Office of Evaluation and Oversight

Country Program Evaluation

Honduras

2011-2014

Inter-American Development Bank

November 2014

This Country Program Evaluation (CPE) with Honduras covers the period between January 2011 and April 2014 and is the fourth occasion on which the Office of Evaluation and Oversight (OVE) has evaluated the Bank's program with the country. Previous evaluations covered the periods 1990-2000 (document RE-263), 2001-2006 (document RE-328), and 2007-2010 (document RE-390). Under the Protocol for Country Program Evaluation (document RE-348-3), the main goal of a CPE is to "*provide information on Bank performance at the country level that is credible and useful, and that enables the incorporation of lessons and recommendations that can be used to improve the development effectiveness of the Bank's overall strategy and program of country assistance*."

The current country strategy (document GN-2645) was approved in November 2011 and does not coincide with the country's political cycle. President Porfirio Lobo's administration was in office from January 2010 to January 2014. IDB Management expects to submit a new country strategy to the Board of Executive Directors in December 2014.

The evaluation is structured into four chapters, plus an annex. Chapter I analyzes the general context of the country. Chapter II provides a general analysis of the Bank's program between January 2011 and April 2014, with particular attention devoted to the relevance of the country strategy and an analysis of the program actually implemented. Chapter III provides a sector-based analysis of the implementation, effectiveness, and sustainability of operations and of progress made toward the Bank's proposed strategic objectives. Chapter IV presents conclusions and recommendations.

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Honduras 2011-2014

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Abbreviations

BANHPROVI	*Banco Hondureño para la Producción y la Vivienda*
CABEI	Central American Bank for Economic Integration
COALIANZA	*Comisión para la Promoción de la Alianza Público-Privada* [Commission for the Promotion of Public-Private Partnerships]
COPECO	Comisión Permanente de Contingencias [Standing Committee on Contingencies]
CNATEL	National Telecommunications Commission of Honduras
CPE	Country Program Evaluation
DEI	*Dirección Ejecutiva de Ingresos* [Honduras Revenue Agency]
EIRR	Economic Internal Rate of Return
ENEE	*Empresa Nacional de Energía Eléctrica* [National Electricity Company]
ERSAPS	*Ente Regulador de los Servicios de Agua Potable y Saneamiento* [Drinking Water and Sanitation Services Regulatory Authority]
FEREMA	*Fundación para la Educación Ricardo Ernesto Maduro Andreu* [Ricardo Ernesto Maduro Andreu Foundation for Education]
FHIS	*Fondo Hondureño de Inversión Social* [Honduran Social Investment Fund]
GDP	Gross domestic product
IFAD	International Fund for Agricultural Development
IHCAFE	*Instituto Hondureño del Café* [Honduran Coffee Institute"
IMF	International Monetary Fund
INJUPEMP	*Instituto de Jubiliaciones y Pensiones de los Empleados y Funcionarios del Poder Ejecutivo* [National Institute of Retirement and Pensions for Public Officials and Government Employees]
KDF	Korean Development Fund
MER	*Mercado Eléctrico Regional* [Regional Electricity Market]
NSG	Non-sovereign guaranteed
PBL	Policy-based loan
PRONEGOCIOS	*Programa de Fomentos a los Negocios Rurales* [Rural Business Development Program]
SANAA	*Servicio Autónomo Nacional de Acueductos y Acantarillados* [Autonomous National Water and Sanitation Service]
SDC	Swiss Agency for Development and Cooperation
SEFIN	Ministry of Finance
SESAL	Ministry of Health
SG	Sovereign-guaranteed
SIAF	Integrated Financial Management System
SOPTRAVI	*Secretaría de Obras Públicas, Transporte y Vivienda* [Ministry of Public Works, Transportation, and Housing]
VPC	Vice Presidency for Countries
VPS	Vice Presidency for Sectors and Knowledge

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Honduras is Central America's second poorest country, it has the region's lowest productivity, and poor quality capital formation.

Executive Summary

Context and Bank strategy

Honduras has been facing a series of economic, social, and institutional challenges. At the economic level, growth has been slow since the financial crisis, with low productivity and expenditure rigidity, and the economy remains dependent on the U.S. economy and vulnerable to weather events, pests, and natural disasters. A deteriorating fiscal position has led to increases in the debt and the cost thereof, and has made it impossible for the Government of Honduras to reach a new agreement with the International Monetary Fund (IMF) since the last agreement expired in 2012. In the social sphere, the levels of poverty and inequality are notably high as are the levels of violence and crime. At the institutional level, the limited management capacity of public institutions should be noted.

The period under evaluation began just a few months after the end of the "pause" declared by the Bank in its relations with Honduras due to the 2009 political crisis. This meant a significant increase in approvals in 2010 and a high volume of balances to be disbursed, before the start of the period. This increase in resources to be executed, along with the country's institutional weakness and its traditionally low portfolio performance, promised to make implementation a great challenge.

The deterioration of the fiscal position could jeopardize the country's borrowing capacity and affects the financial sustainability of many of the Bank's operations. The Bank has undertaken significant efforts to improve fiscal performance through support for measures to control spending on payroll and social welfare institutes, increase tax revenues and improve public financial management, and support for reaching a new agreement with the IMF. Despite these efforts, the fiscal deficit has grown to higher-than-expected levels.

The Bank's program for 2011-2013

The Bank's country strategy proposed working on five priority sectors, for which it defined strategic objectives while leaving open the possibility that operations would be conducted in other sectors. The Bank also approved four operations that were not associated with any of the priority sectors in the country strategy. The five priority sectors identified in the country strategy were: (i) public management; (ii) financial system; (iii) social protection; (iv) health; and (v) energy. The country strategy also opened up the possibility of Bank support for implementation of the 2011 2012 Comprehensive Policy on Coexistence and Citizen Security and determined that the private sector, through its four windows, could address the following areas: (i) support to financial intermediaries, credit lines for exports; (ii) support for small and medium-sized enterprises (SMEs) in agriculture, manufacturing, tourism, finance, and textiles; and (iii) support to the agroindustrial sector, and to health, low-income housing, higher education, and ports through public-private partnerships (PPPs). The four approved operations not associated with the five priority sectors in the Bank's country strategy were in the transportation, urban development, and education sectors, along with one operation to support the census.

The bulk of the lending program targeted primarily the social area, and there was a significant increase in loans to the private sector. Total approved operations amounted to US$690 million. Of the operations approved during the period, 74% were sovereign guaranteed loans, including ten investment loans and two policy-based or programmatic loans; 4% corresponded to 40 nonreimbursable technical-cooperation operations; and 16.7% to non-sovereign guaranteed (NSG) operations. Of the total of US$514.3 million in sovereign guaranteed (SG) operations, 80% (US$409 million) was concentrated in the social sector, whereas approvals in the areas of financial markets and infrastructure accounted for approximately 8% (US$40 million) each, and modernization of the state accounted for 5% (US$25 million). During the period, the amount of NSG loans increased approximately six times, from US$20 million during the previous period to US$115 million between 2011 and 2013. Of the US$115 million in NSG operations, 48% corresponded to trade operations and the rest to financial market operations and business development (26% each).

During the country strategy period, the Bank maintained its financial presence in the country, made an effort to target its intervention, and, despite the difficulties faced, managed to significantly improve portfolio execution thanks to the adoption of a project-specific risk management approach. The level of approvals was consistent with the most favorable scenario anticipated in the country strategy. The increased volume of loans and improved disbursements increased the Bank's financial significance in the country as compared to the previous period. Bank disbursements have amounted to more than 30% of the country's total public investments since 2011, reaching as high as 40%. Honduras's debt to the Bank represents approximately two thirds of the country's debt to multilateral development banks. In addition, the Bank's presence went from 16 to 10 sectors. Lastly, portfolio management has improved substantially, with significant improvements in nearly all management indicators, thanks to actions taken by both the Honduran government and the Bank, primarily related to adopting a contextualized approach for each project and managing the corresponding risks. Average disbursements between 2011 and 2013 were nearly three times higher (i.e. US$265.6 million) than the previous average. Despite the increase in the level of approvals, this produced a gradual decline in balances to be disbursed to US$543.7 million at the end of 2013.

Nonetheless, responding in a more strategic and integrated manner to the country's development problems remains a challenge. The improper functioning of certain elements related to the Bank's structure, processes and incentives, diagnosed in the Evaluation of the Results of the Realignment, hindered coordination between sectors and between the Vice Presidency for Countries (VPC) and the Vice Presidency for Sectors (VPS) in the preparation of the country strategy. As a result, the country strategy does not provide criteria for a clear understanding of the rationale for the Bank's intervention with respect to its comparative advantages and those of other donors (i.e. selection of development problems to be addressed, identification of sectors for intervention, and the prioritization of projects). Moreover, despite the fact that the resolution of development problems tends to require a multisector approach, the selection of the objectives in the country strategy, the preparation of the sector technical notes, and the design of projects tend to be addressed from a single sector in the Bank. While there has been a notable increase in the Bank's activity in the private sector, a clear strategy is needed to identify market failures to be resolved and coordinate them with other Bank operations.

Implementation, effectiveness, and sustainability

Most implementation problems are the result of designs that fail to adequately weigh institutional and governance risks or that include unrealistic procurement plans and complex execution mechanisms. In addition, portfolio management was also hindered by the fact that, as a result of the guide for preparing country strategies in effect at the time, the country strategy did not include the sectors from the inherited portfolio. In all cases, execution delays have arisen as the result of technical and administrative weaknesses in executing agencies and in the legal-institutional frameworks of their respective sectors, the politicization and high turnover of officials, or the existence of vested interests that are difficult to overcome. In some instances, there have been projects with unrealistic procurement plans or execution mechanisms inadequate for the proper performance of the operation. The volume of balances to be disbursed at the start of the period was more than US$670 million, but the country strategy did not include the sectors from the inherited portfolio, making it more difficult to obtain the technical cooperation resources to address the execution problems and maintain the corresponding sector dialogue. The impact of these problems has been mitigated, in part, by the increase in the number of specialists in the Country Office since the pause.

The bulk of the lending program targeted primarily the social area, and there was a significant increase in loans to the private sector.

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Although many of the projects analyzed have achieved some of the desired outcomes, their effectiveness and sustainability are usually threatened by the country's institutional and fiscal weakness. For example, the Bank has done notable work in the area of fiscal consolidation through policy-based loans (PBLs) and technical cooperation operations to support tax collection and reduce the actuarial deficits of social welfare institutions. However, the weak institutional capacity of the Dirección Ejecutiva de Ingresos [Honduras Revenue Agency] (DEI) has hampered achievement of the collection targets and made it impossible to meet both programs' fiscal targets. Along these same lines, the weakness of many of the institutions involved in program execution, such as the Empresa Nacional de Energía Eléctrica [National Electricity Company] (ENEE) and the Secretaría de Obras Públicas Transporte y Vivienda [Ministry of Public Works, Transportation, and Housing] (SOPTRAVI), and others, makes it difficult to achieve the objectives. Low quality information makes it difficult to conduct good diagnostic assessments, develop good policies, and adequately monitor and evaluate interventions. In all cases where sustainability problems have been identified, there are underlying problems of institutional or regulatory capacity or financial viability.

The Bank's collaboration with other donors is active and productive. The Bank is an active participant in the Stockholm Declaration Follow-up Group (G-16)[1] meetings and supports financing the work of some of its forums. The Bank has also coordinated its work closely with other donors and international organizations in specific sectors such as social investment, financial systems, agriculture, citizen security, etc. Lastly, the Bank has provided technical support to the Government of Honduras, in coordination with the IMF and the World Bank, to monitor the Stand-By program and prepare a possible new program with the Fund.

Based on the findings from this evaluation, OVE makes the following recommendations:

1. Give priority to fiscal consolidation. For such purposes, it is recommended that the Bank continue work with the IMF and the World Bank in order to ensure a sustained process of fiscal consolidation that reduces risks related to program sustainability.

2. Design the country strategy based on the most critical development challenges, clearly defining the criteria for participation by the Bank's various sectors (including the Vice Presidency for Private Sector and Non-Sovereign Guaranteed Operations (VPP)), and for the prioritization of projects, while ensuring consistency between the diagnostic assessment and the country strategy. To do this, Management should consider:

   a. Forming an interdisciplinary team to identify and determine the scope of the development problems faced by the country (e.g., worsening fiscal position, poverty, insecurity, low productivity, etc.) and their causes, based on the growth study, the government's priorities, and other necessary elements.

   b. Including criteria explaining why the Bank is engaged in the solution to those development problems and the selection of the sector or sectors proposed for resolving them (e.g., in the case of the fiscal consolidation problem, possible actions could be considered in the area of revenues, expenditures, and weaknesses in the respective institutions (ENEE, COALIANZA, ERSAPS, FHIS, etc.), inefficiencies in the energy sector, potential contingent liabilities that may arise from public-private partnerships (PPPs), etc.). This could involve the preparation of multisector Technical Notes.

3. Strengthen the design of operations by: (i) conducting more rigorous institutional assessments; (ii) performing more realistic analyses of governance and financial sustainability; and (iii) engaging fiduciary staff more intensively in the design of execution, disbursement, and procurement mechanisms and plans for investment projects.

4. Devote greater efforts to building management capacity (e.g., human resources, financial and budgetary management, procurement, etc.) in the institutions responsible for projects in execution (e.g. DEI, the Police, SEFIN, SESAL, SOPTRAVI, etc.) and consider making disbursements for future policy-based loan operations contingent on effective changes in the management capacity of key institutions and in the institutional framework of their respective sectors in order to improve their governance.

5. Include in future country strategies the sectors corresponding to each country's existing portfolio in order to facilitate their execution and the continuity of the relevant dialogue, as OVE has recommended in prior CPEs.

OVE Recommendations and Management's Response

OVE Recommendation	Management's Response
Give priority to fiscal consolidation. For such purposes, it is recommended that the Bank continue work with the IMF and the World Bank in order to ensure a sustained process of fiscal consolidation that reduces risks related to program sustainability.	**Agreed.** Management is aware that fiscal consolidation is a priority. A technical dialogue is under way on this subject with the government in the context of preparing the Bank's country strategy for 2015-2018. As part of this dialogue, fiscal consolidation is being considered for inclusion as one of the priority sectors of intervention, continuing support for the country in the strengthening of public finances
Design the country strategy based on the most critical development challenges, clearly defining the criteria for participation by the Bank's various sectors (including VPP), and for the prioritization of projects, while sectors (including VPP), and for the prioritization of projects, while ensuring consistency between the diagnostic assessment and the country strategy. To do this, Management should consider: a- Forming an interdisciplinary team to identify and determine the scope of the development problems faced by the country (e.g., worsening fiscal position, poverty, insecurity, low productivity, etc.) and their causes, based on the growth study, the government's priorities, and other necessary elements. b- Including criteria explaining why the Bank is engaged in the solution to those development problems and the selection of the sector or sectors proposed for resolving them (e.g., in the case of the fiscal consolidation problem, possible actions could be considered in the area of revenues, expenditures, and weaknesses in the respective institutions (ENEE, COALIANZA, ERSAPS, FHIS, etc.), inefficiencies in the energy sector, potential contingent liabilities that may arise from PPPs, etc.). This could involve the preparation of multisector Technical Notes.	**Partially agreed.** The design of the Bank's country strategy for the period 2015-2018 will consider the most critical development challenges. In doing so, a process of analysis and consultations is being followed that process of analysis and consultations is being followed that seeks to enhance the Bank's actions in the country. This process includes the following components: a- Technical analyses regarding constraints on growth and productivity. b- Agreements reached with government authorities during the dialogue (including discussions on national development plans). c- Analysis of the portfolio status and presence of other donors. In addition, the process of preparing the new strategy will follow the suggested guidelines in terms of a multisector approach. Four of the five sector notes to be completed are multisector notes: (1) fiscal consolidation; (2) roadways for regional integration; (3) social inclusion; and (4) sustainable urban development. It should be noted that the urban development note will unequivocally respond to this recommendation as it will be a document prepared by a multidisciplinary team made up of seven Bank divisions attached to the Institutions for Development (IFD) and Infrastructure and Environment (INE) sectors.[1] The note will be based on a multisector diagnostic assessment and will propose territorial interventions that coordinate the actions of the various sectors in specific geographic areas. Lastly, while Management agrees with the recommendation as a whole, it would like to express its difference of opinion with OVE's

OVE Recommendation	Management's Response
	observations regarding the consistency between the diagnostic and the country strategy. Its clarification is presented in **paragraph 3.1 of this document.**
Strengthen the design of operations by: (i) conducting more rigorous institutional assessments; (ii) performing more realistic analyses of governance and financial sustainability; and (iii) engaging fiduciary staff more intensively in the design of execution, disbursement, and procurement mechanisms and plans for investment projects.	**Partially agreed.** Management agrees with OVE's recommendation to strengthen the design of operations, but would like to reiterate that it is already giving priority to the issues highlighted in the recommendation: *(i) Institutional assessments.* The institutional capacity assessment of executing agencies is being conducted systematically in accordance with the Bank's current model for these purposes (the Institutional Capacity Assessment System (ICAS)). This model is based on the analysis of the planning, organizational management, personnel management, goods and services management, financial management, and internal and external control systems. Efforts will continue to improve the quality of institutional assessments under the new country strategy; *(ii) Risk analysis.* Similarly, resources will continue to be allocated for conducting and improving project risk analyses; and *(iii) Engagement of fiduciary staff in the design of execution mechanisms and plans.* The participation of fiduciary staff has been maintained in 100% of IDB-financed projects in Honduras, both in the designand during the execution of operations. This will continue during the next strategy period. In addition, as OVE points out in the CPE, strengthening the Country Office in terms of specialists, and the improvement in risk-based portfolio management achieved during the evaluation period will allow the strengthening of the design and execution of operations to continue.
Devote greater efforts to building management capacity (e.g., human resources, financial and budgetary management, procurement, etc.) in the institutions responsible for projects in execution (e.g. DEI, the Police, SEFIN, SESAL, SOPTRAVI, etc.) and consider making disbursements for future policy-based loan operations contingent on effective changes in the management capacity of key institutions and in the institutional framework of their respective sectors in order to improve their governance.	**Partially agreed.** Management would like to note that the management capacity of the institutions responsible for projects being executed has been strengthened through the training of staff on financial and budget matters, as well as on issues specific to the intervention area. In this regard, the Bank is playing a central role in the dissemination of knowledge (courses, seminars) aimed at strengthening the government's capacities. Management agrees on continuing these efforts, while noting that they have been under way since implementation of the 2011-2014 strategy.

OVE Recommendation	Management's Response
	However, it recognizes that there is room to deepen support in this area. In this regard, the Bank is considering a series of measures to improve execution, which will be set out in detail in the new country strategy. These measures will be aimed at deepening the efforts undertaken to date, such as, for example, in the following areas: (i) tailoring the design of operations to the counterparts' capacities; (ii) coordinating with the borrower in order to anticipate risks; and (iii) deepening training processes in integrated and results-based management in the project executing units. With respect to making disbursements for PBLs contingent upon changes in the management capacity of institutions, this is feasible provided that it is consistent with the Bank's policies and current national legal frameworks. Decisions on the content of operations will be determined in accordance with the programmatic dialogue with the authorities. It is also important to bear in mind that achieving sustainable institutional changes requires a combination of PBLs and technical assistance.
Include in future country strategies the sectors corresponding to each country's existing portfolio in order to facilitate their execution and the continuity of the relevant dialogue, as OVE has recommended in prior CPEs.	**Agreed.** We agree that the design of the country strategy has to consider the portfolio in execution. Management is currently engaged in a process of revising the methodology for preparing the country strategies and programs, in consultation with the Board. This exercise is being done in the framework of implementation of the recommendations stemming from OVE's IBD-9 evaluation.

[1] Fiscal and Municipal Management Division (FMM), Institutional Capacity of the State Division (ICS); Climate Change and Sustainability Division (CCS); Environment, Rural Development, and Disaster Risk Management Division (RND); Transport Division (TSP); Water and Sanitation Division (WSA); and the Emerging and Sustainable Cities Initiative (ESCI).

The Honduran population is engaged in low productivity occupations and half of the country's economic activity depends on the United States.

1 Overall Country Context

The economic growth of Honduras has still not recovered to pre-2009 crisis levels. The 2009 economic and political crises led to a 2.4% decline in Honduras's GDP after nine consecutive years of growth.[2] In recent years, the Honduran economy has shown growth rates that are positive but below those observed in the period immediately prior to 2009. As of the end of 2013, economic activity recorded a year-on-year change of 2.6%, which is less than the 3.9% seen in 2012.[3] Several of the factors that have impacted Honduras's economic performance are external, such as the slow recovery of the global economy—particularly in the United States—and weak international prices for Honduran exports. Domestically, the fiscal position has increased the pressure on the performance of the economy as a whole.[4]

A. Structural problems

The Republic of Honduras suffers from high levels of poverty and inequality. Honduras is Central America's second poorest country with per capita GDP of US$2,322,[5] the region's lowest productivity, and poor quality capital formation.[6] Honduras has the worst child poverty in Latin America with 75% of the population age 17 and younger living in households considered to be poor and 50% living in extreme poverty.[7] Honduras is the second most unequal country in the region—second only to Haiti—and the eighth most unequal country in the world.[8] While the top earning 10% of the Honduran population receives 42.4% of total income, the lowest paid 10% receives only 0.4%. This situation is even worse given the characteristics of the Honduran economy, the economic and political crisis of 2009 2010, the country's vulnerability to natural disasters, high levels of insecurity and crime, and institutional weakness.

The Honduran population is engaged in low productivity occupations and half of the country's economic activity depends on the United States. Approximately 47% of the total population lives in rural areas primarily devoted to agricultural activities, involving 39% of the labor force, and as a result of their low productivity, they contribute only 14% of domestic output.[9] In contrast, 40% of the economically active population is engaged in services and produces nearly 60% of GDP. Exports to the United States—clothing, coffee, shrimp, cables—represent 30% of GDP and remittances sent by Honduran migrants residing in the United States represent 20%.[10] In addition, about 70% of foreign direct investment comes from U.S. companies.

Institutional weakness and corruption limit Honduras's capacity to implement development policies and projects. Various institutional development and corruption indexes show Honduras lagging behind the countries of the region. For example, Honduras scored -0.71 on the World Bank "Government Effectiveness" index and -0.83 on the "Control of Corruption" index, while the region's averages were 0.01 and 0.03, respectively. Honduras also scored 17 on the index of meritocratic practices in the civil service prepared by the IDB, more than 50% lower than the regional average. The World Bank's *Doing Business* index, which evaluates 10 areas of the legal-institutional framework for economic activity, ranks Honduras number 127 out of a total of 189 countries for 2014.[11]

In addition, the high crime level affects social coexistence and economic activity. Honduras has a high crime rate. Theft and crime in general are the third most important factor limiting business activity.[12] The high rate of homicides warrants special mention. Honduras is the country without armed conflict with the highest homicide rate per inhabitant (79 homicides per 100,000 inhabitants in 2013). The causes of this high crime rate are complex and involve the activities of international criminal groups associated with drug trafficking and gangs in poor districts in cities like Tegucigalpa, San Pedro de Sula, and El Progreso.

The Honduran economy is extremely vulnerable to weather events, natural disasters, and pests. The *Germanwatch Global Risk Index* (CRI) ranks Honduras as the world's most vulnerable country in terms of climate effects.[13] Between 1980 and 2010, Honduras endured more than 60 natural disasters (i.e., hurricanes, earthquakes, tropical storms) involving a loss of 7.6% of GDP over the last 50 years, 15,000 fatalities, and more than four million people affected.[14] A Bank study shows that the effects of natural disasters involved an estimated reduction equivalent to 20% of the capital stock in 1974 and 1998, due to the devastating hurricanes Fifí and Mitch.[15] Estimates indicate that minor events (i.e., floods and landslides) occur with greater frequency and are, over time, more costly than large disasters.[16] Given the lack of adequate phytosanitary measures, coffee leaf rust has caused considerable economic losses.[17] According to figures from the Instituto Hondureño del Café [Honduran Coffee Institute] (IHCAFE) revenues from exports between 2011 and 2013 fell by more than 40% (from US$1.3 billion to US$752.6 million). The Ministry of Finance (SEFIN) estimates that the disease will have a negative impact of about 2% of GDP each year over the next three years.

B. Fiscal imbalance and recent accelerated indebtedness

The crises and subsequent low economic growth have accelerated the growth of debt. Between 2007 and 2013, the fiscal deficit of Honduras went from 2.9% to 7.9% of GDP, above the initially projected 5.2%.[18] The causes of this deterioration are varied and include, in addition to low growth, excessive and rigid spending, particularly related to wages and salaries,[19] weakening of fiscal discipline in 2011 and 2012, weak mechanisms for controlling spending, and tax collection problems, among other factors.[20] In addition, repayment of the floating debt from earlier years (3.9% of GDP), amortization of foreign and domestic debt (2.3% of GDP), and coverage of the deficit of the ENEE (2% of GDP) put the cash needs of the Government of Honduras at 14.4% of GDP at the end of 2013.[21] This fiscal deterioration made it impossible to reach a new agreement and standby credit facility with the IMF (the earlier agreement from September 2010 expired in March 2012). The new government that took office on 28 January 2014 is currently in negotiations to reach a new agreement.[22]

There is a risk that public debt will continue to increase over the short and medium terms. Honduras's participation in the HIPC debt relief initiative in 2007 enabled it to reduce its public debt by approximately 77%, reaching 17% of GDP. Despite this reduction, at the end of 2013, total public debt as a percentage of GDP reached 42.6% and is expected to reach 46% by year-end 2014 (see Figure 1.2 in the annex).[23] This growth is in response to the need to finance the aforementioned fiscal deficit. The composition of public debt has changed over time. In 2008, domestic debt was just above 20% of total debt while as of the end of 2013, it had increased to 40% of total public spending. As a result, there was an increase in the cost of servicing the debt. Principal and interest payments amounted to 20% of total spending.

At the end of the previous administration, various changes were made in the tax system and public spending was reorganized, with the expectation of reducing the deficit to 5.2% by the end of 2014.[24] Despite this, the payments schedule for fiscal years 2014 and 2015 suggests that the fiscal outlook could deteriorate even further if the tax measures approved fail to substantially increase revenues. The Honduran government's budget policy guidelines for 2014 project that total government revenues will cover just 78% of total spending, and the debt could continue to grow (see Figure 1.2 of the annex).

C. Reform agenda

A set of reforms approved by the National Congress during the final months of the previous administration could reduce public spending. In addition to the aforementioned tax reform, the Honduran Congress approved various provisions,

During the period, three operations were approved in the health sector which sought to improve health offerings by decentralizing the system.

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including reforms to the CONATEL Law, BANHPROVI, the INJUPEMP Law, the Biofuels Law, and the Contribution for Social Programs and Conservation of Roadway Assets. In addition, new frameworks have been created such as the Electrical Industry Law, the Hourly Employment Law, and the Law Governing Public Finances. These reforms could reduce the tax liability of various public sector bodies and enterprises and increase the productivity of the Honduran economy. However, experience in the implementation of reforms and institutional weaknesses would lead one to believe that their implementation is going to be challenging.

D. Relations between the IDB and the Government of Honduras during the period

The period under evaluation began a few months after multilateral organizations declared a "pause" in relations with the country due to the political crisis of 2009. The IDB, World Bank, and the European Union froze loans to Honduras in the amount of US$450 million between 2009 and 2010. This entailed freezing disbursements, suspending new operations, and halting formal relations with the Government of

Honduras. Following the election of President Porfirio Lobo, the various multilateral organizations resumed their operations, although this was a major challenge. As a result of the pause, the balances to be disbursed by the Bank amounted to more than 70% of the portfolio (i.e., US$670.4 million) at the beginning of the period, which represented an increase of 26% compared to the previous period.[25]

2

One objective of the Bank's country strategy was to improve the financial and actuarial sustainability of social welfare systems and the capacity to control and manage spending by personnel.

2 The Bank's Program for 2011-2014

The Bank has a significant financial presence in Honduras. Bank disbursements represented more than 30% of the country's total public investment in 2013 and 40% in 2011. Honduras's debt with the Bank represents about two thirds of the country's debt with multilateral development banks and represented about 25% of the country's total external public debt during the period under evaluation (see Table 2.1 of the annex).

A. Relevance

The Bank's country strategy (document GN-2645) identified five priority sectors to which it assigned a total of seven strategic objectives that were generally in line with the government's priorities. The five sectors for which the country strategy defined objectives were: (i) public management; (ii) financial system; (iii) social protection; (iv) health; and (v) energy. The main purpose of the sectors selected in the country strategy was to support the achievement of the following three objectives in the "Country Vision":[26] (i) a modern, transparent, responsible, efficient, and competitive State; (ii) an educated, healthy Honduras free of extreme poverty, with consolidated social welfare systems; and (iii) a productive Honduras that produces opportunities and decent jobs, and that uses its resources in a sustainable way and reduces environmental vulnerability. Table 2.1 details the relationship between the country strategy's strategic objectives and the Country Vision.

Operations approved during the period associated the five priority sectors of the Bank's country strategy were generally consistent with country strategy objectives and the country's development challenges.[27]

a. *Public and financial management and public procurement.* One objective of the Bank's country strategy was to improve the financial and actuarial sustainability of social welfare systems and the capacity to control and manage spending by personnel. The Bank approved a PBL operation for US$40 million (HO-L1079) and a technical cooperation operation for US$300,000 (HO-T1194) to promote the sustainability of the social welfare institutes and control unplanned growth of public employee compensation,[28] and six technical cooperation operations for US$5.1 million that provided continuity for the Bank's work in the area of public financial management (i.e., budget, public credit, public investment, macro fiscal management, etc.).[29] These operations are also highly relevant to the development challenges involving fiscal consolidation and institutional fragility. Note that much of the technical assistance provided to the Government of Honduras was used to monitor the stand-by arrangement with the IMF and support negotiations for the new arrangement.

Table 2.1. Relationship between the Bank's sector-level strategic objectives and the "Country Vision" (document GN-2645)

Country vision Country	Country strategy sector	Strategic objectives of the Bank's country strategy
A modern, transparent, responsible, efficient, and competitive State; An educated and healthy Honduras without extreme poverty with consolidated social welfare systems	Public management	• Improve the financial and actuarial sustainability of social welfare systems and the capacity to control and manage spending by central administration personnel and increased of national systems
An educated and healthy Honduras without extreme poverty with consolidated social welfare systems	Social protection	• Increase the effectiveness and efficiency of the conditional cash transfer program
An educated and healthy Honduras without extreme poverty with consolidated social welfare systems	Health	• Improve coordination of and access to basic health and nutrition services
An educated and healthy Honduras without extreme poverty with consolidated social welfare systems; A productive Honduras that produces opportunities and decent jobs	Energy	• Increase the rate of coverage for electric power at the national level • Increase the share of renewable sources in the electric power grid • Improve the operational and commercial efficiency of the electricity sector
A productive Honduras that produces opportunities and decent jobs	Financial system	• Strengthen the financial security network and promote greater financial inclusion

b. *Social protection.* The Bank's strategic objective in this sector was to "increase the effectiveness and efficiency of the conditional cash transfer program," expected to result in increased program coverage and targeting. One loan was restructured (HO-L1032) and three more loans were approved (HO-L1042, HO-L1071, and HO-L1087). These operations were designed to improve the management and transparency of the Bono 10,000 program, expand its coverage, and ensure access to basic health and education services by beneficiary families. Moreover, although not an explicit objective, these operations are helping ensure its absorption by the national budget, thus contributing to fiscal consolidation and poverty reduction.

c. *Health.* The objective of the Bank's country strategy for this sector was to improve coordination of and access to basic health and nutrition services. During the period, three operations were approved (loans HO-L1072 and

HO-L1090, and technical cooperation operation HO-G1001), which sought to improve health offerings by decentralizing the system, as well as to improve the quality of medical services, targeting the country's most vulnerable population.

d. *Energy.* The objectives of the Bank's country strategy for this sector were to increase the rate of coverage for electric power and the use of renewable sources in the production of electricity, to improve the sector's institutional, operational, and financial weakness, and to reduce the sector's impact on the government's deficit. However, the country strategy indicated that the Bank's support for the sector through investment loans would be subject to progress in terms of financial sustainability and strengthening of the electricity sector. Given that no progress was made on these fronts, the Bank only approved one loan operation in the amount of US$22.9 million (HO-L1039) to support Honduras's integration into the Regional Electricity Market (MER) and five technical cooperation operations to support mitigation of the effects of climate change. Four months prior to approval of the country strategy, the Bank also approved an NSG operation for US$20 million with financial intermediaries for granting green loans in the energy sector, which was not originally considered in the country strategy (HO-L1077).

e. *Financial system.* The objectives of the Bank's country strategy for this sector were to strengthen the financial security network and promote greater financial inclusion. During the period, the Bank approved a PBL for US$40 million aimed at improving banking supervision and regulation and promoting access to the financial system. Although this represents a step in the right direction, deeper reforms are still needed.[30]

The Bank's country strategy opened up the possibility of carrying out operations in other sectors for which strategic objectives had not been defined. In these cases, the operations were, to a certain extent, aligned with some of the country's development challenges. The Bank's country strategy also considered providing Bank support for implementation of the 2011-2012 Comprehensive Policy on Coexistence and Citizen Security and determined that the private sector, through its four windows, could address the following areas: (i) support to financial intermediaries, credit lines for exports; (ii) support for SMEs in agriculture, manufacturing, tourism, financial, and textiles; and (iii) support to the agroindustrial sector and to the health, low-cost housing, higher education, and ports through PPPs.

a. *Citizen security.* During the period, the Bank approved one loan (HO-L1063) for US$59.8 million and two supplementary technical cooperation operations: a grant (HO-X1021) for US$6.6 million funded by the Swiss Agency for Development and Cooperation (SDC) and a technical cooperation operation (HO-T1169) for US$300,000 funded by the Korea Poverty Reduction Fund

(KPRF). These funds were specially targeted on building police capacities, and thus, a priori, these actions are relevant to the challenges related to security and institutional weakness.

b. *Trade and business development.* The Bank supported these sectors through providing SG loans, guarantees (NSG), and technical cooperation.[31] Although these projects are formally consistent with the need to improve productivity and promote growth, the Bank's support was provided in the absence of a clear strategy that would make it possible to identify and address the market failures and coordinate with other Bank operations.

The Bank approved four operations not associated with any of the sectors prioritized in the country strategy but that responded to the country's development challenges.

a. *Modernization of the State.* In 2011 the Bank approved an operation for US$25 million to support development of the 2012 census and a system of household surveys (HO-L1044). Given the limitations of the information that the Government of Honduras uses in decision-making, this project was relevant with respect to the development challenges since it could help to target social spending and improve the impact of public policies on poverty and inequality. However, the approval was granted without a specific intervention strategy defining the Bank's support to resolve the problems of production and quality of information in Honduras, which are systemic issues, affecting all sectors.

b. *Transportation.* In 2013 the bank approved an operation (HO-L1089) for US$17.2 million to cover cost overruns on one of the operations approved in the previous cycle (HO-L1020). This was an important operation in that it links the most important economic hubs (Puerto Cortés to the north, San Pedro de Sula, and Tegucigalpa) with El Salvador to the south.

c. *Urban development.* The Bank approved a program (HO-L1088) for US$17.2 million in 2012, to follow up program HO-L1007 approved during the previous period. The program's objectives were to provide access to basic urban services (e.g., water and sanitation) to periurban neighborhoods, increase the job skills of at-risk groups, and increase the social capital of traditionally excluded communities. This program addressed the challenges of inequality and poverty. The program, due to its specific focus on high crime areas, was presented as a citizen security project.

d. *Education.* The education sector was not included among the country strategy's sectors, since operation HO-L1062 had been approved a few months earlier.[32] In addition, the Bank approved three technical cooperation operations (HO-T1149, HO-T1162, HO-T1165) needed for executing the loan and relevant to addressing the reduction of poverty, vulnerability, institutional fragility, and fiscal consolidation.[33]

Responding in a more strategic and integrated manner to the country's development problems remains a challenge. The improper functioning of certain elements related to the Bank's structure, processes and incentives, diagnosed in the Evaluation of the Results of the Realignment,[34] hindered coordination between sectors and between the VPC and the VPS in the preparation of the country strategy and the definition of clear criteria for a solid understanding of the rationale for the Bank's intervention. The country strategy did not provide an argument justifying the selection of development problems to be addressed, the priority sectors, or the intervention modality. For example, there are problems having a profound impact on the economy on which the Bank too no action, without the country strategy explaining this absence.[35] In addition, there are contradictions between the recommendations of the various documents used to prepare the country strategy that are not explained.[36] For example, the growth study,[37] prepared to identify Honduras's development challenges and the potential best ways to address them, argues that access to financing, although it can and should be improved, is not one of the principal causes of the country's low growth. Despite this, the respective Sector Technical Notes advocated (and the Bank's subsequent action in the sector was directed to) promoting access to financing. It also indicates that the greatest impact on productivity and poverty, in the transportation sector, could be obtained by deconcentrating the investment away from the main corridors. Nonetheless, the Bank's activity focused on the primary network. It also indicates that the low performance of exports is not due to difficulties in accessing international markets, but rather to restrictions affecting the country's growth as a whole (i.e., low human capital, institutional weakness, and excessive bureaucracy, etc.). However, the Bank continued to focus its support on access to international markets. Although these actions may be worthy endeavors, the country strategy does not explain why the Bank has opted for some recommendations and not others. Lastly, despite the fact that the solution of development problems usually requires multisector action, the country sector objectives and the preparation of the Sector Technical Notes were addressed from a single sector in the Bank.[38]

Because of the guide for preparing country strategies, the Bank's country strategy did not include the sectors from the inherited portfolio, causing difficulties in its execution and in maintaining the corresponding dialogue. In 2010, to compensate for what was not done during the pause, the Bank approved a total of US$343.3 million, an amount well above the annual average of US$150 million for the preceding three years. In addition, shortly before the country strategy's approval, the Bank approved a project in education. Partly for that reason, at the start of the period, the amount of the balances to be disbursed amounted to US$670.4 million (see Table 2.3 of the annex). According to the interviews conducted of Bank staff and representatives of the executing units, the failure to include the corresponding sectors in the country strategy hindered the ability to obtain technical cooperation resources to continue the dialogue and execution of the projects.[39]

There is no evidence that the country's Fund for Special Operations (FSO) status has affected the Bank's programming in Honduras. As a beneficiary of the FSO, the resources that can be allocated to Honduras are determined every two years based on its economic and portfolio performance. Thanks to successive cancellations equivalent to 75% of the portfolio, Honduras became one of the FSO countries with the lowest debt risk. Thus, since 2007, these funds have been mixed with Ordinary Capital in a fixed proportion that depends on the sustainability of the debt. During the period, the proportion of Ordinary Capital funds reached 70%. This significantly increased the cost thereof, but increased the availability of funds by 33% (from some US$160 million per year to more than US$200 million; see Table 2.4 of the annex). The inability to carry over funds assigned every two years from one two-year period to another seems not to have forced the approval of immature or rapidly disbursing operations to prevent the loss of the funds allocated. The approval patterns and operation preparation times for Honduras are not systematically different from the approval patterns for countries that do not receive FSO funding.

The Bank's collaboration with other donors has been intense and has generated important synergies during the period. In 1999, in response to Hurricane Mitch, the G 16 was created to monitor the reconstruction process and subsequently the country's transformation. This forum has been used to facilitate the coordination of international aid with the Government of Honduras. The Bank is an active participant in the G 16 meetings and supports financing the work of some of its forums (e.g., security, education, and health). Thanks to one of the works financed by the IDB, for example, it was possible to counteract the opposition that existed to applying universal education tests. In addition, the Bank has closely coordinated its work with other international donors and organizations in specific sectors such as social investment (World Bank, CABEI, and the Japan International Cooperation Agency (JICA)), financial systems (Spanish Agency for International Development Cooperation, KfW, the World Bank, and the IMF), agriculture (IFAD, CABEI, EU, USAID, and the World Bank), and citizen security (SDC, KDF), etc.

The Bank has provided technical support to the Government of Honduras, in coordination with the IMF and the World Bank, to monitor the stand-by arrangement, and for the preparation of a possible new arrangement with the Fund. To do this, funds from the special program for Group C and D countries (HO-T1160 and HO-T1174), as well as other funds, have been used.

B. The program implemented

The bulk of the loan program targeted the social area, and there was a significant increase in loans to the private sector. The total amount of operations approved amounted to US$690 million. Of the operations approved in the period, 74% were sovereign guaranteed loans and included 10 investment loans and two policy-based or programmatic loans; 4% corresponded to 40 nonreimbursable technical cooperation operations; and 16.7% corresponded to NSG operations.[40] Of the total of US$514.3 million in SG operations, 80% (US$409 million) was concentrated in the social sector, while the financial markets and infrastructure areas approved approximately 8% (US$40 million) each, and the area of modernization of the State 5% (US$25 million). During the period, the amount of NSG loans increased approximately six times, from US$20 million during the previous period to US$115 million between 2011 and 2013. Of the US$115 million in NSG operations, 48% corresponded to trade operations and the rest to financial markets and business development operations (26% each) (see Table 2.2 of the annex).[41]The level of approvals was consistent with the most favorable scenario anticipated in the country strategy. The strategy considered an estimated basic lending framework for approvals of SG loans for a total of US$648 million over the period 2011-2014 (US$162 million per year), of which 30% (US$48.6 million per year) would come from the FSO and 70% (US$113.4 million per year) from Ordinary Capital. The most optimistic scenario set annual approvals at US$171 million (US$684 million), which has been marginally exceeded (US$171.3 million).

During the period under evaluation, the Bank has reduced the dispersion of its portfolio. The Bank's program in the country has traditionally been highly dispersed.[42] During the period 2007-2010, a total of 35 approved operations were distributed among nearly 15 sectors. However, during the period under evaluation, the Bank approved a total of 12 SG operations and 10 NSG operations attached to ten sectors (see Table 2.2 of the annex).

C. Challenges and achievements in portfolio management

At the start of the period, the conditions for execution of the portfolio were not favorable and foreshadowed additional difficulties for its execution. Honduras was considered one of the countries with the Bank's worst portfolio indices: execution times (68 months) were 58% higher than the Bank's average; costs to prepare operations (US$5,190 per million approved) were more than twice the average; and execution costs per million disbursed were in fourth from last place among the Bank's countries.[43] In addition, the balance to be disbursed was high at the start of the period.

Despite this, the Bank has managed to improve portfolio execution substantially. Between 2007 and 2010, the Bank disbursed an average of US$96.4 million per year. The average of balances disbursed between 2011 and 2013 was nearly three times higher (i.e. US$265.6 million). This, despite the increase in the level of approvals, produced a gradual decline in balances to be disbursed, reaching US$543.7 million at the end of 2013.

The improved pace of disbursements produced an increase in the flow of Bank funds to the country and reduced the age of the portfolio. In 2005, the Bank's balances with the country were negative. The annual average of net flows from the Bank to Honduras for the period 2007-2010 was US$63.1 million, while the average over the last three years was US$226.5 million (see Figure 2.1 of the annex). Historically, the disbursement period was 6.4 years for investment projects and 3.5 years for sector loans in Honduras. During the period, these periods fell to 4.4 and 2.1 years, respectively (see Figure 2.2 of the annex).[44]

Response time by the Country Office to respond to its internal and external counterparts has improved. According to the information obtained from the Bank's official correspondence system (SISCOR), the Country Office's average response time went from 22.6 days in 2010 to 11 days in 2013 (49% reduction) (see Figure 2.3 of the annex). The counterparts interviewed by OVE reported that the Country Office generally responds within five days of the date they send correspondence, a response time four times quicker than that of the World Bank (20-30 days on average).[45]

There has been a gradual reduction in program delivery costs. For the 2010 2013 period, the average cost per dollar disbursed and approved fell by 55% and 53%, respectively, with respect to the prior period. In addition, there was a significant reduction in staff hiring costs. Annual average hours paid declined by 16% between the periods 2005 2008 and 2010 2013. Figure 2.4 of the annex shows the changes in both indicators.

The systemic problem related to financial audits has been eliminated. As of the end of 2010, five of the 31 portfolio operations were problematic, 26 were qualified, and 25 showed delays. As of the end of April 2014, the last deadline for submitting audits, there was no delayed, qualified, or problematic audit.

The solid results obtained in execution have, in part, been the result of actions taken by the Government of Honduras to improve internal coordination, perform strategic monitoring of implementation, and strengthen the executing agencies. As a result of the pause, approximately 50% of public investment, which was financed through international cooperation, was left unfunded. Once the political crisis was resolved, the Government of Honduras reacted by adopting a series of measures to accelerate the execution of projects financed using international cooperation funds. On one hand, it revived the "Control Tower" to coordinate and conduct strategic monitoring of international cooperation in coordination with SEFIN.[46] The Government of Honduras proceeded to strengthen existing executing units, reducing their number (from 22 during the preceding period to 15 at present) and to leverage the capacity of those with excellent capacity (e.g., the Millennium Account of Honduras in the case of transportation projects—see Box 2.1) so they would assume the execution of programs that were experiencing serious execution problems.

For its part, the Bank has strengthened its presence, and the Country Office has optimized the use of funds and provided appropriate risk management for projects. When the pause ended, the Bank's Country Office in Honduras had four specialists. It currently has nine specialists with high-level technical skills and extensive international experience in project execution. The Country Office also strengthened the project executing units by transferring consultants located in the office.[47] Thanks to this, the executing units have completely assumed execution of operations, and the confusion of responsibilities between team leaders and operations analysts/consultants has been considerably reduced.[48] In addition, the Country Office's management team collaborated to create an early warning and troubleshooting system. Another key factor in improved implementation has been the capacity that the Country Office has shown for managing and assuming the risks of each project on an individualized basis (see Box 2.1).

Box 2.1 Examples of individualized management of risks

Bono 10,000. Three operations were developed since 2004 to finance conditional cash transfers to poor beneficiaries (HO-0222, HO-L1032, and HO-L1042). The design of these projects required concurrent unqualified audits every six months as a condition for disbursements. This resulted in delayed disbursements, since 85% of the audits had qualifications. An analysis of the causes of the observations revealed that nearly all the observations were procedural rather than substantive. Based on this analysis, in the design of the new Bono operations (HO-L1071, HO-L1087, and currently HO-L1093), the choice was made to separate the technical audit from the financial audit. This facilitated gradual progress from transfers every six months to transfers every two months. As a result, the pace of disbursements has accelerated and 100% of the audits are submitted without qualifications and by the established deadlines.

Primary Roadway Network. The execution of the transportation loans approved during the previous period was delayed due to undeveloped designs, weak management capacity of the executing agency (SOPTRAVI), delays in the management of rights of way, additional deterioration of highways, and cost overruns due to inflation and expansion of supervision contracts. In this context, the government asked the Bank to change the executing agency for the roadway portfolio and suggested that those functions be transferred to the Millennium Challenge Account (MCA-Honduras) an entity attached to the Office of the President of the Republic. The Bank justified the change based on the technical, financial, and administrative autonomy of MCA Honduras and the technical quality of its staff. The results of this decision have been very positive considering the completion of work on the CA-5 North, substantial progress in work on the Agricultural Corridor, and annual growth in disbursements for transportation sector operations, increasing from US$10 million/year in 2010 to US$65 million/year in 2013.

PRONEGOCIOS. This project, the objective of which is to support the development of rural businesses, necessitated contracting consulting assignments to support the beneficiaries in identifying business opportunities and formulating the respective business plans. Upon completion of each of the 220 business plans programmed, five International Competitive Bidding processes were required, which represented about 600 days per business plan. The Country Office designed a new execution method adapted to the requirements and specific nature of each project. Given that this required the identification and formulation of numerous rural business plans, which by their nature did not fit neatly into consulting methodologies, the choice was made to use a competitive method for selecting consultants based on predetermined standards of quality, obtaining flexibility and agility in the process. To date, 78% of the loan proceeds and all the counterpart funds have been disbursed.

3

The population's access to electrical power has increased substantially (90%) and the share of renewable sources in the generation of electrical power has increased from 38% to 43%.

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3 Program Implementation, Effectiveness, and Sustainability

This chapter analyzes progress made in implementation and the results of the Bank's program of loans and technical cooperation between 2011 and 2013. It analyzes, in particular, the extent to which the projects under consideration have fulfilled their targets and met their execution deadlines, possible reasons they have not been able to do so, and their sustainability. The projects associated with the priority sectors identified in the country strategy and for which specific objectives were assigned were analyzed first, followed by the projects associated with the priority sectors or areas of dialogue identified in the country strategy but for which no objectives had been assigned. Lastly, projects not associated with any of the priority sectors or areas of dialogue identified in the country strategy were analyzed.

A. Objectives of the Bank's country strategy

Objective 1: Improve the financial and actuarial sustainability of social welfare systems and the capacity to control and manage spending by central administration personnel and increase the use of national systems

By providing technical cooperation and a loan, the Bank supported the achievement of this objective, which contributes to fiscal consolidation and to the reduction of rigidity in public spending. In particular, it approved a PBL for US$40 million the objective of which was to reduce the actuarial deficits of the National Institute for Teachers' Pensions (INPREMA) and the National Institute for Retirement and Pension for Public Employees and Government Employees (INJUPEMP), to improve the financial viability of the Honduran Social

Security Institute (IHSS), and to increase control over personnel spending.[49] In addition, the Bank has approved loans and technical cooperation operations in the area of improving revenue collection (HO-L1015, HO-L1030, HO-T1188, and HO-L1055), national financial administration (HO-L1015, HO-T1079, HO-T1134, HO-1143, and HO-1168), municipal financial administration (HO-L1015 and HO-T1182), macrofiscal management (HO-T1143 and HO-1200), and macroeconomic statistics (HO-L1015).[50]

Disbursements have generally been made as scheduled. Cases of substantial delays have been due to problems in the design of the operations. The two PBLs (HO-L1030 and HO-L1079) made disbursements as scheduled 100% of the time. As a result of cessation of the arrangement with the IMF in 2012, the third PBL planned was not prepared. The fiscal and municipal management consolidation program (HO-L1015), despite having to overcome design problems,[51] has disbursed more than 80% and is expected to be completed as scheduled in 2015. Three of the technical cooperation operations (HO-T1134, HO-T1136, and HO-T1143) have disbursed 100% while another three, those targeted at improving budget management (HO-T1079, HO-T1168, and HO-T1182), have been subject to delays due to designs that failed to adequately consider institutional and governance risks. The Puerto Cortés Customs Modernization project has disbursed only 18% of loan proceeds and has less than one year of execution left. This project was designed with multiple objectives and required the participation of various entities independent of each other. The execution mechanism has not resolved the problems of coordination. In addition, there were many changes in the management of one of the participating entities (i.e., the DEI).

In general terms, the sector's programs have delivered their outputs and, to a lesser extent, achieved their outcomes, but there are doubts as to whether the expected impacts can be achieved. The PBLs supporting fiscal consolidation (HO-L1030 and HO-L1079) were disbursed and have achieved seven of the nine outcomes,[52] but the tax ratio only amounted to 14.5% of GDP in 2013 and not the established goal of 16.8% of GDP. In addition, the fiscal deficit increased.[53] The PBL to support the social welfare system did not clearly define concrete indicators and targets for measuring impact: *"maintenance of an appropriate policy framework,"* but the macroeconomic context deteriorated during and after the reforms, even leading to suspension of the agreement with the IMF, and so the impact has not been achieved. The technical cooperation operations have been used to support the execution of the earlier projects. Some have helped to improve the dialogue on the design of public policies.[54] However, in the Puerto Cortés Customs Modernization project,[55] no progress has been made toward the project outcomes.

The sustainability of the Bank's action in this area shows mixed results. The PBL to support reform of the social welfare institutes seems adequate; the one supporting consolidation of fiscal and municipal management seems adequate but faces risks of technical obsolescence; the PBL supporting fiscal reform and the Puerto Cortés Customs Modernization project show weaknesses. The technology used to develop the systems supporting the Integrated Financial Management System (SIAF) is subject to rapid technical obsolescence and its updating requires intensive use of costly specialized human resources. Given the fiscal position of the Government of Honduras, it is unlikely that such updating could be done using the government's own funds. The institutional and governance weakness of the DEI jeopardizes the achievement of the PBL's collection goals supporting the consolidation of fiscal management and the Puerto Cortés Customs modernization.

Objective 2: Increase the effectiveness and efficiency of the conditional cash transfer program

To help achieve this objective, the Bank restructured one loan (HO-L1032) and approved three more (HO-L1042, HO-L1071, and HO-L1087). These programs were designed to improve the management and transparency of the *Bono 10,000* program, expand its coverage, and ensure access to basic health and education services by the beneficiary families.

There were substantive improvements in the execution of operations during the period. The Integrated Support for the Social Safety Net Program (HO-L1032) experienced significant delays as a result of the pause and various factors such as: (i) weakness of the management information system; (ii) lack of funds for the Education and Health Secretariats to verify shared responsibility; (iii) delay in transfer payments; and (iv) delay in the allocation of national counterpart funds. Accelerated incorporation and payment of transfers was not accompanied by effective strengthening of the processes required to verify program conditions and operations. This weakened its operations and created some problems such as irregularity in the schedule of payments to beneficiaries and delays in the verification of shared responsibilities. To resolve these problems, the Government of Honduras and the Bank adopted a series of measures, notably the redefinition of the program,[56] the government's designation of the Secretariat of the Presidency as the coordinating entity for social programs, and the Bank's streamlining of the execution mechanism (see Box 2.1). The verification of conditionalities is now faster, helping to improve educational and health services. The payment systems have also been improved, although it has not been possible to solidify a payments schedule.

The main outcome was national expansion of the program. However, there are still weaknesses in the program's targeting and implementation. Despite errors, the results reported from the *Bono 10,000* program are positive. The impact evaluation indicates that the program is achieving its objectives in education and health:[57] (i) households in covered villages have increased their consumption of food and beverages by 30% and have increased spending on school supplies by 25%, compared with households in the control group villages; (ii) the percentage of children whose last visit to the doctor was for a routine check-up rather than an illness has increased from 7% to 12%; (iii) no evidence has been found of negative changes in adult job participation; and (iv) coverage has reached 350,000 families. Despite this, universal coverage of the poorest families has not been achieved, and payments remain irregular.

The sustainability of the program is tied to improvement in the country's fiscal position and the quality of services in education and health. The program's most troubling concern is its fiscal sustainability given that its own resources have been very limited since last year. The long-term success of the program is tied to improvement in the education and health system. In addition, the program should continue improving the verification of shared responsibilities to really increase capacities for improving educational and health and nutrition levels.

Objective 3: Improve coordination of and access to basic health and nutrition services

The three operations approved during the period (loans HO-L1072 and HO-L1090 and technical cooperation operation HO-G1001) sought to improve the supply of health by decentralizing the system, in addition to improving the quality of medical services, targeting the country's most vulnerable populations.

Disbursements to finance the decentralized system occurred as scheduled. However, there have been operational delays in financing for hospital infrastructure. The first operation (HO-1059) has been almost fully disbursed; the second operation (HO-1072), approved in June 2012, has disbursed 26% of the total (US$7.8 million). To date, the last operation (HO-L1090), approved in 2013, has disbursed 20% this year. Delays were caused due to the lack of a budgetary allocation at the start of the project.

Health sector results are partial and sustainability is a challenge due to fiscal pressures and problems with the managers' capacity. With support from the Bank, the coverage of decentralized services was expanded to include more than 1.13 million people in 74 municipalities in 14 departments as of December 2013. The users' level of satisfaction is above 85% (the project objective was 70%). However, it has not yet been possible to determine what achievements have been made in the area of chronic malnutrition and anemia among children and anemia in pregnant women since the planned survey has not been conducted. In addition, expansion faces serious challenges in the short and medium term (e.g., standardization of quality, institutional weakness of providers, and principally financial sustainability of the program).

Objective 4: Increase the rate of coverage for electric power at the national level and the share of renewable sources in the electric power grid and improve the operational and commercial efficiency of the electricity sector

The Bank has not approved any new operation during the period because the Government of Honduras had not proceeded with implementation of previously agreed reforms.[58] However, there has been adequate progress made in achieving the expected outcomes from earlier operations. Execution was concluded on the project to construct the Amarateca electrical power station and expand the Zamorano power station that provide power to the country's central and western areas. In line with the objectives of the Bank's country strategy, the population's access to electrical power has increased substantially (90%) and the share of renewable sources in the generation of electrical power has increased from 38% to 43%, although losses in distribution from the ENEE have increased from 26% to 31% (the goal was reduce losses to 20%). In January 2014, Congress approved the Electrical Industry Law, restructuring the ENEE to include different companies (generation, transmission, and distribution), opening those companies to private investment, and establishing an Electrical Energy Regulatory Commission. The Bank's action with the program to support fiscal reform (HO-L1030 and HO-T1192) plus the ongoing dialogue maintained with the authorities helped to improve the rate system, limit subsidies, and introduce the 15% tax for residential consumption above 750 kWh/month, which supports the financial sustainability of the ENEE.

Although the financial and institutional problems affecting the ENEE represent a risk to the fiscal sustainability of the country and the sector, the changes introduced recently are a step in the right direction. The ENEE deficit represents two points of the fiscal deficit. To the financial problems must be added the absence of adequate regulation and policy for the ENEE and inefficient management as reflected in the level of losses in transmission/distribution and commercial losses (e.g., the difference between amounts invoiced and amounts collected). The recent reforms may mean a step in the right direction. Experience with failed reforms in the sector necessitates being cautious and taking every precaution to ensure that the reforms bear fruit.

Objective 5: Strengthen the financial security network and promote greater financial inclusion

The Bank's support to the financial sector helped to improve the financial security network and access to financing. PBLs HO-L1065 and HO-L1069 for US$40 million each supported the development of legislation intended to stabilize the financial system and facilitate access to financing for SMEs and vulnerable groups. According to the evaluation done by the Bank, financial supervision capacity has improved, so that the country would be better prepared to deal with potential financial crises. NSG loan HO-L1085 for US$10 million sought to facilitate the granting of lines of credit, but given the lack of information on the development objectives, it has not been possible to confirm its results.[59] Nonetheless, the conditions and incentives necessary to promote financial inclusion do not exist.

Objective 6: Use of national systems

The goal established in the Bank's country strategy with respect to national systems for the end of 2014 has already been achieved: One hundred percent of current loan operations are already using the accounting and reports subsystem (SIAFI/UEPEX).[60]

B. Approved operations associated with the priority intervention areas in the Bank's country strategy

1. Citizen security

Although the Government of Honduras urgently needs to respond to the challenge of insecurity, disagreements on the direction of the program and political and institutional difficulties faced have affected execution and cast doubts on the achievement of program results and sustainability. In 2012, the Bank approved three operations: a loan (HO-L1063) for US$59.8 million, a grant (HO-X1021) for US$6.6 million and a technical cooperation operation (HO-T1169) for US$3 million.[61] The objective of the loan was to improve crime prevention and prosecution through improvements in the effectiveness of the Department of Security and National Police, criminal investigation capabilities, and municipal management of crime prevention programs. The grants supplemented the loan funds specifically for the training and municipalities components and to strengthen program execution. However, once the operation was approved, the Government of Honduras wanted to place greater emphasis on infrastructure investments even though the effectiveness of actions of this kind in reducing crime is not clearly proven. In particular, the Government of Honduras proposed to direct a large portion of the funds allocated to institutional strengthening in order to construct judicial outposts. The Bank's technical team did not support this proposal, leading to an impasse in project execution. In response to political pressure, the Bank agreed to allocate US$5 million in addition to the US$1.5 million originally allocated under this heading, which, a priori, could weaken the effectiveness of the operation. In addition, in a sensitive political context, there have been difficulties finding coordinators who are neutral, properly trained, and have the experience necessary to lead the program under adverse conditions. As a result of this, only 6% of the loan proceeds have been disbursed, 35.6% of the Korean Fund technical cooperation funds have been disbursed (HO-T1169—primarily to support project execution), and none of the Swiss grant (HO-X1021) has been disbursed.[62] In addition, crime reduction will depend on progress made on other factors such as reducing the porosity of the borders, controlling access to firearms, strengthening the judicial system, inequality, economic opportunities, etc.

2. Trade and business development

The absence of results indicators has made it impossible to determine the effectiveness of the Bank's activity in the trade sector and, with respect to the business development sector, results have yet to be achieved given the lack of progress made in implementation.[63]

C. Approved operations not associated with the priority intervention areas identified in the Bank's country strategy

1. Modernization of the State

The pace of the execution of the census program is adequate and outputs are being achieved as scheduled. The census program has disbursed nearly 90% of its funds, and there are nearly two years left of program execution. The anticipated outcomes are expected to be achieved at the end of this year. The census program and the previous technical cooperation operation have strengthened the institutional capacity of the National Statistics Institute (INE). It is important for the Government of Honduras to maintain and increase this capacity over time and that the necessary funds be secured to conduct future censuses without depending on foreign assistance.

2. Education

Two of the three components of the education project were delayed due to problems with design development, inadequate planning of the procurement plan, and restrictions in the fiscal space allocated to the project during execution. The first component—Access to Preschool Education—has been adequately executed by the Fundación para la Educación Ricardo Ernesto Maduro Andreu [Ricardo Ernesto Maduro Andreu Foundation for Education] (FEREMA), although there have been delays in the counterpart payments as a result of the fiscal restrictions. In the second component—educational materials and physical adaptations made to schools—there have been delays in delivery of the educational materials for reading, writing, and mathematics primarily due to delays in the review process by the Ministry of Education and fiscal restrictions. In addition, problems with access to schools and their geographic dispersion delayed the determination of their needs for electrical work.[64] In the third component—introduction of technology to improve the second cycle of basic education (grades 4 to 6)—the purchase of computers was delayed because determination of the technical specifications took longer than expected.

Despite the delays, nearly all the outputs in the education sector have been delivered and we have begun to see some results that can be attributed to the project. Particularly notable are the opening and furnishing of 624 new Community

Preschool Centers (CCEPREB) in 2012, pedagogical support for 1,500 pre-existing CCEPREB in 2011, training of 2,145 CCEPREB teachers, delivery of 2,145 methodology packages and consumables to all participating centers, procurement of approximately 53,000 notebooks (of the anticipated 70,000), and contracting of Internet access services for schools and teachers participating in the program, and services to strengthen the technical and managerial capacities of the Project Management Unit of the SDP (UAP/SDP). Lastly, an initial review performed by FEREMA and the Ministry of Education shows that participating children have made progress in acquiring cognitive skills.

However, fiscal problems cast doubt on the sustainability of project outcomes. All the components generate current expenses that must be covered by the Government of Honduras: payment to volunteer educators and extension of coverage to the country's poorest and most remote areas; continuous updating of texts and ongoing training for educators; and maintenance of Internet access. To date, loan HO-L1062 has been the main source of financing. Although a trust has been formed with Claro and Tigo to support Internet expansion, the fiscal limitations of the Government of Honduras may call into question the future of the program.

3. Urban development

Implementation of the urban development project experienced delays due to weather events, the pause, and the institutional weaknesses of some of the units involved in its execution. The low-income housing program (HO-L1007) for US$30 million approved in 2006 should help to improve the housing and habitat conditions of low- and middle-income Honduran families by granting individual and collective housing subsidies, improving financial instruments for housing, improving the information available on the sector, and strengthening the Secretaría de Obras Públicas, Transporte y Vivienda [Ministry of Public Works, Transportation and Housing] (SOPTRAVI) and the Fondo Hondureño de Inversión Social [Honduran Social Investment Fund] (FHIS). The investments include drinking water, sewage, drainage, public lighting, social facilities, and mitigation works. Due to administrative and technical difficulties attributable to the area's rugged topography, and the climate of insecurity (e.g., attacks on workers, theft of materials, etc.), progress in construction was delayed.

The project made significant progress in achieving its objectives but its sustainability is at risk. In terms of progress made, the Bank disbursed 3,734 subsidies for housing improvements and 3,695 subsidies for the construction of new homes. The project completion report (PCR) indicates increases in access to water and sanitation and other basic urban services, and reductions in the levels of violence. However, it was not possible to create a market for microloans. There is no mechanism for continuing to monitor and maintain services in the areas of intervention, so there is a risk that the services provided will deteriorate. The second operation (HO-L1088) approved in 2012 has only disbursed 5.8% of its funds, and specific outcomes cannot yet be identified.

4. Transportation

The Bank primarily focused on executing the portfolio pending from earlier periods. At the start of the period, the sector's balances to be disbursed amounted to 94% of the total approved. Nearly all of the US$45.9 million allocated to the Tourism Corridor (HO-L1013) was intended to finance damages caused by weather events and to cover cost overruns on the Atlantic Corridor (HO-L1020). The Government of Honduras decided to finance that corridor through the private sector using the PPP method. The remaining highway projects experienced delays due to a series of complex factors, including the pause, problems acquiring rights of way, the resettlement of settlers, the absence of final designs, weakness of the executing agency (i.e., SOPTRAVI), deterioration of highways, scarcity of contractors in some areas, and the obligation to have contracts awarded after each legislative election ratified by the Congress. Many of these problems were resolved with the change of executing unit (see Box 2.1). As a result, operations HO-L1013 and HO-L1020 (Tourism Corridor and Atlantic Corridor) have disbursed all their funds; operation HO-L1033 (Agricultural Corridor) has disbursed 47%; and HO-L1018 (Logistics Corridor) has disbursed 7%.[65] The Tegucigalpa public transportation project (HO-L1061) has disbursed 84% of its funds and construction is moving ahead.[66] Lastly, the Puerto Cortés project was delayed until the decision was made, with help from the Comisión para la Promoción de la Alianza Público-Privada [Public-Private Partnership Promotion Commission] (CoAlianza) to issue an invitation to bid on the port operation.[67] The company with the successful bid is expected to deliver twice the square meters planned for the port in 2016.

Despite progress in making disbursements the expected physical goals have not yet been obtained. For example, none of the planned 37.1 kilometers have been constructed in the Tourism Corridor, only 80 of the 112 kilometers planned for the Logistics Corridor have been constructed, and 52 of the expected 56 kilometers have been constructed on the Atlantic Corridor.[68] In terms of results, the data on the basis of which to establish its progress has not been collected as yet. However, the administrative information available indicates there has been improvement in the quality of the highways and that, despite cost overruns on the Atlantic Corridor, the project continues to generate an economic return (EIRR 15%-17%).

The weakness of some key institutions jeopardizes the sustainability of highway projects. Privatization of the port's management seems to have improved its sustainability. In the first case, SOPTRAVI's performance has been intermittent in the past due to the inadequate technical level of its personnel, excessive turnover, and politicization of its human resources as well as the lack of mechanisms to ensure the transparency of its management. In the second case, the creation of CoAlianza, with support from the Bank, is a step in the right direction for managing PPPs like those being used to complete the Tourism Corridor and manage the Puerto Cortés containers terminal. The sustainability of the Tegucigalpa transportation project depends to a great extent on the conditions of the concessions and the definition of rates, which are complex problems that are difficult to resolve.

5. Environment and natural disasters

The Bank's support for the sector has served to alleviate some of the effects of natural disasters and has advanced the disaster prevention and mitigation agenda. However, the institutional and financial weakness of the institutions in charge of prevention and mitigation jeopardizes the consolidation of the Sistema Nacional de Gestión de Riesgos [National Risk Management System] (SINAGER). Consistent with the Bank's policy on the management of disaster risk,[69] the Bank's support for Honduras has focused on improving risk analysis capacity, implementing prevention and mitigation measures, improving the management of financial risk, strengthening the ability to respond to emergencies and to implement repair and reconstruction works following disasters. The portfolio executed during the period consisted of the Disaster Risk Management and Prevention Project (MITIGAR) operation (HO-L1031).[70] To date, 53% of its funds have been executed, primarily those related to the construction of the civil works component, whereas the components relating to the development of institutional capacity have shown moderate progress. In addition, the Bank executed 100% of two technical cooperation operations (HO-T1147 and HO-T1164) from the Ordinary Capital Fund Allocated for Natural Disaster Emergencies to provide food, first aid, and shelter to the victims of tropical storms in Francisco Morazán, Choculeta, and Valle. In addition, funds were used from the Tourism Corridors highway project (HO-L1013) to cover repair work after natural disasters. Despite these effects, the Comisión Permanente de Contingencias [Standing Committee on Contingencies] (COPECO) and municipal entities continue to lack the financial and technical resources they need to carry out their prevention and mitigation functions.

6. Digital agenda and telecommunications

The Bank's support for this sector has been modest in terms of the volume of funds and results, although ongoing dialogue with the Bank has served to guide the reforms. During the period, one operation approved in the previous period was executed and two new operations were approved. The objective of the first (HO-T1145) was to advance the design of a digital agenda through the sharing of experiences. There is no indication of any outcome. The objective of the other two operations (HO-T1152 and HO-T1161) was to prepare studies on reform of the telecommunications system in general and the Empresa Hondureña de Telecomunicaciones [Honduran Telecommunications Company] (HONDUTEL) in particular. The sector's legal-institutional framework has seen positive development but has yet to adopt some of the proposed measures, such as professionalization of personnel, liberalization of the sector, and privatization of HONDUTEL.

7. Water and sanitation

The Bank's program in this sector has obtained some partial results but not all the goals have been achieved nor have the institutional problems affecting the sector's effectiveness and sustainability been resolved. In 2006 the Bank approved an operation (HO0174) for

US$30 million to execute water and sanitation projects in municipalities, decentralize service, and improve institutional capacity. To date 62.26% of its funds have been disbursed. It also approved an operation (HO-X1017) with the Spanish Cooperation Fund for Water and Sanitation in Latin America and the Caribbean (SFW) for US$25 million to improve access to water and sanitation services in rural areas with fewer than 2,000 inhabitants. To date, 29% of its funds have been disbursed. As a result of the Bank's intervention, potable water has been provided to 396,515 beneficiaries (6,000 more than planned). However, only 60.10% of the goal with respect to the sewer system has been achieved (30,424 households). Service increased from 0.9 hours per day but did not reach the goal of 11.91 hours of service per day. Lastly, the project has not succeeded in having collections cover consumption expenses. Slow progress in execution and in achieving results is primarily due to the existence of slow bureaucratic processes (e.g. environmental licensing) and the limited technical capacity of the Servicio Autónomo Nacional de Acueductos y Alcantarillados [National Autonomous Aqueducts and Sewers System] (SANAA) and the Ente Regulador de los Servicios de Agua Potable y Saneamiento [Drinking Water and Sanitation Services Regulatory Authority] (ERSAPS). In addition, problems of coordination persist among the Consejo Nacional de Agua Potable y Saneamiento [National Water and Sanitation Council (CONASA), SANAA, ERSAPS, and FHIS and high turnover and politicization in the sector's leading entities.

8. Agriculture

During the period, problems were resolved in execution of the PRONEGOCIOS. At the start of the period, only 1.8% had been disbursed of the US$27.1 million under the PRONEGOCIOS program, approved by the Bank in 2008. As of July 2014, the Bank has already disbursed approximately 78% of those funds, thanks to actions adopted by the Bank and the Government of Honduras (see Box 2.1).

Preliminary information seems to indicate adequate progress made toward the achievements proposed. The evaluation results are not expected until the end of 2014. However, according to the information collected to date, households living in extreme poverty are being served by the conditional transfer cash program whereas the PRONEGOCIOS service model is better designed to reach poor households in rural areas. The established target of 3,500 households has already been exceeded; there are 78 businesses with an average internal rate of return (IRR) higher than 30% (the goal was an IRR higher than 12%), and 170 businesses are expected to be operating by the end of 2014 (two more than expected). There are still no data on increased incomes in the beneficiary households.

The intervention model ensures the sustainability of investments. To benefit from the program, projects must submit a financial viability plan based on a market study. Beneficiaries must also contribute up to 50% of the counterpart funds. All this helps to make the projects sustainable. One hundred percent of the projects remain in operation and are obtaining the goals set for each project (e.g., income, profitability, employment, sales, etc.). This contrasts with a 40% failure rate for similar companies in the country.

During the period of the Bank's country strategy for 2011-2014, the Bank has maintained significant financial relevance in the country, has made an effort to target its intervention, and, despite facing adverse conditions, has managed to substantially improve portfolio execution.

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4 Conclusions and Recommendations

The deterioration of the fiscal position could jeopardize the country's borrowing capacity and affects the financial sustainability of many of the Bank's operations. The Bank has undertaken significant efforts to improve fiscal performance through support for measures to control spending on payroll and social welfare institutes, increase tax revenues and improve public financial management, and support for the Honduran government for reaching a new agreement with the IMF. Despite these efforts, the fiscal deficit has grown to higher-than-expected levels.

During the period of the Bank's country strategy for 2011-2014, the Bank has maintained significant financial relevance in the country, has made an effort to target its intervention, and, despite facing adverse conditions, has managed to substantially improve portfolio execution, thanks to the adoption of a project-specific risk management approach. The increased volume of loans and improved disbursements increased the Bank's financial presence in the country as compared to the previous period. In addition, its presence in country went from 16 sectors to 10 sectors. Lastly, portfolio management has improved substantially with significant improvements in nearly all management indicators, thanks to actions attributable to both the Government of Honduras and the Bank, primarily related to the adoption of a contextualized approach for each project and proper management of the corresponding risks.

Nonetheless, responding in a more strategic and integrated manner to the country's development problems remains a challenge. The sectors prioritized in the country strategy and the program executed have been, in general terms, relevant to some of the many challenges facing the country. However, the improper functioning of certain elements related to the Bank's structure, processes and incentives, diagnosed in the Evaluation of the Results of the Realignment, hindered coordination between sectors and between

VPC and VPS in the preparation of the country strategy. As a result, the country strategy does not provide criteria for a clear understanding of the rationale for the Bank's intervention with respect to its comparative advantages and those of other donors (i.e. selection of development problems to be addressed, identification of which sectors face these problems, and the prioritization of projects). Moreover, significant inconsistencies have been identified between the various technical documents the Bank developed to prepare the strategy (e.g. sector technical notes and the growth study), which the Bank did not explain or justify. In addition, despite the fact that the resolution of development problems tends to require a multisector approach, the selection of the objectives in the country strategy, the preparation of the sector technical notes, and the design of projects tend to be addressed from a single sector in the Bank. While there has been a notable increase in the Bank's activity in the private sector, a clear strategy is needed to identify market failures to be resolved and coordinate them with other Bank operations.

Most execution problems are the result of operational designs that do not adequately weigh institutional and governance risks, or that include unrealistic procurement plans and complicated execution mechanisms. Delays in execution have occurred due to the technical and administrative weakness of the executing agencies and the legal-institutional frameworks of their respective sectors, politicization and high turnover of officials, or the existence of vested interests that are difficult to overcome. In some instances, there have been projects with unrealistic procurement plans or execution mechanisms inadequate to the proper performance of the operation. The impact of these problems has been partially mitigated by the increase in the number of specialists in the Country Office due to the pause.

Although many of the projects are achieving some of the desired results, their effectiveness and sustainability are threatened by the country's institutional and fiscal weakness. The weaknesses of the institutions intervening in program execution (e.g., DEI, ENEE, SOPTRAVI, etc.) impede the achievement of the objectives. The limited quality of the information available makes it difficult to perform good diagnoses, formulate good policies, and adequately monitor and evaluate interventions. In all cases where sustainability problems have been identified, there are underlying institutional capacity, regulatory, and financial viability problems.

Based on the findings from this evaluation, OVE makes the following recommendations:

1. Give priority to fiscal consolidation. For such purposes, it is recommended that the Bank continue work with the IMF and the World Bank in order to ensure a sustained process of fiscal consolidation that reduces risks related to program sustainability.

2. Design the country strategy based on the most critical development challenges, clearly defining the criteria for participation by the Bank's various sectors (including VPP), and for the prioritization of projects, while ensuring consistency between the diagnostic assessment and the country strategy. To do this, Management should consider:

a. Forming an interdisciplinary team to identify and determine the scope of the development problems faced by the country (e.g., worsening fiscal position, poverty, insecurity, low productivity, etc.) and their causes, based on the growth study, the government's priorities, and other necessary elements.

b. Including criteria explaining why the Bank is engaged in the solution to those development problems and the selection of the sector or sectors proposed for resolving them (e.g., in the case of the fiscal consolidation problem, possible actions could be considered in the area of revenues, expenditures, and weaknesses in the respective institutions (ENEE, COALIANZA, ERSAPS, FHIS, etc.), inefficiencies in the energy sector, potential contingent liabilities that may arise from PPPs, etc.). This could involve the preparation of multisector Technical Notes.

3. Strengthen the design of operations by: (i) conducting more rigorous institutional assessments; (ii) performing more realistic analyses of governance and financial sustainability; and (iii) engaging fiduciary staff more intensively in the design of execution, disbursement, and procurement mechanisms and plans for investment projects.

4. Devote greater efforts to building management capacity (e.g., human resources, financial and budgetary management, procurement, etc.) in the institutions responsible for projects in execution (e.g. DEI, the Police, SEFIN, SESAL, SOPTRAVI, etc.) and consider making disbursements for future policy-based loan operations contingent on effective changes in the management capacity of key institutions and in the institutional framework of their respective sectors in order to improve their governance.

5. Include in future country strategies the sectors corresponding to each country's existing portfolio in order to facilitate their execution and the continuity of the relevant dialogue, as OVE has recommended in prior CPEs.

1 In 1999, following Hurricane Mitch, the Stockholm Declaration Follow-up Group (G-16) was formed to monitor the reconstruction process and subsequently, the country's transformation.

2 The political crisis began with the departure of Manuel Zelaya in June 2009. See http://www.oas.org/es/centro_noticias/comunicado_prensa.asp?sCodigo=C-219/09

3 Central Bank of Honduras, Economic Commission for Latin America and the Caribbean (ECLAC) (2014).

4 IDB, Honduras Monthly Newsletter.

5 World Bank. *World Development Indicators.* Estimated figure for year-end 2012.

6 Pagés, C. 2010. *The Age of Productivity.* Inter-American Development Bank, Washington, D.C.

7 ECLAC (2014). Economic Outlook, ECLAC, Chile, p. 31.

8 The GINI coefficient is 57. See *World Bank* http://data.worldbank.org/indicator/SI.POV.GINI.

9 World Bank. *World Development Indicators.* Estimated figure for year-end 2012.

10 Ibid.

11 See World Bank. *Worldwide Governance Indicators*, http://www.worldbank.org/wbi; Doing Business, http://www.doingbusiness.org/data/exploreeconomies/honduras/, and *Informe sobre la situación del servicio civil en América Latina* (IDB, 2006).

12 See Central American Bank for Economic Integration (CABEI), *Ficha Estadística de Honduras*, 2014 and Carrión, F. and M. Dammert, comp. 2009. *Economía política de la seguridad ciudadana*. FLASCO, Quito, Ecuador.

13 *Germanwatch Global Climate Risk Index* 2014. http://germanwatch.org/en/download/8551.pdf.

14 IDB-TN-169 Indicators of Disaster Risk and Risk Management: Program for Latin America and the Caribbean (Honduras), IDB 2012.

15 Auguste, S. 2010. Competitividad y Crecimiento en Honduras. IDB. Washington, D.C.

16 Comprehensive Natural Disaster Risk Management Program of Honduras, Annex 2, IDB, 2011.

17 Rust is caused by the *Hemileia* vastatrix fungus that causes coffee plant leaves to fall prematurely.

18 See Figure 1.1 of the Annex and Honduras Monthly Newsletter. IDB. February 2014.

19 The total public sector wage bill went from 11.1% of GDP in 2009 to 9.5% in 2013 (SEFIN).

20 IMF, 2013. Staff Report for the 2012 Article IV Consultation.

21 SEFIN, Year-end 2013.

22 IMF, 2014. 2014 Article IV Consultation with Honduras.

23 The 2007-2010 CPE indicated that in the worst-case scenario, debt would not reach 30% of GDP in 2015.

24 The legislative changes approved include the *Law on the Reorganization of Public Finances, Control of Exemptions, and Anti-evasion Measures,* the purpose of which is to expand the income tax base, regulate exemptions granted, the sales tax, and customs duties on imports. These changes are expected to increase revenues by up to 4%. However, the Honduran Congress relaxed the measures, particularly as regards exemptions, so that the initial objective could not be achieved.

25 The key factors contributing to the backlog of balances to be disbursed include the implementation of debt relief and the Bank's concessional financing reform in 2007. For Honduras, the annual average for SG investment loans approvals during the period 2003-2006 was US$95 million, while in the period 2007-2010 the figure was US$130 million, an increase of 36%. The global financial crisis also meant supplementary allocations for the period 2009-2010, doubling the amount of FSO resources for Group D2 countries compared to the period 2007-2008 (paragraph 3.3 of document GN-2442-34). Lastly, as a result of the crisis in late 2009, the Bank approved a waiver of the no-carry-over policy for FSO resources for Honduras to allow the entire amount of funds allocated for the 2009-2010 cycle but not approved during 2009 to be used in 2010 (paragraph 3.5 of document GN-2442-34).

Notes

[26] Legislative Decree 286-2009, dated 2 February 2010.

[27] The Bank's country strategy proposed maintaining dialogue in the following six additional sectors: food security, early childhood development, labor markets, telecommunications, fiscal sustainability, and citizen security.

[28] The Bank classified this operation under the category of "Social Investment," not "Public Management."

[29] During the previous period, to support this sector, the Bank approved the Fiscal and Municipal Management Consolidation Program (HO-L1015) for US$28.6 million and the PBL for the Fiscal Reform Support Program for US$45.8 million.

[30] Despite significant advances such as the approval of the new Law on Cooperatives on 28 August 2013, the regulation thereof by the National Bank and Insurance Commission is voluntary and lacks standards. The same holds true for regulation of conditional cash transfers (mobile banking and electronic payments), at both the financial and communications levels, to increase financial inclusion. Challenges also exist in enhancing the transparency of services and the financial culture in Honduras.

[31] The Bank approved four Trade Finance Facilitation Program (TFFP) operations: two to support Banco Atlántida (HO-L1094 and HO-L1098), one to support Banco Lafise (HO-L1095), and another for Banco Ficohsa (HO-L1096). The Bank's TFFP does not prepare specific intervention strategies to identify market failures in each country, as it is understood to respond to needs common among all countries in the region. The Bank also approved a technical cooperation operation (HO-T1097) to strengthen the country's ability to attract foreign investment; a technical cooperation operation to strengthen the authority responsible for public-private partnerships (COALIANZA); a pilot experiment to support the productive and commercial integration of SMEs; and an NSG operation for US$30 million to internationalize SMEs.

[32] See the Preface.

[33] The operations were designed to strengthen the quality of the educational offering; estimate the fiscal cost of expanding services for education; expand the coverage of pre-school programs; strengthen the quality of programs in primary education; and seek alternatives for the third and fourth cycles.

[34] Document RE-541-2, pp. 18-21 and 28-30.

[35] For example, given the country's vulnerability to pests and its rates of rural poverty and the Bank's extensive experience in this sector, a discussion in the country strategy of why the Bank was not taking action to improve agricultural productivity and phytosanitary considerations could be considered missing. See paragraphs 1.1-1.3. The World Development Report (2008) concludes that investment in agriculture is up to three times more effective in reducing poverty than investment in other sectors.

[36] The six Sector Technical Notes for the following sectors: public management, financial system, energy, social protection programs, health, and fiduciary matters; and the growth study: Auguste, S., 2010. *Competitividad y Crecimiento en Honduras.* Inter-American Development Bank, Washington, D.C.

[37] See note 36 above.

[38] OVE was able to validate during visits and interviews that the sectors in the country strategy are highly correlated with the respective sector divisions in the Bank. Moreover, the strategy's indicators are, in many cases, project level indicators.

[39] Note that, despite these added difficulties, the Bank improved execution of the portfolio during the period (see paragraphs 2.14-2.21).

[40] In addition, three investment grants were approved for US$33.4 million.

[41] A total of seven MIF grant operations were also approved in the amount of US$5.5 million but are not being evaluated.

[42] Document RE-390.

[43] See document RE-390, paragraphs 3.7-3.9.

[44] However, the age of the Bank's portfolio with Honduras remains above the average for FSO countries and other Country Department Central America, Mexico, Panama and Dominican Republic (CID) countries.

[45] Executing agency representatives interviewed said that these differences could be explained in part by the fact that the Team Leaders for World Bank projects are located outside the country, making communications difficult.

[46] The Control Tower was created during Ricardo Maduro's administration.

[47] In addition, the Country Office, in collaboration with the Bank's training department (KNL) has trained more than 100 employees of 15 executing units on project execution (75 of whom were specifically trained in PM4R between 2012 and 2013).

[48] The representatives of executing units interviewed reported that prior to this measure, there was confusion in the assignment of responsibilities for project execution between team leaders and operations analysts, which delayed the Bank's response.

[49] In addition, two technical cooperation operations were approved in December 2013: one to strengthen INPREMA (HO-T1194), and another to support strengthening of macrofiscal governance (HO-T1200).

[50] Operations HO-L1015, HO-L1030, HO-L1055, and HO-T1134 were approved before 2011 but continued to be executed during the period under evaluation.

[51] Governance, institutional, and execution risks were not adequately evaluated and the execution and procurement plans were not realistic and they had to be amended.

[52] The INPREMA deficit fell to 13%; IHSS revenues for contributions as a percentage of GDP were at 1%; the percentage of government staff hired by the SIAFI rose to 75%; 100% of the Secretariats of State publish their budgets on the SEFIN portal in real time; 100% of the macroeconomic statistics series produced are published; collection per DEI employee has been exceeded; and the 60 positions in the State Modernization Unit have been filled. As for the fifth outcome, already 19 of the planned 25 municipalities are recording their accounts in the Municipal Administration System. The remaining six are expected to do so this year.

[53] See paragraphs 1.7-1.9.

[54] Particularly thanks to the development of a revenue projection model, a subsidies simulation model, and energy sector reform studies (HO-T1143).

[55] The Bank has classified this project under the category of "Trade." However, it includes a component for improving the efficiency of the DEI's customs collection operations at the port, which is consistent with the objective of improving the fiscal position.

[56] The redefinition of the program included the creation of Community School Committees, in which the participation of the Ministry of Health and Education in the verification of shared responsibilities was promoted. However, the lack of flexibility in the adjustments to the program's rules of operation and limited information provided to local authorities on the beneficiary populations required the establishment of an operations office to do field work to expand the discussions and strengthen institutional credibility. This caused delays in the operation of the program because new design, procurement, and implementation processes had to be coordinated. Moreover, the lack of identity cards and difficulties verifying joint responsibilities for students caused delays.

[57] University of Chicago and ESS Consultores. (2013). *"Primera Evaluación de Impacto del Programa Presidencial de Educación, Salud y Nutrición "Bono 10.000" en Zonas Rurales de la República de Honduras."*

[58] Note that an operation was approved to support Honduras in joining the MER. See paragraph 2.3.d above.

Notes

[59] However, in terms of outputs, Banco del País (HO-L1085) increased its SME portfolio from 2,826 in 2010 to 6,753 in 2013, more than doubling the objective for 2015 (3,390). This number reflects the efforts by Banco del País in further downscaling, with the addition of 5,640 new micro clients and 792 new SME clients. Banco del País also increased the volume of outstanding loans from US$571.2 million in 2011 to US$714 million in December 2013, again exceeding its target for 2015 of US$685.4 million.

[60] The UEPEX is a module of the SIAF, used exclusively for the management of Project Execution Units with external financing.

[61] As the Urban Development sector was not identified in the country strategy, project HO-L1088 for US$17.2 million, which provided continuity for HO-L1007 and was approved in 2006, was submitted as a security project. Although it is true that some of the impact indicators are crime reduction indicators and that urban development (i.e., situational prevention) can be an effective crime prevention vehicle, the program clearly involves urban development.

[62] Despite this, it has been possible to make some progress such as conducting studies, designing police training programs, and designing the pilot for the Safer Municipalities program.

[63] However, there is evidence that these operations are yielding results. For example, between 2011 and 2014, 48 guarantees and five direct loans were granted under the TFFP to support foreign trade from Honduras. These transactions facilitated 116 individual foreign trade operations for a nominal value of US$175.8 million and an Average term of 162 days. Of these individual operations, 37% were exports from Honduras to the rest of the world. In terms of products, 32% of exports financed under the program were agricultural products, 26% manufactured goods, and 23% processed foods. On the import side, 60% of imported products were gas and oil, and 20% were manufactured goods.

[64] The "Reverse Trade Fair" method was adopted so as to have various providers for the electrical work in the schools.

[65] This project was delayed due to the relocation of the families affected. The executing agency found a solution to the problem and it is expected that it will soon be possible to speed up the pace of execution. There have been no disbursements as yet from the supplementary financing (HO-L1089) to cover cost overruns on the Atlantic Corridor.

[66] Ninety-eight percent of the six kilometers in the first section has been completed while only 65% of the second section has been completed. The third section has been put out for bids but has not been awarded as yet.

[67] CoAlianza was established by a law enacted by Congress in 2010 to promote and manage public-private contracts in the development, execution, and management of public works and services.

[68] The delays in each corridor have different causes. In the case of the Tourism Corridor, they are because funds were used for emergencies. In the case of the Atlantic Corridor, they are due to cost overruns. In the case of the Logistics Corridor, they are due to problems related to relocation of the settlers affected.

[69] Document GN-2354-5.

[70] This operation was prepared using funds from technical cooperation HO-T1102 for US$1 million.