coordinación de la Cooperación Internacional* (25 February 2010).

¹³⁶The other countries with similar predetermined funding allocations, with greater concessionality, are Nicaragua, Guyana, and Bolivia.

¹³⁷The fundamental criterion for determining the OC/FSO blend was debt sustainability, that is, the likelihood that the recipient country would have trouble servicing the debt. The countries most likely to experience difficulties would receive a blend with a higher proportion of FSO resources. Honduras and Bolivia were identified as countries with lower debt risk, so their blend was set at 30% FSO. For Guyana and Nicaragua the proportion rose to 50%; Haiti was excluded since it received only grant assistance during the period.

¹³⁸See Annex 2 for more information on the evolution of FSO allocation systems. The cost increase should not be underestimated. For a loan to be considered “concessional” according to the IMF classification it must carry a 35% grant element compared to the commercial interest rates published by the OECD. According to IDB Management calculations, the 30/70 blend carries a 35.4% concessional element (100% FSO has 89.3% concessionality, 100% OC has 12.3% concessionality). See “Fund for Special Operations. Allocations for 2009-2010,” document GN-2442-16, p. 6. This distinction is not trivial: Honduras has constraints for nonconcessional borrowing because of the recent SBA with the IMF.

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¹³⁹ Public Sector Lending Program 2007-2009 and Pipeline (Country Strategy with Honduras).

¹⁴⁰ With 30% FSO and 70% Ordinary Capital funding. Since 2009 the Bank has been using an allocation formula in line with its enhanced performance-based allocation system (document GN-2442).

¹⁴¹ The formula called for a +/-5% change in FSO allocations, corresponding to a low scenario of US\$112.6 million annually and a high scenario of US\$124.6 million annually.

¹⁴² *Fund for Special Operations. Allocation for 2007-2010* (document GN-2442-16). For this reason, a supplementary allocation of FSO resources for the two-year period was requested and subsequently approved (document GN-2442-20).

¹⁴³ Public sector loans. Total approvals came to US\$111.3 million in 2007 and US\$120.5 million in 2008.

¹⁴⁴ Mostly for the US\$50 million Tegucigalpa-Puerto Castilla Agricultural Corridor Road Program (HO-L1033).

¹⁴⁵ A number of recent changes have been made to the FSO allocation policy. For one, changes have been introduced in the policy on carryovers within an FSO allocation period. At Management's suggestion, the Board of Executive Directors adopted the recommendation set forth in document GN-2442-34 to eliminate the restriction on carryovers within an allocation period, while maintaining the restriction between biannual programming periods. And as part of the review of the New Lending Framework (document GN-2494-6), the possibility of increasing the percentage of PBLs in the FSO portfolio to 30% is being explored, though the Governors have not yet weighed in on this proposal.

¹⁴⁶ Approvals anticipation rate: proportion of projects programmed in the country strategy that ultimately were approved. Programming anticipation rate: proportion of approved operations that had been proposed in the country strategy.

¹⁴⁷ TFFPs were not considered for this purpose.

¹⁴⁸ One possible explanation is that the 2010 approvals are occurring under a scenario not envisaged in the country strategy. As mentioned previously, “[t]he country strategy predicted a continuing ‘expanding economic cycle’ if the country held to its economic policy course.”

¹⁴⁹ 13 investment loans, 4 multiphase loans, 2 private-sector loans, 2 PBLs, 1 supplementary loan, 1 PDL, and 1 global multiple-works operation.

¹⁵⁰ The cutoff date for approvals, disbursements, and cancellations is 31 December 2010.

¹⁵¹ This situation is primarily due to the impact of the interruption in 2009. If 2009 is excluded from consideration, net Bank-country flows were primarily countercyclical for the country.

¹⁵² Mostly owing to 2010 new approvals. By December 2009 the undisbursed loan balance had come down 9% from December 2006.

¹⁵³ Calculations at 31 December 2009. For breakdowns of loan preparation and execution times see Table 3.6 in the annexes.

¹⁵⁴ Calculations done from early 2007 to late March 2010.

¹⁵⁵ In 2003-2006 the Bankwide average cost per million in approvals was US\$3,180. No cost data are available for 2001 and 2002.

¹⁵⁶ After Suriname, Barbados, and The Bahamas.

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¹⁵⁷ The government expressed its commitment to correct this situation with the Bank's support. See Government of Honduras, SEFIN, *Comments on the Country Program Evaluation*, May 2011.

¹⁵⁸ The evaliability analysis was performed for a sample of 31 projects approved between 1999 and 2009, looking at 222 logical framework indicators for the projects.

¹⁵⁹ The PPMRs report 19 kinds of issues that fall into three categories: (i) ownership issues that include: passage of legislation; borrower/executing agency ownership; counterpart funding shortfalls; political/ community opposition, and national policy changes; (ii) institutional capacity which includes: executing agency institutional capacity; consultant performance; interagency coordination; vendor/contractor performance; procurement issues; cost overruns; qualified external audits; executing agency policy changes, and absence of monitoring and evaluation systems; and (iii) design issues having to do with project/component design; delays in fulfilling contract conditions; Bank efficiency (delays in responding); environmental issues, and Bank policy changes.

¹⁶⁰ During the interruption, nonresident specialists were appointed to review and reactivate the portfolio. According to Management, remote supervision and occasional missions were not enough; on-ground presence and day-to-day support for the executing agencies were needed. This work was done by operations analysts and consultants at the Country Office, with results that surpassed the most optimistic predictions. In 2011 the Country Office is expected to be fully staffed.

¹⁶¹ See the Annexes section for details of estimates and data sources.

¹⁶² Honduras CPE 2001-2006, paragraph 3.7.

¹⁶³ Types of EFA opinions considered "unfavorable" for purposes of this evaluation are: "Qualified," "Disclaimer," "Adverse," and "With Observations."

¹⁶⁴ The Natural Resources Management in Priority Watersheds program, for instance, received audit observations for six consecutive years.

¹⁶⁵ For instance, Honduran companies and individuals accounted for 35% of all Bank sanctions in 2008. Calculations from data reported on the IDB Web page <http://www.iadb.org/topics/transparency/IAD/sanctionedfirms.cfm?lang=es&id=tran>.

¹⁶⁶ Consisting of 5 traditional investment loans totaling US\$257.75 million, 2 programmatic loans for US\$85.8 million, a US\$10 million nonsovereign guaranteed loan, 4 small projects for US\$2.7 million, a US\$500,000 MIF operation, and 15 technical-cooperation grants totaling US\$7.06 million. See Table 2.7 for details of 2010 approvals.

¹⁶⁷ According to the IMF the Bank will be assisting the country in: (i) a review of the legislation regulating civil servant recruitment and selection; (ii) an audit of government arrears to private-sector suppliers; and (iii) consolidation of the conditional cash transfers system. (Source: Honduras. Request for a Stand-By Arrangement and an Arrangement under the Stand-By Credit Facility, October 2010. IMF Country Report No. 10/332.)

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¹⁶⁸ Fulfillment of recommendations of the 2001-2006 Country Program Evaluation:

RECOMMENDATION	PROGRESS	COMMENTS
The Bank should work with the country and development partners to sharpen its strategy for poverty reduction. This effort should be based on: (a) identification of mechanisms that would promote pro-poor growth; (b) assessment of the incidence of all Bank-supported programs, particularly in programs impacting real sectors; and (c) identification of mechanisms and policies that will encourage the poor to accumulate assets, and more broadly, escape poverty.	LIMITED	The Bank assisted the country in updating its Poverty Reduction Strategy (PRS) in 2006 to incorporate a new multidimensional approach to the problem of poverty. However, this version did not secure official approval. In 2010 the country approved a new “National Vision” development plan.
The Bank should continue efforts to integrate its program with the country. In particular: (a) incorporate the tracking of Bank strategy indicators with the country’s monitoring systems and review the progress toward the indicator targets periodically with the Honduran government; (b) move away from Project Executing Units as a delivery mechanism, instead relying on line ministries or country entities to manage project execution, and accelerate the move toward sector-wide approaches.	LIMITED	The strategy indicators were not incorporated into the country’s monitoring systems. In a component of one project the Bank provided support for creation of the SIERP system to track PRS indicators, but the system has not been updated since 2006 and cannot be accessed. The Bank, for its part, did not track the 17 indicators set out in its strategy. As for project management mechanisms, the Bank continued to use executing units not integrated into ministry structures, which left projects less vulnerable to frequent staff turnover in ministries but did not contribute to institutional development.
Results-based management requires the identification of the effectiveness of Bank programs and policies, which in turn requires rigorous evaluation designs and appropriate data on results. The Bank should intensify its efforts to produce estimates of project impact, focusing on measuring adequate baseline information and developing, ex ante, strategies to assess program effectiveness. This is particularly relevant for projects that focus on the real sectors, for which this practice is not well developed.	LIMITED	The Bank did not make progress on measuring the effectiveness of its program in the country. 94% of the 120 development objectives for the period were not tracked, and program effectiveness was measured for just two programs in the portfolio reviewed—the Marena program and the flexible instruction delivery formats component of the Secondary Education and Job Training Program.

¹⁶⁹ IDB disbursements in 2007-2009 came to roughly 1.9% of the country’s annual capital expenditure. From 2009 forward, as the Bank transitioned from PPMRs to Project Monitoring Reports (PMRs), it stopped updating its project monitoring systems. At this writing, data from the previous system have not migrated to the new one, so the PPMR indicator data are discontinuous. Moreover, qualitative data on implementation progress and lessons learned in project delivery are not being updated in the new PMR.

¹⁷⁰ See Tables 4.1, 4.2, 4.3, and 4.4 in the Annexes section for details of progress on development objectives by sector. The measure of “country progress” was changes in indicators for the development objectives proposed by the Bank (in the country strategy and loan documents) for each area. For objectives that had no set indicators or the indicators had not been tracked we used proxies that generally corresponded to socioeconomic indicators for 2007-2009—unless these were unavailable—from various sources (World Bank, SEDLAS, World Economic Forum, UNDP, Central Bank of Honduras, Honduran Ministry of Finance, Empresa Nacional de Energía Eléctrica, Instituto Nacional de Turismo, and others).

¹⁷¹ This is largely explained by the economic slowdown that began in 2007. Otherwise, the rate might have fallen during the review period.

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¹⁷² In 2008 the government concluded a Standby Arrangement with the IMF with the goal of strengthening macroeconomic stability by means of a package of reforms in three priority areas: (i) *Fiscal consolidation and reorientation (The overall fiscal deficit will be reduced to 1½ percent of GDP in 2008, from 2¼ in 2007. This is consistent with a stable wage bill, a recovery in priority spending, and a stable debt-to-GDP ratio);* (ii) *Containing inflation and safeguarding external stability (The monetary program seeks to maintain single digit inflation, bring credit growth to sustainable levels, and build up net international reserves. The program also envisages prudential measures to encourage banks to internalize risks from rapid credit expansion. The existing exchange rate band will be used more actively to help maintain external competitiveness and an adequate level of foreign reserves);* (iii) *Strengthening the energy sector (In collaboration with the World Bank and the IADB, the program envisages the implementation of a tariff policy that covers operational costs of the electricity company and the clearance of arrears with private generators).*

¹⁷³ The program had three components: (i) strengthening the Ministry of Finance (SEFIN) and Honduras Revenue Agency (DEI); (ii) strengthening areas at the Central Bank of Honduras involved in compiling, storing, and analyzing economic statistics; and (iii) supporting implementation of the Poverty Reduction Strategy Tracking System (SIERP) at the Technical Support Unit of the Office of the President (UNAT).

¹⁷⁴ As of December 2009 the loan was 14% undisbursed. By end-2010 it was disbursed in full.

¹⁷⁵ The IFMS consists of Budget, Cash Management, Accounting, Human Resources, Government Property Management, and UEPEX (Project Executing Unit Support) subsystems. The UEPEX module is intended to facilitate financial management of external loans and harmonize IDB and World Bank requirements. Other achievements were process reengineering, cleaning of taxation databases, and professionalization of the DEI (June 2009 PPMR). Fiscal, monetary, and financial statistics were published in accordance with the IMF manual.

¹⁷⁶ In May 2010 the SIERP website (www.sierp.gob.hn) was accessible but had not been updated since 2006. In September 2010 the system could not be accessed. In 2010, with the approval of the National Plan and creation of the Ministry of Planning (SEPLAN), the Technical Support Unit (UNAT) that had been the component's executing unit was disbanded; the remaining funding for that component will be apportioned among the others.

¹⁷⁷ The policy reform matrix contained six action focuses: (i) macroeconomic stability; (ii) institutional framework for results-based management; (iii) revenues: tax and customs administration; (iv) public finance management; (v) procurement management, and (vi) the control environment.

¹⁷⁸ Budget, Accounting, Cash Management, and Government Property Management subsystems.

¹⁷⁹ The program has three components: (i) macroeconomic stability, (ii) tax reform, and (iii) increasing public-enterprise revenues.

¹⁸⁰ The first tranche was US\$22.9 million. This PBL, which had been envisaged in the country strategy, helped the country be able to access other budget supports.

¹⁸¹ The program's specific objectives are to: (i) consolidate the progress made on the domestic tax collection system and establish a modern, flexible customs control system; (ii) consolidate the reforms undertaken in public finance administration and finalize the Integrated Financial Management System implementation and its modules; (iii) strengthen municipal fiscal management by improving collection efficiency and spending effectiveness through the implementation of a municipal management system; and (iv) improve and integrate Central Bank of Honduras fiscal and macroeconomic statistics. As of

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December 2010 15% of the approved loan funding had been disbursed. During the interruption in disbursements the government continued to fund the program activities using own resources.

¹⁸² This is the total competitiveness loan portfolio, i.e., 2007-2010 approvals plus the start-of-2007 balance of previous approvals. The complete competitiveness portfolio including other products (technical assistance, etc.) came to US\$661.9 million.

¹⁸³ Source: ENEE.

¹⁸⁴ See SIEPAC May 2010 monthly supervision report (IDBDOCS 35239043). The report also discusses difficulties in obtaining easements, particularly for road section 17 “La Parrita-Palmar Norte” in Costa Rica.

¹⁸⁵ The Bank financed US\$240 million of the US\$405 million SIEPAC project. The balance of funding was provided by other cooperation partners (CABEI and CAF) and by equity investments of electric utility companies in the region. The Bank provided US\$13 million of the supplemental US\$89 million by redirecting proceeds of other loans—in the case of Honduras, US\$4.5 million from loan 2016/SF-HO. The slippages were attributed to “delays in timely securing of easements, changes in some substations, addition of transposition towers, and other factors that made it impossible to complete the project on schedule (24 April 2009).” *Perfil de financiamiento por sobrecostos de la SIEPAC* (<http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=35214602>).

¹⁸⁶ According to the loan document, “Investments will be made to improve and expand service in the following zones: Zone 1 (La Puerta-Naco) in the departments of Santa Bárbara and Cortés; Zone 2 (Danlí-Chichicaste-Trojes) in the department of El Paraíso; Zone 3 (Erandique-Flores) in the departments of Lempira and Intibucá; and Zone 4 in the department of Olancho. Investments consist of procuring and installing reactive compensation equipment for the 34.5-kV and 69-kV systems, which primarily serve the latter three zones. In addition, two new 69/34.5-kV substations will be built (Erandique and Chichicaste) and two 69-kV subtransmission lines will be installed: a 42-km line between Danlí and Chichicaste⁵ and a 60-km line between Las Flores and Erandique. Rural electrification services will be extended to approximately 8,000 new users in Zones 1, 2, and 3, in support of the national social electrification plan currently being implemented by the Honduran government. Improvements to existing service are expected to benefit some 27,000 rural users.”

¹⁸⁷ See 30 June 2009 PPMR.

¹⁸⁸ As of December 2010, US\$23.21 million of the program funds were still undisbursed (source: OVEDA).

¹⁸⁹ One example of these difficulties is the lack of confidentiality and transparency in the SCADA/EMS bidding processes. See PPMR of 30 June 2009, which cites lack of transparency in the tendering process. See *Informe de Evaluación de la Unidad Ejecutora*, ENEE, 25 June 2008.

¹⁹⁰ Construction of the Erandique and Chichicaste substations financed by the Nordic Development Fund through loan NFD440 is complete but the facilities cannot operate because only 4% of the transmission line work is finished. See Unidad de Gestión de Proyectos BID-ENEE, *Informe Semestral, Financiamiento BID 1584, Julio-Diciembre 2009*, February 2010.

¹⁹¹ A major difference between the new operation and the ongoing one was the decision to set up a project team within ENEE, as per the institutional assessment done of that agency.

¹⁹² For example, Hurricane Mitch destroyed or damaged close to 80% of the country’s roads and highways. See <http://lwf.ncdc.noaa.gov/oa/reports/mitch/mitch.html>.

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¹⁹³ Highway CA-5, one of Honduras's main arterial roads, carries more than 25% of vehicle traffic in the country and most commercial goods shipped from Puerto Cortés to the nation's main consumption and production centers (San Pedro Sula, Tegucigalpa, Comayagua). It is approximately 294 kilometers long. Two sections are slated for Bank financing: (i) from the start to the end of Comayagua Valley, 24.7 kilometers, and (ii) from Villanueva to La Barca, 25.5 kilometers.

¹⁹⁴ Other donors include the Millennium Account, CABEI, and the World Bank. The Millennium Account (MCC), in particular, signed an agreement with Honduras that called for US\$215 million to be disbursed between 2005 and 2010. The MCC's focus was productivity development, with road infrastructure programs (Highway CA-5, secondary roads, weight enforcement) and rural development programs. The investment commitment for the transport component was US\$125 million, close to US\$100 million of it for the project to rehabilitate 35 kilometers of CA-5. One feature of the Millennium Account approach was the use of designs based on concrete substrates, which despite their higher upfront cost have turned out to be faster to build because they are less reliant on banks of materials. See <http://www.mcc.gov/mcc/bm.doc/061305hondurascompact.pdf>.

¹⁹⁵ Which is why in 2008 the Bank granted a 10-month extension of the disbursement cutoff date.

¹⁹⁶ As of December 2010, 17% of the original amount (source: OVEDA).

¹⁹⁷ As of December 2010 only US\$270,000 of project HO-L1018 had been disbursed. HO-L1033 had not yet begun disbursing (source: OVEDA).

¹⁹⁸ Estimated start date, once final designs are in place and the works tendered (March 2010 PMR).

¹⁹⁹ During the previous cycle the Bank had provided US\$25 million in funding for the Financial Sector Program (HO-0219) which had featured good donor coordination and “[increased] Basel ratios in the financial sector” (OVE, Country Program Evaluation: Honduras 2001-2006).

²⁰⁰ Particular aims of this PBL's components are to increase the stability of financial intermediation, make financial services more transparent, and increase bank credit to the private sector, particularly SMEs. The program has three components: (1) macroeconomic sustainability; (2) strengthening the Financial Security Network (FSN), fundamentally by: (2a) strengthening prudential regulation and supervision and (2b) strengthening the institutional framework for the other core FSN components; and (3) improving access to financing, with the following subcomponents: (3a) promoting information transparency and protection for financial services users and (3b) developing the regulatory framework and procedures for enforcement of secured transactions.

²⁰¹ The following regulations approved by the Honduran Banking and Insurance Commission (CNBS) were released: (i) Update of the Capital Adequacy Ratio Calculation, for Recording and Treatment of Multiple Leveraging (CNBS Resolution GE No. 430/15-03-2010); (ii) Loan Portfolio Assessment and Rating (CNBS Resolution SB No. 1580/07-10-2010); and (iii) Liquidity Risk (CNBS Resolution SB No. 1579/07-10-2010). Other activities were: (i) definition of a CNBS budget line for the financial education campaign, and (ii) issuance of the Secured Transactions Law enacted by the Honduran Congress (published in official gazette *La Gaceta* on 28 January 2010).

²⁰² The Bank's private sector loans include the following: In 2008, US\$12 million for Banco Ficohsa (HO-L1036) and a US\$5.3 million MIF loan to “Enhance the Development Impact of Workers' Remittances” (HO-M1006). In 2009, two trade finance facilities (TFFPs) for US\$1 million each, to Banco Lafise Honduras S.A. (HO-L1041) and Banco de los Trabajadores (HO-L1049). In 2010, another US\$10 million for a Banco Ficohsa Sustainable Financing Facility (HO-L1067). Nonreimbursable support, MIF grants: Financial Management of Agricultural Price Risks (US\$480,000), Improving Rural

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Microfinance Services in Western Honduras (US\$150,000), Creation of New Microfinance Institutions to Enhance Microentrepreneurs' Access (US\$4.24 million), Diversification of Urban and Rural Finance Services of MFIs in Honduras (US\$150,000), Improving Financial Services for Rural Microenterprises (US\$1.48 million), Competitiveness and Financial Security of Credit Unions (US\$4.15 million), Service Transparency and Consumer Protection in Microfinance (US\$500,000). Nonreimbursable technical-cooperation operations: Financial Inclusion: Regulatory Framework for Bankruptcy and Insolvency (US\$150,000), Strengthening the Regulatory Framework for SME Saving and Investment Alternatives (US\$650,000).

²⁰³ The program, intended to improve natural resources management and increase investment in selected priority watersheds, provided support for: (i) strategic and management capacity building in the central and local governments (US\$8.5 million); (ii) investments in priority subwatersheds (US\$14.5 million), and (iii) administration and monitoring activities (US\$3.1 million). The strategic and management capacity building component addressed line agencies' institutional, strategic, regulatory, and management capacity needs. The investment component consisted of three modules: (i) publicity/promotion and organization, (ii) institutional and organizational capacity building, and (iii) investment funding. The investment funding for natural resources and environmental management was to support projects at three levels: sustainable production systems (small farms and communities), municipal-level initiatives, and regional initiatives.

²⁰⁴ Total project financing came to Lps. 300,982,207 (Lps. 85,763,166 in local counterpart contributions and Lps. 215,219,041). The 645 local production system projects benefited 13,686 families (Lps. 166,327,558), the 88 municipal-level projects, 15,860 families (Lps. 166,327,558), and the 20 regional projects, 13,058 families (Lps. 80,392,009).

²⁰⁵ Five executing units and two allied agencies or institutions.

²⁰⁶ Boris E. Bravo-Ureta, Alexandre Nunes Almeida, Daniel Solís, and Aarón Inestroza, "The Economic Impact of Marena's Investments on Sustainable Agricultural Systems in Honduras," forthcoming in *Journal of Agricultural Economics*, 2011.

²⁰⁷ At 31 October 2008, 33 of the 34 indicators required to trigger a second phase had been 100% achieved. The plan in this second phase was to scale up the investments, using the capacities developed in the first phase. Regarding the transition between phases, the final evaluation indicated, "*A fundamental point is continuity. However, in order to achieve continuity, the transition process between one phase and the next must be carefully stipulated. As has happened with the MARENA program, it is very hard to discern how continuity could be ensured in a second phase because no roadmap has been devised and the team that was ultimately assembled is rapidly falling apart... In the case of a second phase, we would have two related but separate projects and the entire process of assembling the PCU and the technical teams would have to begin anew, with significant time lost during which the beneficiaries would be without services, threatening the sustainability of the progress that had already been made.*"

²⁰⁸ As of December 2010 only US\$500,000 had been disbursed (2% of the program funds) (source: OVEDA).

²⁰⁹ March 2010 PMR.

²¹⁰ At the request of the candidate municipality, talks are under way regarding a reallocation of these funds to build an airport in Concepción, which has a larger stable population base but is less conveniently located for visitors to archaeological sites.

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²¹¹As of December 2010 the program funds were 45% undisbursed (source: OVEDA). Roughly US\$14 million of the US\$17 million “Promotion of Private Investment in the Tourism Sector” component was to be spent on infrastructure (mainly paving, electricity, water supply and sanitation) to support the Los Micos project, in which major private investors were involved with minority indigenous community participation. Funding was provided for this venture without evidence of any competitive processes for its selection. The Los Micos venture also is in transition, having changed its development team and pursued a market repositioning.

²¹²The project funded by this loan was to have been executed by an outside agent (third party). The National Tourism Office (Instituto Nacional de Turismo) decided to end the contract with the contractor. The possibility of force account or tendering is being examined. At this writing legal alternatives are being explored.

²¹³The logical framework was updated and activities focused on implementing the monitoring and evaluation systems and institution-strengthening in forest management agencies, primarily the Forest, Protected Areas, and Wildlife Conservation Authority (ICF).

²¹⁴Strengthening of Decentralized Management and Supply of Health Services (HO-L1059, US\$27.5 million) and Second Operation for Comprehensive Support for the Social Safety Net Program (HO-L1042, US\$55 million).

²¹⁵This is the total social development loan portfolio, i.e., 2007-2010 loan approvals plus start-of-2007 balances of previous approvals. The total social development portfolio including other products (technical assistance, etc.) came to US\$335.5 million.

²¹⁶Under the *Education For All – Fast Track Initiative* (EFA-FTI), most international donors have focused on closing the universal basic education gap. Targets were proposed for preschool enrollment, lowering the proportion of students over-age for grade, increasing the proportion of students completing the basic cycle, and reducing repetition and dropout rates. (See for example UNESCO, 2009, *Background Paper Prepared for the Education for All Global Monitoring*.) The Bank, for its part, identified secondary education as the main challenge, stating that “*Honduras presents low levels of secondary education coverage, low levels of quality education, and inefficient sector spending. Net secondary school coverage for 2006 was 39%, substantially lower than the average for Latin America and the Caribbean (68%). Only 37% of adolescents eligible for third cycle ... are enrolled, and only 19% for fourth cycle*” (document GN-2475, paragraph 1.21).

²¹⁷For fourth cycle the program is financing construction of at least 50 basic education establishments.

²¹⁸The program also provides a small number of grants for secondary students who complete third cycle but cannot find slots at a public school for fourth cycle.

²¹⁹The first subprogram was targeted to teens from 12 to 18; the second was designed to help young people aged 19 to 27 become employable.

²²⁰There appears to have been a slight improvement in Spanish language learning performance and a decline in mathematics performance, but since this occurred in the control and treatment groups alike, it cannot be attributed to the Bank’s involvement.

²²¹There are plans to track the employment status of the program beneficiaries. See *Informe de Ejecución 2006-2009*, EPEM [Job Training Program]. See Aide-Memoire of the HO-0202 Administration Mission, 9 to 13 August 2010, paragraph 2.11. According to Management, the program would have contributed to strengthening the Ministry of Labor and Social Security for delivering labor training and intermediation

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services. The partnership with the private sector for delivering those services entails the involvement of (economic, human, and material) resources, as well as support for the comanagement and sustainability of those services and making them demand-oriented.

²²²Funds were to be disbursed as external auditors verified that the targets had been attained. The specific indicators proposed in the loan's results matrix are: (i) number of births recorded in maternal and child clinics or hospitals (baseline 10,500; targets 11,300, 12,100, 13,100 for tranches I, II, and III respectively); (ii) number of prenatal checkups of pregnant women (BL 142,900; targets 148,200, 151,800, and 156,500 for tranches I, II, and III respectively); (iii) number of new mothers receiving checkups in the 42 days following childbirth (BL 19,000; targets 19,900, 20,800 and 21,900 for tranches I, II, and III respectively); (iv) number of women of childbearing age using some method of family planning (BL 16,600; targets 21,400, 26,300, and 32,600 for tranches I, II, and III respectively), and (v) number of children under 1 completing the Sabin vaccination series (BL 27,600; targets 28,000, 28,400, and 28,800 for tranches I, II, and III respectively).

²²³The end-target for some indicators was achieved in the early years of the project, which is suggestive of target calculation difficulties. Other indicators showed a downtrend between 2006 and 2007. In any event, virtually all the data used in the performance audit are for a period prior to the PDL's disbursement eligibility. For details on indicator achievement see Table 4.3 in the Annexes section.

²²⁴The project split the executing unit into a technical unit (PROMESALUDH) and an administrative-financial unit (UECF) in a bid to better coordinate the program's activities with the work of the other donors. Initially the government proposed to use procurements, particularly pharmaceuticals purchases, to account for the outlays, but since the procurement rules and procedures for those products do not match Bank policies that course was not an option. In the end it was decided to account for recurrent expenditures, specifically maternal and child health personnel costs; this increased the administrative workload since it meant a shift from accounting for spending on a few large transactions (pharmaceuticals purchases) to individual medical services contracts. When the UECF proved ineffective for this task the Bank used the PROMESALUDH technical unit team for field administrative tasks relating to fiduciary due-diligence checks of health personnel appointment records, on-site employment checks, personal-data reconciliation, and so on. These issues had already been identified in the July 2009 PPMR, which recommended that when designing performance-driven loans they be tied to the use of country procurement policies, and also that the matter of eligibility of recurrent expenditures be made very clear.

²²⁵ Disbursements to December 2010 (source: OVE).

²²⁶ According to Management, based on data from the Ministry of Health of Honduras (SESAL).

²²⁷According to the HO-L1059 loan proposal (total amount US\$34.2 million) the reformulation of the loan was proposed to move from a PDL to a traditional investment loan because the activities would be consistent with the new program's objective and target population. A further aim of the reformulation was to consolidate Bank efforts in a single operation so as to integrate and rationalize operations in the sector.

²²⁸ 23,000 families in 211 villages.

²²⁹ A study authored by Gustavo Arcia (*Alternativas de Focalización para el Programa PRAF/BID Fase II*, Tegucigalpa, 2004) found discrepancies among the poorest municipalities according to loan 1026 and the findings using poverty map data (INE/MECOVI). The issue of the low amount of the transfers had come up in the midterm review of loan HO-0132. The average US\$18 dollar per capita transfer represented just 3.6% of targeted-household expenditure (IFPRI, *Sexto Informe, Proyecto PRAF/BID*

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Fase II: Impacto Intermedio, Washington, D.C., July 2003 [Sixth Report, IDB/PRAF Project Phase II: Interim Impact Assessment]. See also HO-0222 loan proposal, paragraph 1.13). And there is some evidence that the PRAF allowance may have raised fertility, since the amount of the loan HO-0132 allowance was determined by the number of children under 3 (Guy Stecklov, Paul Winters, Jessica Todd, and Ferdinando Regalia, *Demographic Externalities from Poverty Programs in Developing Countries: Experimental Evidence from Latin America*. American University, WP 2006-01, January 2006). This evidence is inconsistent with the fact that the transfer amount was very small.

²³⁰ Lempira, Intibucá, La Paz, and Santa Bárbara.

²³¹ The idea of initial and integrated interventions was to harmonize Bank and country efforts behind a holistic approach. In villages never before targeted for such support the PRAF is aiding household consumption with a US\$113 transfer. It prescribes no conditions for families to fulfill to receive the transfer but provides demand-side incentives for health and education services. This type of intervention is government-funded and conceived as a preliminary intervention in areas where the PRAF has never operated and which lack education and health care infrastructure. The initial interventions are a preparation for the second-stage integrated interventions where nutrition allowances are supplemented with education and health care transfers for which families do have to fulfill certain conditions. To move into the second stage the villages had to have the requisite infrastructure to supply the demand for education and health services. The integrated interventions are the ones the Bank has funded via project HO-0222 (Comprehensive Social Safety Net Program) for the poorest villages in four Honduran departments. For a description of the initial and integrated stages see the loan document. For a discussion of the Honduran government's proposed certification system for education and health services see Charity Moore, *Assessing Honduras' CCT Programme PRAF, Programa de Asignación Familiar: The Expected and Unexpected Realities*, International Poverty Center, IPC Country Study No. 15, April 2008.

²³² Specifically: (i) sharpen social services targeting; (ii) introduce the concept of comprehensiveness in PRS programs and projects; (iii) foster management by results; and (iv) protect priority PRS programs by setting physical and financial targets.

²³³ In practice, the first-tranche conditions entailed creation of the Solidarity Social Safety Net with its proposed organization structure and operating regulations and an action plan for the use and adjustment of the PRAF program's Beneficiary Registration System (SIRBHO) as a Solidarity Social Safety Net tool. See Policy Matrix and Means of Verification, HO-L1009.

²³⁴ Among other conditions, such as maintaining macroeconomic stability and updating PRS Indicator System data. For the full set of conditions see Policy Matrix and Means of Verification, HO-L1009.

²³⁵ The Ministry of Social Development and Solidarity Social Safety Net were created in October 2008. However, the Ministry of Social Development, created in 2009, now has this responsibility. Even though the conditionality matrix explicitly mentions "consolidation" and "permanent institutionalization" of the Solidarity Social Safety Net, the condition was deemed to have been fulfilled on the assumption that *the core principles of the Solidarity Social Safety Net are maintained* (see document PR-3101-2). Moreover, even though the conditionality matrix requires the "consolidation" of the SIERP, at August 2010 the PRS Information System (SIERP) Web page (www.sierp.hn) could not be accessed.

²³⁶ According to Moore, *op. cit.*, p. 15, when the new administration took office in 2002 all the employees were let go. The situation was repeated in 2006 when all but five PRAF employees were dismissed.

²³⁷ For example, the tracking survey for HO-0222 scheduled for August 2009 (HO-T1120) could not be performed because of the June 2009 interruption of operations with Honduras. The chosen evaluation

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methodology was a quasi-experimental difference-in-differences framework design to ascertain changes in outcomes in the treatment and control groups. The treatment group and control group consisted of 82 villages each, and baseline data were compiled (*Human Development Survey, 2007*). Baseline data for loan 1568 were used as part of the diagnostic for the design of the new CCLIP operation (HO-X1012, first loan HO-L1032) approved in 2009. See *Nota Técnica: Arreglos de Monitoreo y Evaluación de Impacto, PIPS*, Inter-American Development Bank, 2009.

²³⁸ The phase I objectives (HO-0161, US\$25 million, approved in 2000) had been to raise Hondurans' living standards by broadening access to basic services. To that end the program proposed to: (i) finance and implement social investment projects that had been backlogged by Hurricane Mitch, (ii) pilot programs to strengthen local communities, and (iii) strengthen the Honduran Social Investment Fund (FHIS) as a key tool of the Poverty Reduction Strategy. The new operation was to provide continuity to the intervention: "*Phase II will extend the key Phase I components shifting their emphasis in some instances to help create a policy framework for municipal and local development, and leverage FHIS/SGJ synergies in the area of poverty reduction*" (p. 2). Phase II had three components: (i) social infrastructure investment, (ii) municipal management and community involvement in the project cycle, and (iii) bolstering the institutional framework.

²³⁹ The Honduran Social Investment Fund (FHIS) was executing the social infrastructure component; the Ministry of the Interior and Justice's focus was local capacity building. The first component (US\$25.9 million) was to finance construction, repair, or expansion of social infrastructure works and purchase equipment and materials to set up basic education, health care, and water and sanitation systems. This component is being implemented by FHIS, which also is in charge of ex ante feasibility assessments of projects. The second-component objective was to build up municipal government financial and institutional capacity through two subcomponents. The Bank would fund the design and execution of Municipal Technical Assistance Plans (PATMUNI) for at least 20 municipalities and implementation of projects incorporating innovations in any key facet of municipal management (Innovar Program). The Ministry of the Interior and Justice, the agency in charge of Honduran government decentralization policy, is the project coexecuting agency.

²⁴⁰ June 2009 PPMR.

²⁴¹ Aide-Memoire of the 13-17 March 2007 Administration Mission (IDBDOCS #934954).

²⁴² Secretary of State for the Office of the President (SDP), as the program's lead agency and coordinator, and the National *Bono 10,000* Program Coordination Office and the Family Allowance Program (PRAF).

²⁴³The Bank had gained experience working in indigenous communities in its support program for indigenous and black communities (PAPIN) (HO-0193) approved in 2001. This program was smaller (US\$3 million, US\$1.5 million of it IDB funding) but its conceptual base was the same. Capacity building in native communities and new infrastructure built using the ethnoengineering model were two of the support focuses. The program also proposed to help obtain passage of an indigenous peoples law, for which then-candidate Manuel Zelaya Rosales's support was secured. The bill was put before the President in March 2009 and is currently making its way through the Honduran Congress. Implementation delays in the PAPIN project were attributable, according to the Project Completion Report, to the inexperience of the executing unit (Ministry of the Interior and Justice) with infrastructure projects.

²⁴⁴The total program came to US\$11,153,000: US\$1,599,000 for component 1, US\$7,572,000 for component 2, and US\$1,107,000 for component 3 (administrative costs).

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²⁴⁵ These native communities live in depressed areas and have proportionately higher poverty and illiteracy rates. There are seven indigenous communities and two Afro-Honduran communities, their 450,000 members comprising roughly 7% of the nation's population. Most live in the Atlantic Coast region, La Mosquitia, and western departments. Among the challenges they face are high infant mortality rates, AIDS prevalence in Garifuna communities, low literacy rates, and poor access to health and education services. A complicating factor is the scarce data about indigenous communities, which makes it hard to discern which of these problems may be specific to these populations and which are problems of rural communities generally. The need for sufficient data on the target population prompted Bank support via technical-cooperation operation ATN/SF-9880-HO to develop a baseline.

²⁴⁶ These frequent changes had been noted earlier. According to the Project Completion Report for PAPIN (the indigenous communities program that preceded the Comprehensive Program discussed here) there had been six successive ministers over the course of that project (through 2009).

²⁴⁷ This component includes financing for productive projects up to US\$200,000. In contrast to the World Bank's Nuestras Raíces program that funds community-level microbusiness ventures, the IDB project provided financing for community enterprises.

²⁴⁸ To manage the impact of Tropical Depression 16 the government asked the Bank to redirect funding from projects that had not begun executing. In addition, in 2006 the government decided to expand the productive component to other indigenous communities (originally that component had been intended only for the Miskito, Garifuna, Pech, and Tawahka people). Funds from the institution-strengthening component were used to finance these changes.

²⁴⁹ The Bank had recently gained experience in water supply and sanitation in Honduras with its US\$13.8 million loan for the Puerto Cortés Sewer System Project (HO-0128) approved in 1997. It also had participated in urban development programs in Tegucigalpa (HO-L1001) and San Pedro Sula (HO-0175); that funding was cancelled in full during the debt forgiveness process.

²⁵⁰ The loans were based on the water and sanitation sector framework bill, enacted in 2003, which decentralized these utility services to the municipalities.

²⁵¹ In December 2010 the program's undisbursed balance stood at US\$5.31 million (source: OVEDA).

²⁵² The project also went through two changes in executing unit—from the Finance Ministry to the Ministry of the Interior and Justice in 2005, then to the Honduran Social Investment Fund in 2006.

²⁵³ The World Bank loan was reimbursable by the central government but not municipal governments, whereas the IDB loan initially was reimbursable by the municipalities. The loan contract was amended in August 2008 to correct this situation and match terms to the World Bank's PROMOSA. See for example the June 2009 PPMR.

²⁵⁴ Source: OVEDA.

²⁵⁵ In 2002 Honduras had an estimated housing deficit of 50,000 to 100,000 units, a result of its young demographic and the toll taken by natural disasters. See *Política de Vivienda en Honduras: Diagnóstico y Guías de Acción. Informe preparado para el BID y el gobierno de Honduras*, New York, July 2002. Previously the Bank had provided US\$10.4 million in funding for a post-hurricane housing program (HO-0146, approved in 1999).

²⁵⁶ The plan was for the group subsidies to supplement the individual subsidies to improve basic infrastructure in low-income neighborhoods.

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²⁵⁷ SOPTRAVI (individual subsidy component) and FHIS (group subsidies). One reason for the choice of executing units was that the group subsidies component is similar in design and eligibility conditions to the World Bank's "Barrio-Ciudad" project in Honduras.

²⁵⁸ The project became disbursement-eligible in February 2008, was reformulated to redirect proceeds of the loan to address the emergency situation created by Tropical Depression 16 in December 2008, and was affected by the halt in Bank disbursements beginning in June 2009. See Aide-Memoire of the 28-30 April Mission, Low-income Housing Program, HO-L1007. Because of the high infrastructure costs, consideration was being given to cutting to two the number of group-subsidy neighborhoods (see June 2009 PPMR).

²⁵⁹ The program's undisbursed balance in December 2010 was US\$18.07 million (source: OVEDA).

²⁶⁰ Includes components of projects pursuing the Fiscal Balance, Competitiveness, and Social Development pillars. Does not include PBLs, the PDL, MIF operations, or nonsovereign guaranteed loans.

²⁶¹ The aim of the first operation (Justice System phase I, HO-0109, US\$7.2 million, approved in 1996) was to modernize legislation, strengthen administrative efficiency in the judiciary, and broaden access to justice by building courthouses and hearing rooms for oral proceedings. As a result of this operation a new Code of Criminal Procedure was adopted and oral hearings were instituted for criminal proceedings. Progress was made as well on the tenure and independence of Supreme Court justices, with the issuance of Decree 262-2000.

²⁶² The SEDI records system, which will continuously track cases from the time a claim or suit is filed until the court hands down its ruling, is fully operational and can be accessed on-line (Web page www.sedi.gob.hn).

²⁶³ Of the 10 works committed, the four smallest (magistrates' courts) are already operational and the six largest ones (including the new Choluteca interagency center) are expected to start operating within a few months. Because of labor and materials cost overruns the quantity of new physical infrastructure was cut back. Consideration is being given to including funds in the new operation's budget to complete and equip the infrastructure. For a mention of the cost overruns see the memorandum and aide-memoire of the 13 July 2010 administration mission (IDBDOCS 35253204). The project also experienced a delay early on relating to the specialized procurement agency. The Project Completion Report (PCR) for the first phase of the Justice System Program had underscored the need to streamline government procurement procedures (Justice System Program I PCR, p. 24), so the agreement for the new operation (paragraph 3.16) required, as a condition for the first disbursement, the hiring of a specialized procurement agency. However, since that agency did not speed up procurements it was decided to replace it with a procurement unit.

²⁶⁴ The object of this operation was to improve public safety levels in the Sula Valley region through capacity building in municipalities and security agencies (component 1), social programs to prevent juvenile crime and violence (component 2), and support for community policing (component 3). A fourth component was to develop communication and information strategies to heighten public awareness of the problem of violence.

²⁶⁵ A condition precedent to disbursement of funds for this activity was the signing of an interagency agreement between the Ministry for Public Safety, the Ministerio Público, and the Municipality of San Pedro Sula (the executing unit) on terms satisfactory to the Bank. *"Prior to disbursing funds for this activity [SISC], evidence will be submitted to the Bank's satisfaction on the conclusion of an interagency agreement between the MSPS, the Department of Security (National Police Force) and the Ministerio*

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Público [Attorney General's Office], the terms of which are satisfactory to the Bank" (HO-0205 loan document, paragraph 2.9).

²⁶⁶ On this point the loan document states that "A large percentage of youths who do not work or study belong to street gangs ... The gangs are a serious social phenomenon whose behavior is influenced by factors such as deportation, family and social breakdown and the lack of incentives to remain in school" (paragraph 1.6).

²⁶⁷ Mario Posas, *op. cit.*

²⁶⁸ Document PR-2747-1 of 4 December 2008. The reformulation cut the loan amount by 30%, from US\$20 million to US\$14 million. The document noted that "*the program had experienced a variety of problems throughout its life cycle*" and concluded that "*given that situation and the imperative need to direct funds toward the emergency, the Honduran government had decided that uncommitted funds should be redirected (US\$6 million).*"

²⁶⁹ Rated unsatisfactory for implementation progress and unlikely to achieve its development objectives.

²⁷⁰ When they took office in 2010 the new authorities informed the Bank that they had found the program in the following state: (i) too few staff, and the employees that were still there were owed back pay; (ii) the building owner had confiscated the executing unit's property because of rent arrears, and (iii) there was no information or knowledge about activities carried out or funds committed. As for the individual components, the executing agency stated that progress on components II, III, and IV had not been verified, all the works had been suspended and nothing was known of their current status, and there was no inventory of completed and delivered works. For component I there was no verification of multisector coordination of the Public Safety Information System and the Municipal Peaceable Coexistence Councils had stopped operating.

²⁷¹ For a full status report on the program see Aide-Memoire of the 30 August–3 September 2010 Supervision Mission, Sula Valley Citizen Security and Peaceable Coexistence Program (IDBDOCS 35356839) and the 30 June 2009 PPMR.

²⁷² (i) Engage consultant services to enable the executing agency to provide an accurate status report on the project as of April 2010; (ii) not extend objections until there is clarity as to the foregoing point; and (iii) produce a Closeout Action Plan. The executing agency has been following that Plan since August 2010, so the 2011 closeout should be achieved.

²⁷³ World Bank, 2005 *Private Solutions for Infrastructure in Honduras*, p. 70.