

**TRANSITION AND SOCIAL PROTECTION PROGRAM****(HO-0145)****EXECUTIVE SUMMARY**

<b>Borrower and guarantor:</b>	Republic of Honduras	
<b>Executing agency:</b>	Office of the Secretary of State in the Office of the President, through the Technical Support Unit (UNAT)	
<b>Amount and source:</b>	IDB: (FSO, foreign exchange)	US\$30 million
	Total:	US\$30 million
<b>Financial terms and conditions:</b>	Amortization period:	40 years
	Disbursement period:	18 months
	Grace period:	10 years
	Interest rate:	1% for 10 years and 2% thereafter
	Inspection and supervision:	1% of the loan amount
	Credit fee:	0.5% annually on the undisbursed balance.
<b>Objectives:</b>	<p>The goal of the program is to help improve the living conditions of the impoverished population. In the post-Mitch context, the most important initiatives for achieving this goal are those that help reconstruct and transform the social sector in accordance with the three following objectives.</p> <p>First, the budget crisis spurred by the hurricane will be prevented from interrupting the process of transformation of the social sector launched before Mitch into models for greater efficiency and participation in the provisions of services. Second, a significant increase in the sector's management and implementation capacities will be achieved, without which it will be impossible to provide the levels of social services that are required or to initiate new reforms. Third, the formulation of a policy framework for the sector will be promoted, that sets it on a course toward greater coordination, participation, and transparency.</p>	

**Description:**

In years past, various social sector initiatives were not satisfactorily implemented owing to the weak capacity of the line ministries, and the lack of an adequate policy framework. The hurricane has simply made this situation worse. In this context, the program will use a fast-disbursing sector loan to support a series of concrete measures and policy decisions designed to preserve the progress already achieved in the transformation process, while at the same time instituting measures for management and efficiency that will later lead to a more in-depth reform of the sector and to higher quality and coverage of social services.

The program has been structured to ensure that previous gains are not lost; to promote measures that reduce management and implementation weaknesses on the part of the line ministries; and to develop the institutional capacity that will ensure a rational, transparent use of public resources.

The program components are described below.

- (i) **Protection of priority programs:** In times of severe fiscal problems, such as the one caused in Honduras by Hurricane Mitch, investment programs and reform initiatives are generally more vulnerable to cutbacks than are recurrent expenses. Therefore, this component seeks to ensure that specific programs highlighting the sector's transition to more efficient service delivery and broader participation by the public are not interrupted. To that end, financial and physical goals will be achieved in the areas of education, health, and social welfare in order to obtain real increases over the levels reached during the previous year in general.
- (ii) **Improving managerial capacity:** Before the hurricane, the limited absorption capacity of the line ministries in the social sector already presented a bottleneck for implementing projects that introduce new modalities and procedures, for launching new reform initiatives, and for expanding the provision of services. The situation has grown worse because of Mitch, increasing demand while further reducing the implementation capacity of the ministries. Therefore, this component will establish strategies for implementing efficiency measures. Existing programs will be relied upon to provide continuity in the efficiency measures launched by this program.

- (iii) **Policy framework:** Coordination in the sector needs to be institutionalized, particularly during a period of nationwide reconstruction and transformation. Therefore, a new agency will be established for the sole purpose of promoting the formulation and implementation of social policies. This agency will foster the development of sector strategies, set overall goals, coordinate mechanisms and procedures, and maintain coordination facilities for maximizing the impact of the initiatives launched. Furthermore, after consultation with the parties involved, the government will implement a municipal development plan, which will set forth strategies for consolidating methodologies, assigning functions, developing procedures that guarantee the full participation of the agencies involved, and implementing oversight and evaluation mechanisms.

**Relationship of project to Bank's country and sector strategy:**

The program is consistent with the mandate of the Eighth General Increase in Resources of the Bank with regard to the priority assigned to the social sector and to loans in support of political reforms in that sector, which must be linked to the country's commitment to provide internal resources for certain priority programs. Furthermore, it is consistent with the mandate to emphasize public sector reform, including budget and spending policies. (AB-1704, paragraphs 2.52 and 2.54)

The program is also consistent with the country paper for Honduras currently pending approval by the Board of Executive Directors of the Bank. The program reflects the support program for the 1999-2001 period, submitted to the Bank by the Government of Honduras, which assigns high priority to promoting the institutional strengthening of the units responsible for implementing Bank-financed projects.

The program is consistent with the country paper strategy, since it will promote improvements in the capacity for action of the executing units in the social sector. The operation is also consistent with the goal of alleviating poverty through actions to improve access to social services for vulnerable groups and to reduce rural poverty. The operation is also part of the coordinated efforts of the IDB, the International Monetary Fund, and the World Bank to support the reconstruction and transformation of the country, emphasizing macroeconomic stability, consolidation of social sector reforms, and the protection of the most vulnerable groups (paragraphs 1.20-1.25).

**Environmental and social review:**

With regard to gender issues, the role of the indigenous population, and environmental protection, the project will follow the arrangements that have already been established for the social programs and projects that will be supported by this operation. In the areas of education, health, and welfare, the projects and programs have primarily been developed with the participation of international agencies, – including the IDB, the World Bank, GTZ, USAID, etc. Hence they incorporate the standards of these institutions with regard to environmental and social considerations. Furthermore, all the programs comply with the country's environmental standards and procedure (paragraph 4.11).

The initiatives to be undertaken for establishing consensus-based procedures for formulating policies and setting priorities must be underscored. The program will make a fundamental contribution to opening up new avenues for the participation of civil society in formulating strategies and in carrying out activities in the social sector. Furthermore, the component for the protection of priority programs will support initiatives by the Ministry of Health to devote a portion of its budget to covering the costs of maintaining infrastructure and treating hospital waste (paragraph 4.12).

**Benefits:**

The program will contribute to improving the living conditions of the impoverished population through measures that ensure that there will be no interruption in programs mainly designed to provide social services and allocations for underserved, needy groups. This will result in greater equality in the provision of social services (paragraph 4.15).

The focus on increasing management capacity is of vital importance at this time since Hurricane Mitch has increased demand while simultaneously reducing the management capacity of the agencies that implement social programs. The program will give the line ministries comprehensive strategies for increasing their capacities, which will enhance the viability of any preexisting or new initiative in the sector (paragraph 4.16).

Initiatives for the policy framework of the social sector are a very high priority for the country, given that the lack of effective coordination is even more important at the moment when a nationwide reconstruction and transformation effort has been mounted and new interventions are expected in all areas. Not only will the program establish links for interagency exchanges and cooperation, but it will also strengthen the mechanisms for

consensus-building among the agencies involved in both formulating and implementing social sector policy (paragraph 4.17).

**Risks:**

**Consistency of strategies:** The government's strategy for reconstruction is consistent with the program objective of preserving advances made in social sector transformation and laying the foundation for new improvements. Nonetheless, there is heavy demand to act immediately to repair the damage caused by Hurricane Mitch, even at the expense of previously achieved reforms. The intense political pressure created by this demand is a palpable risk in terms of accomplishing the program's goals, since the program aims at more deliberate advances by building consensus on development policies, formulating projects that reflect lessons learned, and taking advantage of the massive reconstruction to set the country on a new course of development. It is therefore very important that the government fully commit to the program goals. Note should be taken of the initiatives already taken to establish effective coordination links and monitoring systems, in order to avoid any deviations from the conditions agreed upon (paragraph 4.18).

**Special contractual conditions:**

(i) The loan will be disbursed in two tranches, in the amounts of US\$20 and US\$10 million, respectively. As a condition precedent to disbursement of each tranche, the borrower will present evidence satisfactory to the Bank that: (i) the macroeconomic environment is consistent with the program objectives; and (ii) the conditions established for the program components, indicated in the conditionality matrix attached as Annex I to this document, have been fulfilled (paragraph 3.26).

(ii) In addition to the standard reports, UNAT must submit the final report described in section E of chapter III.

**Poverty-targeting and social-sector classification:**

This operation qualifies as a project as a social equity enhancing project, as described in the key objectives for the Bank's activities set forth in the Report on the Eighth General Increase in Resources (document AB-1704).

**Exceptions to Bank policy:**

None

**Procurement:**

Not applicable, as discussed in paragraphs 3.33-3.36.

## **I. BACKGROUND**

### **A. Challenges in the social sector**

- 1.1 This decade began with approximately 75% of Hondurans living below the poverty line, and despite all the efforts of the Government of Honduras the proportion is expected to be even higher in 1999. The "poor", as they are called, are characterized by being commonly locked into a vicious circle based on poor nutrition, high exposure to health risks, scanty and ill-defined skills for the workplace owing to inadequate and poorly targeted education, and low incomes. These same deficiencies result in an extremely limited capacity to break the inter-generational cycle of poverty on their own, and therefore they require outside interventions, in this case by the State, in order to improve their living conditions.
- 1.2 The limited advances made in poverty reduction are explained, in part, by the country's relative inability to achieve equitable growth and by poor arrangements and inefficiencies in the models and mechanisms used for channeling social spending.
- 1.3 Between 1990 and 1997, the per capita GDP (in constant 1990 U.S. dollars) rose only a modest US\$14, increasing from US\$686 to US\$700. Additionally, the scant advances achieved in economic growth were diluted, and did not benefit the poor in a significant way given the unequal distribution of income (Gini coefficient 0.54), and the high growth rate of the population (3% annually). The combination of these factors means that if the growth rate remains at historic levels (2.4% per year), it will be another 20 years before half the population rises above the poverty line.
- 1.4 With reference to social services, some significant advances were made in the coverage of primary education and preventive medical services, while the mortality rate was cut at the same time. Since 1990, the percentage of social spending relative to total spending by the central government rose slightly, from 28% to 29%. It is important to note that this increase does not reflect an expansion in spending on the part of the line ministries, but the introduction of two special programs – FHIS and PRAF – which were created in 1990 to overcome the ministries' difficulties in providing for the needs of the most impoverished population. Since that time, FHIS (Honduras Social Investment Fund) has been in charge of building the basic social infrastructure in the poorest areas; at the same time, encouraging changes toward models of greater community involvement have occurred. PRAF (Family Allocation Program) provides incentives for improving nutrition, the health of mothers and children, and school attendance among the most impoverished families. Additionally, a momentary dip occurred in 1993 with the passage of the Municipalities Act, which increased the resources transferred to municipalities to provide services at the local level.
- 1.5 The following table shows the relative involvement of the institutional players in the social sector in overall government spending in 1990 and 1997. It is noteworthy

that the relative participation in social spending by the two main ministries (education and health) decreased over the period, to make room for the special programs, FHIS and PRAF.

**Distribution of Social Spending as a Percentage of Total Government Expenditures**

Area	1990	1997
Education	16.2	15.7
Health	10.4	8.1
FHIS	0.3	3.1
PRAF	0	1.4
Transfers to municipalities	0.7	1.1
Total	27.6%	29.4%

Source: Ministry of Finance figures, 1999.

- 1.6 The fact that special programs like FHIS and PRAF have been more successful in providing solutions for the most impoverished populations underscores the feasibility and need for changing the models that the line ministries use in carrying out their spending. This implies changes in the administrative and financial management systems and in the technical models applied to beneficiaries.
- 1.7 In fact, the models and systems applied by the line ministries or managing their spending and providing social services was characterized by: (i) allocating nearly all resources to operating expenses, limiting the amounts available to expand services; (ii) concentrating decision making at the central level; (iii) inefficient financial management, due among other thing to lack of independence from the Ministry of Finance; (iv) inequitable delivery of services that discriminates against rural areas and pockets of poverty; and (v) agencies that lack systems and procedures to ensure efficient administrative management.
- 1.8 As part of an effort to initiate transformation of those ministries, in recent years a series of initiatives has been undertaken to restructure the line ministries, to improve the provision of services at the primary level, and to focus decision-making authority at the point where services are delivered. In this respect, emphasis must also be placed on initial efforts at decentralization that are seeking to strengthen the mechanisms of participation, and to increase efficiency and sensitivity to demand by transferring responsibility and resources to municipalities and communities.
- 1.9 According to national legislation, transfers to municipalities must be at least 5% of fiscal resources. However, over the past few years, due to managerial weakness on the part of the municipalities and the lack of central government resources, the government has not been able to achieve the 5% goal. It should be noted in this connection that most of the municipalities do not have the internal capacity to generate significant amounts of resources and the transfers are therefore very

important for management of those municipalities, the viability of their being delegated greater responsibilities, and for the provision of basic services to the communities. Given the leading role the municipalities play in advancing the process of delegating authority to the local level and meeting basic community needs, municipal development should be a component of the proposed sector program.

- 1.10 Given the important of the transfers for the vast majority of the 298 municipalities, note should be taken that in the Policy Letter (Annex II), the government has indicated its intention of gradually strengthening the municipalities by increasing the respective annual contribution until it reaches 5%. Moreover, an initiative has been taken to amend the applicable legislation in order to increase the proportion of the transfers allocated to the neediest municipalities. And a legislative amendment is being processed to ensure greater stability in the technical teams that are usually replaced every time a new municipal government takes office. The latter two initiatives will help eliminate major obstacles to greater transfers of resources and delegation of authority to the local level.
- 1.11 Over the years, the number of municipalities has gradually risen. The problem is that in many cases, the new municipalities do not have a solid financial foundation to provide for proper management, limiting their capacity to provide services to the communities. During preparation of the proposed sector program, the potential benefit of strengthening the regulatory framework was identified with regard to the criteria necessary for the establishment of new, financially viable municipalities. However, given the current situation in Honduras due to Hurricane Mitch, consideration of that matter had to be postponed to a future stage. In this context, the most relevant and feasible approach was to create new mechanisms to group existing municipalities in order to share costs and create economies of scale.
- 1.12 The proposed sector program includes measures that will help strengthen the transparency and efficiency of activities to develop the poorest municipalities. In addition, it will support new arrangements for the association of poor municipalities.

## **B. The impact of the Hurricane**

- 1.13 The transition process was interrupted in dramatic fashion in late 1998, when Hurricane Mitch lashed the country with devastating force, wiping out many of the advances that had been achieved and weakening the public sector's already limited capacity to take care of social needs.
- 1.14 The emergency forced the government to reorient its strategies radically. Essentially, an agenda of national reconstruction was given preference over all previous plans and strategies. This is a decisive moment in the history of Honduras, since the reconstruction deals not only with replacing what has been damaged, but with viewing the crisis as an opportunity for the country to set off on a new path to

development. In this sense, there exists a general agreement that the models that characterized the past, in terms of the State's interventions, must be changed in order progressively to incorporate dimensions of efficiency, transparency, decentralization, equality, the active participation of civil society, and mitigation of environmental vulnerability.

- 1.15 To this end, the government formulated specific plans for each sector, which were consolidated into a Master Plan of National Reconstruction. The plan was submitted to the Consultative Group in Stockholm this past May, in order to promote support from donor countries to the national reconstruction and transformation effort. Nonetheless, the government still has to strengthen its capacity to implement the new initiatives presented to the donors for the various sectors.
- 1.16 In this regard, there is an explicit acknowledgment on the part of the authorities and the multilateral institutions of the indispensable need to continue to improve the managerial capacity of the line ministries, so that new investment programs can be more successfully carried out.

### **C. The macroeconomic program**

- 1.17 Before the hurricane, the government and the International Monetary Fund (IMF) were prepared to formalize an Enhanced Structural Adjustment Facility (ESAF). Nonetheless, the magnitude of the upheaval caused by the disaster decisively altered the conditions underpinning that economic and social development program. On March 26, 1999, a modified version of the ESAF was approved, establishing the macroeconomic outlines for managing the country's economy. One objective of the ESAF is to improve the administration and management of public spending, in order to address pressing social needs.
- 1.18 The challenge facing the government is enormous. It is expected that the impact on production will be reflected in a decrease in GDP of 1 to 2% in 1999; inflation will be over 14%, and there will be a current account deficit of over US\$600.0 million. The heavy external debt is in addition to these sums; debt service accounts for 11% of the GDP, over 22% of exports, and nearly a third of public spending. More than half of the US\$3.9 billion debt cannot be rescheduled because credits with international agencies are involved (the IDB is the main creditor, with 23% of the total).
- 1.19 The financial situation is such that, despite the transfer of outside donations and the partial forgiveness of the debt payment, the government will still need to have recourse to additional financing through new credits and through increased budget deficits. Without additional outside financing, it will be impossible to maintain the level of essential services while simultaneously addressing the urgent demands of reconstruction.

**D. The strategy of the Bank**

- 1.20 In 1996, the Bank approved a sector loan (967/SF-HO) to support a public sector reform program that included measures to increase the proportion of spending by the Ministry of Education and Ministry of Health allocated to primary education and primary health care, respectively. In addition, through a parallel technical-cooperation loan (968/SF-HO), the project sought to launch a reorganization of the institutional structure of the two ministries in order to improve their efficiency. In the social sector, the project was to help initiate a long-term reform of education and health, and was designed to rely on subsequent operations to achieve further progress.
- 1.21 Under this strategy, in 1997 and 1998, the Bank approved loan 1000/SF-HO for the alternative education program and loan 1005/SF-HO for the program for institutional reorganization and reorganization of basic health care services. Both projects include the introduction of new arrangements and models to lay the foundations for the sector transition process and supplement the activities launched under the technical-cooperation project for public sector reform.
- 1.22 The proposed sector program (HO-0145) was designed taking into account the Bank's experience in the above three operations. The first component of the new program also includes financial goal, but instead of seeking increases in overall primary education and health case, it seeks to protect specific investment programs that not only provide primary level services but also target the most vulnerable groups, ensure greater decentralization, protect the environment, and improve maintenance. The second component of the proposed new program includes as an integral part of it the measures necessary to strengthen the execution and management capacity of the line ministries. In essence, the component will ensure the continuity of these measures through reformulation of the two previous projects (loans 1000/SF-HO and 1005/SF-HO), in order to better reflect the demand generated by Hurricane Mitch, to expedite their execution, and to increase their contribution to the transition process. The third component introduces new issues that reflect the priorities indicated at the recent Consultative Group meeting in Stockholm: the need to institutionalize social sector coordination, make progress in the decentralization process, and increase participation by civil society.
- 1.23 This program is consistent with the mandate of the Eighth General Increase in Resources with respect to the priority given to the social sector and to loans in support of political reforms in that sector, which must be accompanied by the country's commitment to allocating internal resources for certain priority programs. In addition, it is consistent with the mandate to emphasize public sector reforms, including budgetary and spending policies. (AB-1704, paragraphs 2.52 and 2.54).
- 1.24 The proposed sector program is consistent with the country paper currently being processed for approval by the Board of Executive Directors of the Bank. The paper reflects the support program for the 1999-2001 period submitted by the

Government of Honduras to the Bank, that assigns high priority to efforts to support the institutional strengthening of the units responsible for implementing the projects financed by the Bank.

- 1.25 The program is consistent with the country paper strategy, since it will promote improvements in the capacity for action of the executing agencies in the social sector. The operation is also consistent with the goal of alleviating poverty through actions intended to facilitate access to social services on the part of vulnerable groups and to reduce rural poverty. The operation is also part of the coordinated effort of the Bank, the International Monetary Fund, and the World Bank to support the reconstruction and transformation of the country, emphasizing macroeconomic stability, consolidation of social sector reforms, and the protection of the most vulnerable.

## II. OBJECTIVES AND DESCRIPTION

### A. Goals and objectives

- 2.1 The goal of the program is to contribute to improving the living conditions of the impoverished population. In the post-Mitch context, the most important initiatives for achieving this goal are those that contribute to the reconstruction and transformation of the social sector in accordance with the three following objectives.
- 2.2 First, the budget crisis spurred by the hurricane will be prevented from interrupting the process of transformation of the social sector into models of greater efficiency and participation in the provision of services, which began before Mitch. Second, a significant increase in the capacity for management and execution will be achieved in the sector, without which it will be impossible to provide the levels of social services required or to initiate new reforms. Third, the formulation of a policy framework for the sector will be promoted, setting it on a course toward greater coordination, participation, and transparency.

### B. Description

- 2.3 In years past, various initiatives in the social sector were implemented unsatisfactorily owing to the weak capacity of the line ministries, and the lack of an adequate policy framework. The hurricane has simply made the situation worse. In this context, the proposed program uses a fast-disbursing sector loan to support a series of concrete measures and policy decisions designed to preserve the progress already achieved in the transformation process, while at the same time instituting measures for management and efficiency that will later lead to a more in-depth reform of the sector and to higher quality and coverage of social services.
- 2.4 Proceeding on this basis, the program has been structured to ensure that previous gains are not lost; to promote measures that reduce weaknesses in management and execution on the part of the line ministries; and to develop the institutional capacity that will ensure a rational, transparent use of public resources.
- 2.5 The operation will be a fast-disbursing sector loan to support a set of concrete measures and policy decisions. It is based on the policy letter (Annex II), which sets forth the broad outlines and overall objectives. The specific conditions are presented in the conditionality matrix (Annex I) and are reflected in the loan contract. The activities described to fulfill each condition are presented in chapter III of this document.
- 2.6 **The conditionality matrix:** It should be noted that the analysis of the problems and the specification of corrective measures presented in the matrix were developed jointly with the agencies responsible for their implementation, and with the

Program Coordination Unit, which will coordinate its implementation. In all cases, the viability of fulfilling each condition within the time frame stipulated has been confirmed, as has the timely availability of the resources needed to support implementation.

- 2.7 **The macroeconomic context:** The program will be implemented in the macroeconomic context defined by the ESAF. Stability and economic growth are essential elements for improving the living conditions of the impoverished population, especially with respect to controlling inflation and generating employment. One global condition that will apply to the program as a whole is that it must maintain a macroeconomic environment that is consistent with the program's objectives. The other conditions have been grouped into three components described below.
- 2.8 **The components:** The first focuses on setting specific goals for existing programs the uninterrupted continuation of which is key to preserve the progress achieved in transforming the sector. The second component supports the formulation of strategies to guide the implementation of efficiency improvement measures that will subsequently lead to more in-depth reforms under other already existing programs. The third component will strengthen the policy framework in the sector and the institutional structures that implement that framework.

### **1. Component one: protection of priority programs**

- 2.9 Prior to the hurricane, the government had recognized the need to change the traditional mechanisms used to provide social services. Consequently, it opted to introduce special programs exclusively targeting the most impoverished groups, and it began gradually to transfer resources and responsibilities to the municipalities. It is essential that these transition measures in the sector not be interrupted owing to the budgetary crisis caused by the hurricane.
- 2.10 In times of severe fiscal problems, such as the one caused in Honduras by Hurricane Mitch, recurrent expenses associated with providing traditional services (mainly salaries and other operations categories) are inflexible owing to legal and administrative structures, which makes it difficult to reduce them. By contrast, innovative programs and investment costs are generally more vulnerable to budget cuts. Therefore, there is a risk that innovative programs may be interrupted, the quality of spending may decline, and the pace of transition in the sector may be slowed or stopped.
- 2.11 The objective of this component is therefore to ensure that specific programs that highlight the transition of this sector are not interrupted. To that end, through teamwork with the respective ministries and government agencies, a list of priority programs to be protected has been identified in the areas of education, health, and social welfare, in order to achieve real increases over the levels reached during the previous year, in general.

- 2.12 The list of selected programs is presented in chapter III. The selection criteria were essentially: (i) providing social services at a basic primary level; (ii) pilot initiatives for testing new models, structures and systems; (iii) priority attention to the most vulnerable groups; (iv) attention targeting rural areas; (v) delegating functions to local offices, municipalities, communities, and civil society organizations; (vi) maintaining physical infrastructure; and (vii) mitigating adverse environmental impact. In all cases, the selected programs are to be financed, at least in part, by national resources.
- 2.13 The program's technical annexes provide documentation about each of the selected programs, including: the objectives and a description of each program; the sources of financing (distinguishing national budgetary resources from external resources); and the respective physical and financial goals. These goals were set by consensus with each agency directly responsible for timely execution of the activities necessary to fulfill the contractual conditions, and with the Ministry of Finance and the Office of the Secretary of State in the Office of the President. The latter has been delegated responsibility for coordination of the Special Office of National Reconstruction and is therefore ideally positioned to ensure broad coordination and timely achievement of the goals agreed upon.
- 2.14 When the physical and financial conditions of all the priority programs have been fulfilled, the pace of the transition process will have been maintained, and the technical equipment of each program will have been preserved; similarly, interruptions in services for the most impoverished groups will have been avoided. Since a significant reduction in the gravity of the budgetary crisis is expected in the year 2000, the program will have supported the priority assigned to these programs during a high-risk period.

## **2. Component two: improving managerial capacity**

- 2.15 Hurricane Mitch has been a painful experience for the people of Honduras, but at the same time it has triggered an awakening to a new reality. The new reality is that what used to take a month to do must now be done in a week. The interest is there, the strength is there, but properly prepared governmental structures and technical frameworks to channel this enthusiasm for change efficiently are lacking.
- 2.16 Before the hurricane, the limited absorption capacity of the line ministries already presented a bottleneck for implementing projects that introduce new modalities and procedures, for launching new reform initiatives, or for expanding the provision of services. The hurricane has made the situation worse, increasing demand and in some cases even weakening the implementation capacity of the ministries. It is essential to seize the opportunity of reconstruction to change systems that limited implementation to such a degree in the past, and that will certainly continue to hold it back in the future.

- 2.17 It is noteworthy that historically, the Ministries of Education and Health were unable to utilize all the resources allocated to them in the national budget. In addition, there were significant delays in introducing investment programs financed with outside resources.
- 2.18 It is generally not recommended that new transformation initiatives be launched or the provision of services be expanded without first improving the management and implementation capacity of the line ministries. However, despite the urgent need to undertake these improvement, they cannot be initiated without first completing diagnostic studies on the institutional structures, identifying critical areas for change, and formulating plans of action for implementing these improvements. This component aims to ensure that the preparatory work is done and the initial measures for transformation are set in motion, measures that will be continued through the reformulation of ongoing programs.
- 2.19 Work has been done in close cooperation with the agencies involved to identify the most pressing improvements. These improvements will provide the agencies in this sector with the strategic framework they need in order to organize and launch specific measures for improvement that will use resources from other programs. A more detailed analysis of the situation of each government agency in the sector, the link between the proposed measures and existing programs, and the impact expected in each area at the conclusion of this component are presented below.

#### **(i) Education**

- 2.20 The post-Mitch situation and the situation of the education sector in particular require more efficient use of resources. A comprehensive transformation of the education system therefore needs to be done, beginning with an administrative and functional reform that will radically change management capacity at both the central and departmental levels.
- 2.21 The IDB is supporting the education sector with a US\$6.5 million loan (1000/SF-HO) for support for alternative basic education and third cycle basic education programs. This project was approved in December 1997 and is close to being eligible for disbursements. Its objective is to improve the quality of education and to increase the level of schooling among the population. To achieve its objectives, the project includes financing for: (i) component I: strengthening of alternative basic education programs in three departments, with the participation of the private sector; and (ii) component II: strengthening and evaluation of 35 basic education centers, as an innovative pilot project for increasing access to grades seven to nine in rural and marginal urban areas.
- 2.22 At a seminar sponsored by the Bank held in February 1999, officials from the Ministry of Education and members of the National Convergence Fund had an opportunity to express what they considered the most important topics for education

reform and to identify those factors that would act as barriers to implementation of a reform in this sector.

- 2.23 The participants agreed on the need for an educational reform that increases the relevance and quality of education while deepening and consolidating the process of deconcentration. Institutional problems were identified as priorities, starting with the high degree of administrative centralization in the Ministry of Education and of financial centralization (outside the ministry) in the Ministry of Finance. A clear view emerged that the budgetary efforts undertaken so far to improve technical and academic aspects had been slow and inconclusive, because the Ministry of Education is unable to set priorities and initiatives are frustrated because the ministry lacks management capacity.
- 2.24 The message was clear: the managerial capacity of the Ministry of Education needed to be improved. Within the ministry, the functions to be performed are not well defined and the desired profiles for each position are not well identified. These features have led to a top-heavy, highly centralized bureaucracy.
- 2.25 In other words, the Ministry of Education demonstrates institutional weakness at both the central level and at the recently established Departmental and District Offices. This situation acts as a barrier to the execution of projects designed to address quality and coverage problems. Given the slow execution of technical-cooperation projects and loans from multilateral institutions and the inefficiency of the administrative and budgetary systems, it can be concluded that institutional strengthening at all levels should be assigned priority by the ministry itself and by the donor community in order to improve efficiency.
- 2.26 Considering this situation, the analysis conducted during preparation of the proposed sector program (HO-0145) led the country authorities and the Bank to conclude that the activities under component I of the project financed under loan 1000/SF-HO were no longer relevant to the current demand in education, mainly due to the hurricane's impact on the operating capacity of the Ministry of Education and the intensified needs of the population. The government therefore decided to submit a request to the Bank that the component be reformulated to include activities that would increase the managerial capacity of the Ministry of Education before any new innovations in the area were initiated. Component II was not to be changed, since it is a pilot project that will test a new model for basic education that will be mostly implemented by FHIS, an agency with extensive execution capacity.
- 2.27 To ensure consistency between the design and the execution schedule of the reformulated component and the goals of the proposed sector program (HO-0145), the government has agreed to submit, prior to presentation of the program to the Board of Executive Directors, a formal request for reformulation. The reformulated component will target the Departmental and District Offices and schools, and will consist of the following main activities: (i) conduct a diagnostic study on operation of the organizational and administrative structure; (ii) adjust the organizational and

functional structure; (iii) redesign administrative procedures; (iv) redesign and automate human resources management in a manner compatible with the central system; (v) reengineer budget, financial, and accounting management; (vi) design and equip a single reception desk; and (vii) train the staff in each of the above activities and in strategic planning. The goal is to formalize the contractual changes necessary for reformulation while the proposed sector program (HO-0145) is still under way and also to begin implementing the new activities that will be introduced under the reformulated project.

- 2.28 The activities covered under the reformulated project (1000/SF-HO) will be supplemented by certain major initiatives that will be carried out in under a technical-cooperation loan (968/SF-HO) associated with the sector program for modernization of the public sector (967/SF-HO), being cofinanced by the World Bank and the IDB. The technical-cooperation project was approved in 1996 at the same time as the sector loan (967/SF-HO), and is set out in a plan of action that establishes the goals, budget, and schedule of the activities to be carried out in the Ministry of Education. It is scheduled to be completed at the end of this year.
- 2.29 The Presidential Commission for Modernization of the State (CPME) is responsible for execution of the technical-cooperation project. The CPME launched the institutional reform of the Ministry of Education with cofinancing from the World Bank and the IDB in 1996. Under that project, the organizational structure of the ministry was reformed in 1998. In a second stage, the CPME conducted the preliminary studies to devise a system for the administration of teaching and non-teaching staff and formulated a plan to create an integrated computer system for financial management (SIAFI). The ministry has initiated a pilot project for financial decentralization through the Honduran Community Education Project (PROHECO), and is carrying out the following activities jointly with the CPME: (i) the Office of Modernization of the Ministry of Education will evaluate the organizational structure of the ministry at the central level; (ii) in July, the CPME will hire consulting services to implement an integrated computer system with statistical education information on human, financial, and material resources, general services, and student evaluation; (iii) the Ministry of Finance will implement the Integrated Financial Management System (SIAFI); (iv) the CPME will supplement the design of the single reception desk with the organizational and functional structure of the Ministry of Education, the integrated Ministry of Education computer system, and the SIAFI; (v) the External Cooperation Unit will be strengthened; and (vi) the CPME will design a job classification system.
- 2.30 The proposed sector program (HO-0145) will include goals to be achieved through reformulated loan 1000/SF-HO and technical-cooperation loan 968/SF-HO. Once the goals of the second tranche of the sector program are achieved, the Ministry of Education will have improved its efficiency in certain administrative procedures and will have designed others for immediate implementation. It will also have made progress in human resource management with the design of a job classification system. The Ministry of Education budget system will be linked to the SIAFI

network, thereby providing the ministry with new budgetary rules and regulations to follow in budget execution. These activities will ensure greater deconcentration of budget management, leading to more independence from the Ministry of Finance, and will improve efficiency and transparency in budget management.

- 2.31 Institutional strengthening of the Ministry of Education will continue after the second-tranche goals have been achieved, completing the previously initiated activities. The final progress report on the proposed sector program (HO-0145) will be submitted 18 months after the first disbursement and will specify the progress achieved in those activities.

## **(ii) Health**

- 2.32 In addition to protecting specific programs in the health sector, it is also important to increase quality by providing a basic package of services targeting the extremely impoverished population. To attain this goal, Honduras must streamline public spending on health by modernizing the Ministry of Health so that it includes the following functions: regulation, financing, information, organization, and consumer protection. The ministry must simplify its operational role and service network, mainly in the tertiary sector, by transferring responsibilities to civil society and by strengthening management of health services at the municipal level.
- 2.33 Given the above-described situation and the impact of Hurricane Mitch, the need to redesign and expedite more efficient service delivery has been recognized. Accordingly, the government has proposed that a sector transformation process be undertaken that will require several stages to be implemented.<sup>1</sup> The main instruments to be used to implement the transformation are the program for institutional reorganization and health service expansion (financed by the IDB under loan 1005/SF-HO) and technical-cooperation loan 968/SF-HO, cofinanced by the World Bank and the IDB. In addition, USAID has activities planned through the year 2000 under the following projects: (i) Health Sector II, for primary care services (immunization, diarrheal disease control, and rural environmental health); (ii) Population Sector III, with family planning activities; and (iii) support for the Ministry of Health access program.
- 2.34 The World Bank financed the rural nutrition and health program, which is at a complementary year-long stage and includes support for the PRAF in nutrition activities, the establishment of rural basic sanitation systems, the provision of primary care medicine, construction of 30 new health centers, and rehabilitation of another 130. Other agencies are supporting for specific Ministry of Health activities, including the access program (the Swedish agency for international cooperation and PAHO).

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<sup>1</sup> Government of the Republic of Honduras, Ministry of Health, "Transformation of the Health Sector in National Reconstruction. Policy Guidelines, 1999-2001." Tegucigalpa, 1999.

- 2.35 The program financed under loan 1005/SF-HO (for US\$40 million) was approved in August 1998 and declared eligible for disbursement in July 1999. The operation is designed as a long-term transition project, under which institutional reform of the Ministry of Health will be carried out, supplementing activities initiated under technical-cooperation loan 968/SF-HO, addressing current health problems, and developing the institutional capacity for future reform of the sector. The specific objectives of loan 1005/SF-HO are to: (i) help lay the institutional, methodological, and managerial foundations for the Ministry of Health to design and implement sector reform in the medium term; and (ii) in the short term, improve the quality of the services and strengthen the promotion of health and health education by expanding access to primary health care.
- 2.36 Given that implementation of the measures to be designed through the proposed sector program (HO-0145) will depend on loan 1005/SF-HO, the latter needs to be reformulated to formally reflect the commitment to implement those measures. Accordingly, it has been agreed that the Government of Honduras will submit to the Bank a formal request for project reformulation. The purpose of the reformulation will be: (i) institutional strengthening of the Ministry of Health; (ii) administrative decentralization to the health regions and health districts; (iii) extending coverage of basic health care services; (iv) modernization of public hospital management; and (v) transformation of the health care model, with stakeholder participation and a new combination of public- and private-sector involvement.
- 2.37 The main objectives of technical-cooperation loan 968/SF-HO, which supports the public sector reform program (CTPRSP), are the following: (i) institutional restructuring of the Ministry of Health; (ii) preparation of a health staff survey; (iii) development of a procurement system; (iv) deconcentration of budget execution; (v) gradual reallocation of the Ministry of Health budget to primary care services; and (vi) incorporation of the Honduran Institute for Rehabilitation of the Disabled into the new Ministry of Health structure.
- 2.38 To date, preliminary activities have been carried out under the above program to pave the way for the Ministry of Health reorganization process and to confirm the government structures. The activities the Ministry of Health has carried out in this connection include the following: (i) institutional restructuring of the ministry based on passage of the 1996 Public Administration Act; (ii) preparation of the health staff census; (iii) development of a basic procurement system and, in particular, establishment of the Special Procurement Unit; (iv) gradual reallocation of the ministry budget to primary care services, which reached 53% of the total health budget in 1999; and (v) incorporation of the Honduran Institute for Rehabilitation of the Disabled into the new Ministry of Health structure.
- 2.39 It should be noted that most of the progress achieved has been accomplished without using the IDB resources assigned to the respective program. Nevertheless, in the second half of 1999, the pace of use of IDB resources to finance technical assistance for the Ministry of Health in the area of supplies and procurement and

quality control is expected to increase. The initial achievements of the ministry constitute a solid foundation to implement the activities planned under reformulated loan 1005/SF-HO. In order to update the goals of the technical-cooperation project, the Bank will work in close coordination with the Ministry of Health and the CTPRSP to reprogram the Bank resources allocated to that part of the technical-cooperation project to support the reformulated activities under loan 1005/SF-HO in the priority areas for institutional development of the Ministry of Health.

### **3. Social welfare**

#### **(i) Honduran Social Investment Fund (FHIS)**

- 2.40 FHIS is the government's most important tool for reducing the deficit in basic infrastructure in impoverished areas. It owes its effectiveness and transparency to the use of a poverty map for targeting resources to the most impoverished areas and an efficient system for evaluating and implementing projects. The poverty map is based on information received through the national census.
- 2.41 The action of FHIS is important for the social sector since the infrastructure that it builds is key for increasing the impact of services provided by the line ministries. It is therefore noteworthy that the hurricane destroyed a large portion of the infrastructure that FHIS had built since 1990, saddling the agency with the twofold task of replacing what was lost without further delaying reductions in the deficit that it faced before the hurricane.
- 2.42 Immediately after the hurricane, FHIS discontinued use of the poverty map and devoted most of its resources to meeting the urgent needs directly caused by the hurricane. The basic criterion that was applied was an effort to cover all the damage, in close cooperation with the municipalities affected. Now that that phase has come to an end, FHIS intends to return to its practice of allocating resources according to the degree to which access to basic social services is lacking.
- 2.43 By returning to its previous allocation system, FHIS will use a new approach based on planning spending at the local level. Project cycle management is to be delegated to the municipal level wherever possible.
- 2.44 The hurricane has had an impact on the relevance of the poverty map. In some geographical areas, poverty has increased while in other areas, new pockets of poverty have been created. These effects significantly reduced the relevance of the map. In response, FHIS has managed to maintain transparency by ensuring ongoing outside auditing, intensifying supervision, and producing reports more frequently. Even so, in light of the fact that FHIS has been selected to channel a major portion of the resources intended for physical reconstruction, it must have a transparent and effective mechanism for allocating resources in the short term.
- 2.45 In December 1998, the Bank approved a project to support FHIS activities (HO-0131). At that time, it was impossible to foresee the extent to which the

property map would be affected by the disaster nor to devise a plan to return to the traditional system of resource allocation. Now that the scope of the damage has been evaluated and recorded, it is possible systematically to incorporate into the map a factor that reflects the relative increase in poverty caused by a hurricane (the Mitch factor). This will solve the problem in the short and medium terms, but it does not obviate the need to adhere to the schedule set for updating the map based on the next national census.

- 2.46 Achieving the goals of the proposed sector program will contribute to transparency in FHIS operations, complementing the objectives of the Bank's ongoing project (HO-0131). Specifically, a system will be introduced for addressing the "Mitch factor" on an ongoing basis, and adherence to the schedule to update the map based on the national census in the year 2000 will be promoted.

#### **(ii) Family Allocation Program (PRAF)**

- 2.47 Before the hurricane, PRAF had resources sufficient to cover only one-third of its target population. Furthermore, inefficiencies in PRAF's targeting mechanism, during its first phase, reduced that coverage even further. Approximately 40% of the vouchers that PRAF issued to mothers and children, and 30% of the vouchers provided as incentives for attending school, were given to beneficiaries in higher income brackets than those of the target population. The need to increase the effectiveness of its targeting mechanism is all the more urgent since the hurricane has expanded that target population.
- 2.48 The measures proposed in the context of this program complement the activities originally programmed in the project the Bank is currently implementing with PRAF (HO-0132). In late 1998, the project included resources to improve the effectiveness of its targeting mechanism and to assess its impact. Since that time, Hurricane Mitch has required PRAF to focus almost exclusively on expanding its operations, to the detriment of measures for structural change. The proposed sector program will help concentrate the institution's attention on the need to improve its targeting mechanism and its mechanisms for impact assessment.
- 2.49 Given the high poverty rate in Honduras, which has been aggravated by the impact of the hurricane, there is a great pressure to use available funds to increase the number of beneficiaries. This sector program aims at safeguarding improvements in targeting and assessment, on the understanding that this is a necessary effort in order to make the social protection network function more efficiently, by decreasing misallocation and creating a fertile ground for the participation of other donors by increasing the efficiency and transparency of operations.

#### **4. Component three: the policy framework of the sector**

- 2.50 **Social policy:** The social sector needs an adequate policy framework to be developed and instituted to guide its activities. Instead of coordinating its activities,

it depends on each agency to set its own strategies. Furthermore, interventions sponsored by national NGOs or outside agencies are carried out without adequate guidelines for their implementation. The result has been a duplication of efforts, undertaking actions that are not necessarily consistent, the unfruitful use of resources, and the use of a wide variety of methodologies for achieving the same ends.

- 2.51 This lack of coordination is all the more serious at this time when a reconstruction effort has been undertaken at the national level and when new interventions are being planned in all areas. Links for interagency exchanges and cooperation must be created, and mechanisms for consensus-building among the agencies concerned must be strengthened for both sector policy formulation and implementation.
- 2.52 Once the program conditions have been fulfilled, a new permanent body will be set up for the sole purpose of promoting the formulation and implementation of social policy. This will include setting overall goals, coordinating mechanisms and procedures, and maintaining consensus-building forums. Furthermore, the new body will develop new strategies in priority areas that have already been established, and the support unit will strengthen its capacity specifically in the social policy sector.
- 2.53 **Municipal development plan:** Weakness in the policy framework also affects the municipal development process, an element that comprises all the areas covered by this program. The efficiency measures planned for education, health, and social welfare include delegating functions to municipalities, but these initiatives are carried out without an overall context. It is essential to improve coordination of the various initiatives being planned in order to expand the role of the municipalities in the reconstruction and transition of the country. Furthermore, as described in chapter I, the respective regulatory framework needs to be strengthened for creating new, financially viable municipalities.
- 2.54 The Ministry of Government Affairs and Justice is the government agency responsible for formulating and overseeing the global strategy for municipal development, the decentralization process, and local development. The General Office of Municipal Technical Assistance (DGATM) has prepared a draft municipal development plan, but it is not the only plan in Honduras that addresses the same goal. In addition to seeking a way to coordinate the various plans, the need to revise the DGATM's plan in consultation with those involved and to deepen it in certain priority areas prior to its implementation has been pointed out.
- 2.55 The outcome of the program will be a municipal development plan on which the parties involved have been consulted. This means that the various municipal development policies will have been coordinated and efforts will have focused on the highest priority topics. These topics may include the consolidation of methodologies; the assignment of roles; the coordination of targeting mechanisms; the introduction of permanent systems for oversight and monitoring; and

mechanisms for achieving economies of scale for impoverished municipalities. In addition, procedures will be developed to guarantee the full participation of those involved, and the DGATM will be strengthened so that it can more efficiently carry out the regulatory responsibilities assigned to it.

- 2.56 Moreover, agreements will be formalized between the DGATM and the main government agencies, and with the NGOs involved in municipal and community development. The agreement with FHIS will make it possible to consolidate methodologies for municipal development, the division of functions among the institutions, and the formulation of joint interventions. The agreement with AHMON (the Honduran Association of Municipalities) will make it possible to consolidate strategies and plans for municipal development, and to coordinate targeting mechanisms and methods and materials for instruction. Agreements with civil society organizations will form the basis for the division of labor, and the startup of the system to establish standards for methodologies and results.

### **C. Cost and financing**

- 2.57 The program will be financed with the proceeds of a US\$30 million loan in foreign exchange from the Bank's Fund for Special Operations. The financial terms and conditions of the loan are presented below. Because it is a sector loan, the program does not require a local counterpart contribution by the government.

<b>Financial terms and conditions</b>	
Source	FSO
Amount	US\$30 million
Terms:	
▪ Amortization period	40 years
▪ Grace period	10 years
▪ Disbursement period	18 months
Interest rate	1% during the grace period and 2% thereafter
Inspection and supervision	1% of the loan amount
Credit fee	0.5% annually on the undisbursed balance

### **III. EXECUTION**

#### **A. Borrower and executing agency**

- 3.1 The borrower will be the Republic of Honduras. With respect to execution, the lack of institutional arrangements to coordinate the activities of the various agencies with responsibilities in the social sector makes it necessary to appoint a special coordinating unit. The Office of the Secretary of State of the Office of the President will be responsible through the intermediary of the Technical Support Unit (UNAT). The Bank is supporting the strengthening of the UNAT so that it will have the ability to function in the effective manner as the Coordinating Unit of the Program (UCP).
- 3.2 In order to facilitate coordination among the agencies having direct responsibility for fulfilling the conditions of the matrix, letters of commitment from each of the agencies will be formalized, indicating their commitment to work in a coordinated manner with the Program Coordination Unit (UCP). The agencies include the Ministry of Education, the Ministry of Health, FHIS, PRAF, and the Ministry of Government Affairs and Justice.

#### **B. Contractual conditions and activities for their fulfillment**

- 3.3 With regard to the macroeconomic framework required for the first tranche, the agreement between the borrower and the International Monetary Fund (IMF) for the Enhanced Structural Adjustment Facility (ESAF) will constitute evidence that the respective condition has been fulfilled. For the second tranche, the most recent ESAF assessment report approved by the IMF will constitute the evidence that this condition has been fulfilled.
- 3.4 This section presents the contractual conditions for each component of the program and the activities to be carried out to fulfill them.

##### **1. Component one: protection of priority programs**

###### **(i) First tranche**

- 3.5 The contractual condition for the first tranche of this component is that the law approving the 1999 budget must have entered into force, reflecting the allocation of resources agreed upon for each priority social program, which in certain cases will show real increases in per capita allocations above 1998 levels.
- 3.6 The activities of the schedule of execution related to this condition are: (i) the submission of an approved budget; and (ii) identification of increases anticipated for each program. Since the population is expanding at approximately 3% per year and inflation of approximately 14% is expected during 1999, the goal has been set

of increasing nominal spending by a minimum of 17% over 1998 levels. This applies only to programs that were already being implemented last year and that will continue to be implemented after 1999. For one thing, it is impossible to calculate such a percentage for programs that began this year. Additionally, it does not make sense to set these goals for programs that will cease to be implemented this year. In these last two cases, goals have been set for this year without linking them to last year.

**(ii) Second tranche**

- 3.7 The contractual condition for the second tranche of this component is the submission of proof, for each priority program, that the financial and physical implementation goals previously established with the Bank have been met. These goals will be analyzed and, if deemed necessary, may be adjusted by joint agreement by the government and the Bank during the periodic program evaluations, provided that such adjustment is consistent with the program objectives.
- 3.8 To fulfill this condition, the borrower will ensure that the Ministry of Education, the Ministry of Health, FHIS, and PRAF carry out the activities shown in the table below. As evidence that this condition has been fulfilled, the borrower will submit documentation, officially signed by each ministry and participating institution, which demonstrates that the goals established for each program have been met. The physical goals will cover the period from the beginning of June to the end of December 1999. The financial goal refers to the commitment of resources and not to their disbursement. The goals set for each area are presented below.

Programs	Physical Goals Scheduled from June to December	Financial Goals Lempiras, in thousands Jan.-Dec.
<b>Education</b>		
<b>PROMEB:</b> Improving the quality of education, strengthening cognitive, affective, and motor skills requiring teachers and the strengthening of the evaluation system and technical and financial support of the Ministry of Education.	Training 2,000 teachers; transforming 6 schools; printing and distributing 2,000 books; acquiring and distributing 4,000 instructional packets; building and remodeling 13 Departmental Offices; purchasing 17 vehicles and 124 motorcycles; purchasing 200 computers; carry out 6 transfers to Departmental and District Offices (emergency projects)	145,935
<b>PROHECO:</b> This is a new model of administrative services or pre-school and elementary education that promotes involvement of organized communities in order to improve internal efficiency in administering resources and providing educational services.	Contracting and training 50 promoters and 4 coordinators; acquisition of office furniture and equipment, transport, and computers; training 1,400 directors; transfers to AECOS.	29,616
<b>EDUCATODOS:</b> This is an elementary education program for young persons and adults who have not had the opportunity to start or complete their primary education. Uses printed materials (primers, books), interactive radio, and volunteer facilitators.	Reorganize 3,500 study centers; enroll 34,400 participants; certify 50,000 participants; train 3,000 facilitators.	27,903
<b>Production in vocational schools in Honduras:</b> Improving the quality of technical education for investment projects in agriculture, industry, and services. Means and inputs of production are supplied and human resources are trained for project sustainability.	Training 20 directors of educational centers, 20 area coordinators, and 10 officials at the central level; providing materials and supplies to 20 educational centers; machinery and equipment for five centers; installing water systems for four agricultural centers; agricultural inputs for 10 centers.	2,420
<b>Basic Education Support Program:</b> Testing, through a pilot project, a model to strengthen basic education from seventh to ninth grade in rural areas.	Agency of the Coordination Unit of the Project; training one hundred five teachers from elementary education centers; training 16 technical experts from the ministry; training 35 directors from primary education centers and initiating works to upgrade 35 basic education centers.	12,800
<b>Subtotal</b>		<b>218,674</b>
<b>Health</b>		
<b>ALA 86/20:</b> Supplying potable water by building aqueducts, providing adequate waste disposal by installing latrines in all rural communities, septic pits in area schools, and digging wells for hand-operated and electric pumps.	377 aqueducts repaired and 421 built; 100 wells drilled and dug; maintenance of 195 wells, and 151 repaired. Construction of 294 latrines, 430 renovated, 618 improved, and maintenance of 46,977 latrines.	19,118
<b>ALA 91/33:</b> Reducing the danger of hospital waste. Purchasing of equipment and infrastructure, and training to reduce risk factors.	Receiving of equipment to treat solid hospital waste; training of hospital personnel and rehabilitation of warehouses for solid waste. Incineration plant.	2,814

<b>Programs</b>	<b>Physical Goals Scheduled from June to December</b>	<b>Financial Goals Lempiras, in thousands Jan.-Dec.</b>
<b>Preventive Health Project for Adolescents in Honduras:</b>	Training of 5,000 young persons and 40% of the personnel; 5,000 educational packets; intervention among networks.	20,114
<b>Nutrition and Health:</b> Providing support to training centers for breast feeding, training of community counselors in breast feeding, overall care of those under the age of five years, emphasizing nutrition. Strengthening of health services; rehabilitation of Health Centers, clinics, and hospitals.	51 training workshops; rehabilitation of two health centers; four studies for health establishments; one vector control campaign; 300 vaccination campaigns; 148 wells rehabilitated; 1,750 latrines; 18 water stations, and 105 water junctions.	41,946
<b>Subtotal</b>		<b>83,992</b>
<b>FHIS</b>		
Reconstruction investments	1,585 projects	610,830
Municipal soc. Investment		
Education	1,025 projects	30,800
Health	10 projects	4,200
Water and sanitation	35 projects	16,100
Municipal	30 projects	11,900
Environment	NA	2,000
Basic needs	75 projects	28,000
Needs for ethnic group participation	800 projects	91,000
Institutional strengthening	Replacement of vehicles and equipment	35,700
Operating expenses	Maintaining the maximum operating expenditure as a percentage of investments	42,700
<b>Subtotal</b>		<b>873,230</b>
<b>PRAF</b>		
School vouchers	416,755 vouchers	25,181
Expanded school vouchers	194,418 vouchers	11,748
Mother infant vouchers	385,938 vouchers	28,607
Nutrition vouchers	50,376 vouchers	7,500
Senior citizen vouchers	22,232 vouchers	3,350
School scholarships	47,885 vouchers	4,413
Provision for women	5,830 vouchers	14,803
<b>Subtotal</b>		<b>95,603</b>
<b>Total</b>		<b>1,271,498</b>

## 2. Component two: improving managerial capacity

- 3.9 Immediately after each condition, the activities the borrower will carry out to fulfill the contractual conditions for this component are described. In each case, they were prepared with the agency responsible for their execution, and altogether represent an indicative, but not mandatory, plan of execution, provided the respective contractual condition is fulfilled.

**(i) Education: first tranche**

- 3.10 **Administrative and budgetary reorganization:** The contractual condition is that the Government of Honduras must submit a proposal for policy guidelines for institutional strengthening of the Ministry of Education according to the principles previously agreed upon with the Bank (see paragraph 2.22 and 2.24).
- 3.11 The activities of the schedule of execution related to this condition are:  
(i) consulting services in project administration and process reengineering must be hired to prepare a comprehensive medium- and long-term plan for administrative transformation of the Ministry of Education; (ii) the Ministry of Education must approve a comprehensive medium- and long-term plan for administrative transformation covering systems for administration, data processing, and training; (iii) consulting services must be hired to perform a diagnostic study of the technical and infrastructure capacities that each departmental and district office has; and (iv) a plan must be prepared establishing the technical foundation for the activities that will be financed with resources from loan 1000SF-HO once it is reformulated. The latter is essential in order to be able to design future initiatives to delegate functions to those offices at a later date.

**(ii) Education: second tranche**

- 3.12 **Administrative and budgetary reorganization:** The contractual condition is that implementation of the institutional strengthening plans must have been initiated (see paragraph 2.27 and 2.30).
- 3.13 The activities of the schedule of execution related to this condition are: (i) the new standardized administrative processes must be implemented, and certification of the validity of those processes provided; (ii) a job classification system must be implemented, (iii) the single reception desk system must be implemented; (iv) the project administration unit must be strengthened and a report submitted on the results of its operation; (v) the Ministry of Education must be incorporated into the budget information network (SIAFI); and (vi) the call for bids must be published for the consulting services for strengthening of administrative and financial procedures at the deconcentrated level.

**(iii) Health: first tranche**

- 3.14 The contractual condition is that a proposal for policy guidelines for transformation of the health sector, that is consistent with the principles described in chapter II, must be submitted (paragraph 2.36).
- 3.15 The activities of the schedule of execution related to this condition are: (i) a formal request for reformulation of loan 1005/SF-HO must be submitted, on terms previously agreed upon with the Bank; and (ii) the terms of reference must be submitted for the consulting services to support the borrower in the preparation of a

health sector transformation plan and proposals for action plans for the years 2000 to 2003, covering the areas described in paragraph 2.32.

**(iv) Health: second tranche**

- 3.16 The contractual condition is that implementation of a health sector transformation plan, based on the policy guidelines and principles described in chapter II, must be initiated (paragraph 2.36).
- 3.17 The activities of the schedule of execution related to this condition are: (i) the specific action plans for sector transformation in the years 2000 to 2003 must be submitted to the satisfaction of the Bank; and (ii) the process must be initiated for the selection and hiring of the consulting services and the studies necessary for execution of the action plan for the year 2000.

**(v) Social welfare: first tranche**

- 3.18 The contractual condition is: (i) submission of a modified version of the FHIS poverty map that reflects the impact of Hurricane Mitch, (ii) submission of proposals for improving the targeting mechanism of PRAF and for evaluating its impact.
- 3.19 The activities of the schedule of execution related to this condition are: (i) submission of the targeting mechanism used in determining allocations of resources to cover the damage caused by Hurricane Mitch; and (ii) submission of the targeting mechanism that is scheduled to be used for determining allocation of resources during the post emergency period. This will include adjustments made in the poverty map to reflect changes caused by the hurricane. PRAF's execution plan activity is to submit the terms of reference for the consulting regarding evaluation of the impact and effectiveness of the targeting mechanisms. The resources of a Bank project currently being implemented by PRAF will be utilized.

**(vi) Social welfare: second tranche**

- 3.20 The contractual condition is: (i) submission of proof that the modified version of the FHIS poverty map is being applied and submission of a plan for updating the map with the year 2000 national census; (ii) establishment of the foundations for the PRAF beneficiary census, and for evaluating the targeting system impact.
- 3.21 The activities of the schedule of execution, to be carried out by FHIS, related to this condition are: (i) submission of proof that the new targeting mechanism has been implemented, a mechanism that includes incorporation of the adjustments in the poverty map that are required to reflect the impact of the hurricane on the relative distribution of poverty. This will include an updating of information on the measures taken by FHIS and by other agencies to repair the damage incurred, in order to be able to assess the degree to which modification of the map is still necessary; and (ii) submission of a proposal to update the poverty map based on the

household survey to be conducted at the national level. Resources of a project currently being implemented with FHIS will be used to finance the related consulting work.

- 3.22 The activities of the schedule of execution, to be carried out by FHIS, related to this condition are: (i) surveying a sample of approximately 2,400 families that will result in the targeting card, using the statistical procedure known as the proxy mean test; (ii) identifying the municipalities where the targeting card will apply in accordance with the census of age and height; (iii) contracting consulting services for an analysis of the survey and subsequent follow-up on targeting and evaluation activities; (iv) starting with the design for the targeting card to be applied as a type of census in the selected municipalities; (v) submission of terms of reference for contracting with the NGOs that will conduct the census; and (vi) working out the addenda and agreements with the Ministry of Education and Ministry of Health to reflect the new targeting modality.

### **3. Component three: sector policy framework**

- 3.23 Immediately after each condition of this component, the activities the borrower will carry out to fulfill the conditions are described. In each case, they were prepared with the agency responsible for their execution, and altogether represent an indicative, but not mandatory, plan of execution, provided the respective contractual condition is fulfilled.

#### **(i) Social policy: first tranche**

- 3.24 The contractual condition is: a new permanent agency whose exclusive purpose is to formulate and implement social policy must be established and a plan for strengthening UNAT as its Technical Support Unit submitted.
- 3.25 The activities of the schedule of execution related to this condition are: (i) an agreement with the Bank on the basic outlines of a new agency created by the Ministry of Health, Ministry of Education, and Ministry of Government Affairs and Justice, and by the key programs in the sector. This will also include a description of a technical team that will support the implementation of the decisions made by this new agency in an on-going manner; (ii) the entry into effect of the Executive Order for the proper functioning of the new agency; and (iii) an agreement with the Bank on the activities needed to strengthen the agency which will operate as the technical team of the social policy body.

#### **(ii) Social policy: second tranche**

- 3.26 The contractual condition is that UNAT must be provided with the staffing and equipment necessary to provide adequate technical support for social policy formulation and implementation and the borrower must submit social policy strategy proposals to the Bank, which must accept them. The proposals must include the following: (I) consolidation of mechanisms for targeting the

geographical areas and groups with the most vulnerable population; (ii) coordination of decentralization strategies; (iii) linkage between resource allocation and performance; and (iv) implementation of monitoring and follow-up systems.

- 3.27 The activities of the schedule of implementation related to this condition are: (i) demonstrating that the agency is functioning; (ii) having contracted with consultants and having acquired equipment and materials to strengthen the technical team supporting the new agency; and (iii) presentation of strategy proposals in the areas of consolidating targeting mechanisms on geographical areas and the most vulnerable groups; coordination of decentralization strategies, linkage between resource allocation and performance, and implementing monitoring and follow-up mechanisms.

**(iii) Municipal development: first tranche**

- 3.28 The contractual condition is: (i) the borrower must submit to the Bank and the Bank must accept a plan for consulting the individuals, groups, and agencies involved in revising the National Municipal Development Plan in order to deepen it in the areas described below in paragraph 3.29 (subparagraphs 1.a-e); (ii) cooperation agreements must be formalized between the Ministry of Government Affairs and Justice and the agencies listed in subparagraph 3 of paragraph 3.29.

- 3.29 The activities of the schedule of execution related to this condition are:

1. Consulting services must be hired to conduct studies on the topics to be determined as part of the process of revising the National Municipal Development Plan. The aim is to deepen the plan in priority areas by developing agreements and specific strategies. These areas are as follows:
  - a. Defining the roles and areas of work for each agency active in the sector, including the role of the General Office of Municipal Technical Assistance (DGATM). What is sought here is a clarification of the fundamental concept of public sector intervention, which should be principally regulatory in nature since direct implementation should be carried out by the public sector only when this does not replace intervention by agencies of civil society;
  - b. Consolidation of categorization mechanisms in accordance with the profile of each municipality, to achieve better allocation of resources. Various systems currently exist to categorize them. The aim is to consolidate these mechanisms as part of an initiative to develop a joint mechanism for focusing aid to municipalities;
  - c. Standardization of systems, procedures, and work methods for strengthening municipal institutions and processes of community participation. The aim is to limit the spread of various methodologies

that focus on the same outcome. Another aim is to establish standards for the results expected from the strengthening effort;

- d. Development of modalities for operational consolidation or association of the weakest municipalities. Some municipalities do not have an economic base that enables them to be financially viable without forming associations with their neighboring municipalities in order to achieve economies of scale;
  - e. Development of evaluation and monitoring systems. Currently, there is no mechanism for systematically identifying success or failure in municipal strengthening efforts. The aim is to establish mechanisms that permit a transparent evaluation of the capacity of service providers, the effectiveness of methodologies, and the advancement of the municipalities.
- 2. A proposal must be submitted to strengthen the DGATM so that it can assume responsibility for coordinating the strategy of the ministry. The aim is to assign responsibility for moving the process forward to a single office, and it will be necessary to strengthen that office in order to achieve this end.
  - 3. Coordination agreements must be drawn up and entered into between the Ministry and FHIS, AHMON, FUNDEMUN, ASONOG, and PROLANCHO (paragraph 2.56).

**(iv) Municipal development: second tranche**

- 3.30 The contractual conditions are the submission of the National Municipal Development Plan revised at least in the areas agreed upon (paragraph 3.29, subparagraph 1.a-e) and that pilot program is already being implemented to test new arrangements for grouping the most impoverished municipalities into associations in order to achieve economies of scale.
- 3.31 The activities of the schedule of execution related to this condition are: (i) having held a workshop to revise the current version of the National Municipal Development Plan, and deepening it in the areas specified above (see para. 3.23); (ii) preparation of a revised version of the National Municipal Development Plan that reflects the refinements resulting from the studies in each priority area and through the workshops that will be conducted in the context of the forum; and (iii) having contracted consulting services for a pilot program to test new mechanisms for linking the most impoverished municipalities for purposes of achieving economies of scale.

**C. Disbursements**

- 3.32 The program will be disbursed in two tranches: the first in the amount of US\$20.0 million and the second in the amount of US\$10 million. The disbursement period will be 18 months.
- 3.33 As a precondition for each disbursement, the borrower will submit satisfactory proof to the Bank regarding the compliance of the macroeconomic environment with the program's objectives. The Bank will consult with the International Monetary Fund on this issue.
- 3.34 The disbursement of resources for each of the two tranches will be subject to the submission of documentation proving that the conditions established for its components and set forth in the conditionality matrix have been achieved.
- 3.35 The resources of the loan for the program will be used to finance the overall cost in cash of eligible imports coming from member countries of the Bank. The new simplified procedures of the Bank for sector loans must be applied in this case in accordance with document GN-2001-2. Disbursements will be made upon application by the borrower, and the application must be accompanied by proof demonstrating that the agreed contractual conditions have been met.
- 3.36 Through the Ministry of Finance, the borrower is responsible for keeping accounting records and for preparing applications for disbursement. The borrower will submit a simple application, on which basis the Bank will disburse resources of the loan for use by the borrower. The resources of the loan must be deposited into a separate account. The Bank will require the borrower to maintain appropriate records of the funds disbursed from the loan, and reserves the right to require the borrower to submit audited reports on the disbursed funds.

**D. Supervision**

- 3.37 The Bank will maintain close cooperation with the UCP during program execution, in order to support the unit and its counterparts in each of the agencies involved.

**E. Reports**

- 3.38 In addition to the documentation submitted to show that the goals of each tranche have been met, the borrower will also submit a final report 18 months after the first disbursement. Given that several of the activities that are part of the matrix will continue to be implemented even after the final disbursement, the report will provide a more thorough evaluation of the impact of the measures presented in the matrix. In addition, it will include the status of the activities financed with existing programs that will provide continuity for the measures started under this program.

## IV. VIABILITY AND RISKS

### A. Viability

- 4.1 The program will promote economic stability, maintaining the levels of care provided by social services, and improving efficiency in providing those services. In addition, it will provide a policy framework that is essential for selecting and directing investments at this key juncture for Honduras.
- 4.2 In terms of economic stability, the program will be carried out within the macroeconomic context defined by the ESAF. Economic stability and growth are essential elements in improving the levels of well-being of the impoverished population. In this sense, economic stability – particularly keeping inflation in check – while reducing regressive contributions to the budget deficit on the part of the impoverished population provide a framework for reducing uncertainty and, consequently, greater credibility of an eventual plan for self-help.
- 4.3 The oversight and control instruments are compatible with the Bank's requirements. The institutional mechanism for implementing the program is based on the commitment of all the agencies directly involved, through letters of commitment from each one (see paragraph 3.2), which were submitted to UNAT. UNAT will be responsible for coordinating and moving forward the activities that are necessary for achieving the goals presented in the matrix. Furthermore, UNAT will be supported by a technical team that is now being put together. This team will ensure that there will be a counterpart with sufficient capacity to support the implementation of the program and the timely accomplishment of its goals.
- 4.4 With regard to the technical viability of the agreed measures, it is important to note that each goal was specified in close cooperation with the agency responsible for the activity related to achieving the goal and with the Ministry of Finance and UNAT. Consensus regarding the viability of the goals, the feasibility of their being implemented within the projected time frame, and the government's corresponding commitment to these goals is demonstrated in the text of the policy framework paper.
- 4.5 Sources of financing have been identified for all the measures included in the matrix, as required.
- 4.6 **Education:** the resources of the technical cooperation linked to the CPME program will be used to finance most of the measures proposed. The additional measures identified in the course of preparing this sector program will be financed with resources from partial reformulation of loan 1000/SF-HO.

- 4.7 **Health:** the activities necessary to achieve the sector program objectives will be financed with resources from the project for institutional reorganization and extension of basic health care services (loan 1005/SF-HO).
- 4.8 **FHIS and PRAF:** In both institutions, resources that are already available from Bank loans will be used to finance the proposed measures that relate to improving their respective targeting mechanisms.
- 4.9 **Coordination of social policy:** The resources of the administrative budget of the respective government agencies will be used to cover the costs of training and operating the Social Cabinet that will formulate and implement social policy. The existing Technical Support Unit (UNAT), which will provide technical support for formulating and implementing the policies and strategies approved by the Cabinet, and the improvements needed so that it can assume its new functions with respect to social policy, will be financed through international donations and the resources of UNAT's administrative budget.
- 4.10 **Municipal development:** The Ministry of Government Affairs and Justice will finance the strengthening of the DGATM with resources from its administrative budget. The workshop and formulation of strategies in priority areas will be financed through international donations and the administrative resources of the ministry and of the other public sector and civil society organizations (AMHON and NGOs) involved in the process.

**B. Environmental and social impact**

- 4.11 With regard to gender issues, the role of the indigenous population, and environmental protection, the project will be subject to the regulations previously established for the social programs and projects supported by this operation. In the areas of education, health, and social welfare, in most cases these projects and programs have been developed with the participation of international organizations including the IDB, the World Bank, GTZ, USAID, etc. Therefore, they incorporate the standards of those institutions with regard to environmental and social issues. Furthermore, all the programs comply with the country's environmental standards and procedures.
- 4.12 The initiatives that will be taken to establish consensual procedures for formulating policies and defining priorities must be underscored. In this sense, the program will contribute in a fundamental way to opening up new avenues for the participation of civil society in formulating strategies and in implementing activities in the social sector. In addition, the component relating to the protection of priority programs will support initiatives by the Ministry of Health to devote a portion of its budget to covering the costs of infrastructure maintenance and treatment of hospital waste.

**C. Classification concerning social equality and poverty reduction**

- 4.13 This program is classified as an operation that promotes social equality, since it aims at improving programs and processes whose beneficiaries are primarily low-income individuals who belong to the most vulnerable and least served groups. In addition, it must be noted that the project specifies explicit fulfillment indicators for measuring poverty reduction and improving social equality. These indicators are presented in the Conditionality Matrix (Annex I) and in the lists of activities related to each contractual condition (Chapter III).
- 4.14 Although it is specifically designed to promote measures and decisions that will result in poverty reduction, the proposed program does not qualify as a poverty-targeted investment (PTI), according to the Bank's classification system because it is a fast-disbursing sector loan. In addition, as a sector operation, a local counterpart contribution to program financing is not required and the option of additional financing therefore is not applicable and will not be used by the borrower.

**D. Benefits**

- 4.15 The program will contribute to improving the living conditions of the impoverished population through measures that ensure that there will be no interruption in programs that focus mainly on providing social services and allocations for underserved and needier groups. This will result in greater equality in providing social services.
- 4.16 The focus on increasing the management capacity is of vital importance at this time, since Hurricane Mitch has sent demand skyrocketing while at the same time reducing the management capacity of the agencies implementing social programs. The program will give the line ministries comprehensive strategies for increasing their capacity, which will enhance the viability of any pre-existing or new initiative in the sector.
- 4.17 The initiatives in the policy framework area of the social sector are a very high priority for the country, given that effective coordination is even more important at the moment, when a reconstruction and transformation effort has been mounted at the national level and when new interventions are expected in all areas. Not only will the program establish inter-institutional links for exchange and cooperation, but it will also strengthen the mechanisms for consensus building among those involved both in formulating social sector policy and in implementing it.

**E. Risk**

- 4.18 **Consistency of strategies:** The government's strategy of reconstruction is consistent with the program's concept of preserving advances made in sector transformation and establishing the foundation for new improvements. Nonetheless, there is strong demand to act immediately to repair the damage caused by Hurricane Mitch, even at the expense of reforms achieved in the past. These demands are a

palpable risk in terms of accomplishing the program's goals, since the program aims at more deliberate advances based on building a consensus regarding development policies, formulating projects that reflect lessons learned, and advancing massive reconstruction to set the country on a new course of development. It is therefore very important that the government fully commit to the program goals. Note should be taken of the initiatives already taken to ensure effective coordination and monitoring that will avoid any deviations from the conditions agreed upon.

**SOCIAL TRANSITION AND PROTECTION PROGRAM  
(HO-0145)**

**CONDITIONALITY MATRIX**

Problem	Action	Impact	First tranche	Second tranche
<b>A. Macroeconomic context</b>				
Macroeconomic instability or recovery of economic growth have a negative impact on the impoverished	Maintaining the Enhanced Structural Adjustment Facility (ESAF) with the IMF, which seeks to maintain fiscal and monetary management that is conducive to macroeconomic stability.	Contribution to macroeconomic stability.	Maintaining a macroeconomic context that is consistent with the objectives of the program (paragraph 3.3)	Maintaining a macroeconomic context that is consistent with the objectives of the program (paragraph 3.3).
<b>B. Protection of priority programs</b>				
Macroeconomic crisis caused by the transition places priority programs at risk, in education, health, and social welfare in 1999.	Ensuring that programs that demonstrate the transformation process in the social sector are not interrupted in the short term.	Upholding the transformation process in priority areas in order to provide social services more efficiently.	The law approving the budget for 1999 must have entered into force, with the level of resource allocation agreed upon for each priority program (paragraph 3.5)	For each priority social program, ensuring that the financial and physical goals are established in the table in paragraph 3.4.
<b>C. Improving managerial capacity</b>				
Weakness: The lack of a clear, accounting, and management of the Ministry of Education (SE) is not centralized and	Establishing the strategic framework for (i) achieving means of efficiency; (ii) reorienting existing programs in order to implement the corresponding means of efficiency; and (iii) implement reforms in the pre-determined areas.	Greater managerial and implementing capacity for expanding programs and launching new reforms in the area of education.	Submission of a proposal for policy guidelines for institutional strengthening of the Ministry of Education consistent with the principles previously agreed upon with the Bank (paragraph 3.10).	Have initiated implementation of institutional strengthening plans (paragraph 3.12).

Problem	Action	Impact	First tranche	Second tranche
The use of inefficient and capacity is There is a high of services in the health (SS).	Establishing the strategic framework for sector transformation, which includes reorienting existing programs so that the corresponding means of efficiency can be implemented.	Increased managerial and implementing capacity for expanding coverage of basic health care services and improving efficiency in public spending on health.	Submission of a proposal for policy guidelines for transformation of the health sector consistent with the principles described in paragraph 2.36.	Have initiated implementation of sector transformation plan based on guidelines described in paragraph 2.36.
<b>Welfare:</b> The impact of Hurricane Mitch rendered targeting mechanism for targeting vulnerable groups obsolete. PRAF's targeting mechanisms are	Improving and updating the targeting mechanisms of the social welfare programs to ensure transparency and focus on the target populations.	Enhanced equality and transparency in transfers to the groups in greatest need.	(i) Submission of the modified version of FHIS poverty map that reflects the impact of Hurricane Mitch (paragraph 3.18). (ii) Submission of proposals for improving PRAF's targeting mechanism and assessing its impact (paragraph 3.18).	(i) Submission of proof that the modified version of the FHIS poverty map has been implemented and of a plan to update the map using the year 2000 national census (paragraph 3.20). (ii) Establishing the foundations for PRAF beneficiary census and a methodology for assessing target system impact (paragraph 3.20).
<b>D. Sector policy framework</b>				
<b>Policy:</b> There is no effective or coordinating mechanism has resulted in the duplication of efforts, inefficiency among activities, and sub-optimal use of	1. Establishing a permanent agency for coordinating the formulation and implementation of social policy.  2. Starting the process of formulating a social policy.	Enhanced efficiency in the use of resources available for the sector.	Establishing a new permanent agency for the exclusive purpose of formulating and implementing social policy and submitting a plan for strengthening UNAT as its technical support unit (paragraph 3.24).	(i) The Technical Support Unit has been provided with the staffing and equipment necessary to provide technical support for the formulation and implementation of social policies and social policy strategy proposals have been submitted in the priority areas described in paragraph 3.26.

Problem	Action	Impact	First tranche	Second tranche
<p><b>Local development:</b></p> <p>Policy context has municipalities that are not viable to lack of targeting; in methodologies; the involvement of agencies in municipal</p>	<p>Updating the National Municipal Development plan in consultation with those involved, and deepening of the plan in terms of targeting, standardization of methodologies, role definition, and mechanisms for categorizing and consolidating impoverished municipalities.</p>	<p>Enhanced transparency and efficiency in providing support resources to the weakest municipalities.</p>	<p>(i) Submission of a plan for consulting the individuals, groups, and agencies concerned by a revision of the National Municipal Development Plan, in order to deepen it in the areas described in subparagraphs 1.a-e of paragraph 3.29 (paragraph 3.28). (ii) Signing of cooperation agreements between the Ministry of Government Affairs and Justice and the agencies identified in paragraph 3.29.</p>	<p>Submission of a National Munic Development Plan that has been at least in the agreed areas (subp 1.a-e of paragraph 3.29) and that program is already being impleme test new arrangements for group most impoverished municipalitie associations in order to achieve economies of scale (paragraph 3.</p>

June 8, 1999

Mr. Enrique Iglesias  
President  
Inter-American Development Bank – IDB

Dear Mr. President:

As you are aware, Honduras is currently encountering a series of structural difficulties that date back several decades, as well as other financial problems that have recently been worsened as a consequence of the disaster caused by Hurricane Mitch. The drop in production in 1999 will mean stagnation in the development of our production system, as well as a reduction in per capita income, an increase in poverty levels, and a decline in the welfare of the country's most vulnerable groups.

Although substantive gains had been realized in the economic sector prior to Mitch, thanks to a broad program of reforms and structural adjustments that solidified the basis for starting the economic recovery, the economy has suffered a downturn that requires a twofold effort: to regain what has been lost and to move forward with our plans.

In terms of structural reforms, the achievements made during this decade have been considerable, and can be seen in the fiscal and financial areas and in such strategic areas as energy, agriculture, and others. With the intent of continuing to deepen these structural transformations and to press forward with economic reconstruction and recovery within a coherent policy framework and to revitalize government activities emphasizing the social sector, the government has signed an ESAF agreement for a three-year period with the International Monetary Fund, the IMF.

Despite these economic and structural achievements, an analysis of performance in the social sectors reveals that the outcome has been less successful than in other countries in the region, even though substantial improvements have been made. Prior to Mitch, approximately two thirds of the population was living below the poverty line; the illiteracy rate is high, at 27% nationally and 45% in rural areas; 53% of the population has no household water supply connection, and 44% has no sewerage service. These factors mean that Honduras ranks 116th in the Human Development Index, ahead of only two countries in Latin America, Haiti and Bolivia.

Currently, the effects of Hurricane and Tropical Storm Mitch have caused a deterioration in the production system, producing a contraction of the economy (2%), an increase in the fiscal deficit (8.4%), and an inability to sustain the debt, which represents a huge fiscal burden. Without a doubt, the above-mentioned social problems have increased, reaching major proportions. The situation in this sector has become increasingly difficult

and sensitive, since the government's ability to meet the people's needs has grown weaker even as those needs have increased and the problems have intensified. This scenario is contributing to an increase in violence and insecurity.

In the education sector, no gains have been made in the illiteracy rate (27%) despite expanded coverage of primary education, from 78% to 90%. The serious problem of high dropout and repeater rates persists. In the health sector, as well, access to services has expanded to 80% of the overall population, but in rural areas, where the most poverty is concentrated, coverage is only 51%. Nonetheless, it should be noted that the efforts to target primary care, emphasizing preventive services that have helped increase immunization rates and improved water supply, have led to lower mortality rates and a lower incidence of contagious diseases. Nonetheless, life expectancy has improved only from 66 to 67 years, and 19% of children under the age of five years suffer from malnutrition.

In the social sector, the FHIS has been an agile mechanism for targeting resources to the most impoverished areas, providing them with basic social infrastructure. Another significant fact is that through the FHIS, more room has been opened for promoting local development, with the direct involvement of local authorities and communities. With the damage caused by Mitch, in most of the municipalities, FHIS has been the ideal governmental agency, channeling a significant portion of the resources earmarked for physical reconstruction of the communities. It should be pointed out that the FHIS and the Family Allocation Program (PRAF), which was set up to promote better nutrition, improve mother-and-child health, and increase school attendance, are two special initiatives launched in 1990 to fight poverty.

In general, the social problems mentioned above are no different from those afflicting other impoverished countries. But in the case of Honduras, the problems have been aggravated as a consequence of Mitch. The challenge is now twofold, because along with the need to reactivate the production apparatus and to achieve macroeconomic stability, to set the country on a course toward increased growth, we must redouble our efforts in the social sector, with the added difficulty of limited financial resources, in order to overcome a great number of deficiencies. Accordingly, the government has designed a strategy in which several core elements are granted priority, such as targeting, deconcentration, decentralization, community involvement, and the strengthening of coordinating bodies, and including strategic guidelines for the different sectors.

Under this strategy, certain measures have already been taken to encourage changes in the administrative performance of the agencies responsible for social spending. The goal is to promote an efficient and effective systematic process on the part of the institutional apparatus, to achieve greater coverage and better delivery of quality social services. In addition, deconcentration and decentralization of the services is being promoted, in order to allow municipalities to work with the community and other centers to address their most pressing needs, through full participation by civil society.

Nonetheless, in order to achieve greater effectiveness and efficiency in the use of resources earmarked for the social sector, it is essential that social policy be better coordinated. Although governments have taken steps to improve living conditions for Hondurans, especially for groups on the fringes of economic growth, through broad-based discussions to lay the foundations of a far-reaching social policy, that policy has not yet come to fruition; only isolated efforts have been made. The government is aware of this situation, and has taken concrete steps to achieve greater interconnection and complementarity among social and economic policies, but these have yet to be consolidated.

Furthermore, as policy initiatives the central government intends to strengthen municipalities gradually through increases in the respective annual contributions until they reach 5%. This decisive effort will be accompanied by mechanisms to ensure effective, efficient, and transparent use of these resources, by prioritizing and ranking investments in community projects selected with the help of the beneficiaries.

We believe, Mr. President, that although the tragedy that has afflicted us is of considerable magnitude, we now have the opportunity to reconstruct and transform a new Honduras, through a more aggressive and innovative social policy, and more equitable and sustainable social spending.

In light of the foregoing, and to further develop the proposed strategy, the government has decided to implement a program for social transition and protection in order to contribute to improving the living conditions of the most impoverished population. With this program, the government seeks to ensure that interventions that contribute so much to the core transition process, improving efficiency, effectiveness, and management in the social sector are not interrupted.

With this program, we intend to support a set of policy measures and decisions in the social sector that will mitigate the short-term impact that may jeopardize the viability of the country's national reconstruction plan. The flood of increased demand and the reduced response capacity may threaten economic stability, the ability to maintain investment levels, and the transition process in the social sector.

Given this situation, it is critical not only to support decisions to protect transition programs, but also to promote policy measures that will help produce a palpable and immediate expansion of the managerial capacities of the principal players in this sector, and to institute key mechanisms for targeting efforts to the most vulnerable segments of the population.

The Social Transition and Protection Program consists of three parts: (i) financial and quantitative goals for priority programs, designed to implement transition measures; (ii) measures for increasing the efficiency of the principal agencies responsible for providing social services; and (iii) consolidation of the institutional framework for formulating policies.

The objective of the component for protection of priority programs is to ensure the continuity of those programs during the transition period. To that end, in 1999 the government will maintain the financing and physical implementation of certain priority programs in the areas of education, health, and social welfare, selected based on the following criteria:

- Providing social services at the primary level
- Pilot initiatives to test new structures and systems
- Priority assigned to serving the most vulnerable groups
- Serving the rural areas
- Delegation of authority to municipalities, communities, and civil society organizations
- Efforts to maintain physical infrastructure

The basic purpose of the component for efficiency and management or improved managerial capacities is to substantially strengthen the limited managerial capacity of the government agencies responsible for providing social services, which has been an obstacle to progress in the transition process. Hurricane Mitch increased demands on the ministries and damaged their systems and infrastructures, reducing their already limited managerial capacity. They therefore urgently need to be strengthened, in order to carry out the investment programs required under the reconstruction process, in an efficient, effective, and transparent manner. The most urgent actions for administrative and institutional reorganization to be taken in the short term have been identified in the Ministry of Education and Ministry of Health, and in the area of social welfare.

With regard to the sector policy component, it is also urgent that greater coordination of activities in the social sector be achieved. Currently, an adequate framework is lacking that coordinates sector policies with NGOs and international organizations, in order to avoid duplication of efforts and support for activities that are not necessarily consistent, and to coordinate the macroeconomic policies set forth in the government program. The goal of the Social Transition and Protection Program is to establish links for institutional exchanges and cooperation, thereby overcoming these limitations and establishing coherent, timely, and effective social policies.

The activities to be carried out under each of these components is presented in greater detail in the Conditionality Matrix attached to this letter, along with the conditions to be fulfilled for each of the tranches, and the expected impact.

The basic purpose of the efficiency and management component is to lay the foundations for transformation of the health and education sectors. The government is implementing projects in both areas, with IDB financing: one to support alternative programs for basic education and the third cycle of basic education (loan 1000/SF-HO) and the other for institutional reorganization and extension of health care services (loan 1005/SF-HO). To support implementation of the reform strategy in these sectors, prior to submittal of project HO-0145 to the Board of Executive Directors of the Bank, the government will

submit a request for reformulation of the two projects, in the terms set forth in the project report.

Finally, I would like to assure you that the Government of Honduras is deeply committed to implementing this strategy and to carrying out that program described in this policy letter. The Government of Honduras is confident that, with the backing of the Bank and of other institutions and governments interested in supporting the country's social sector, it will be possible to achieve the objectives established.

Very respectfully yours,

Gabriela Núñez de Reyes,  
Minister

PROPOSED RESOLUTION

HONDURAS. LOAN \_\_\_/SF-HO TO THE REPUBLICA DE HONDURAS  
(Program of Transition and Social Protection)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República de Honduras, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Program of Transition and Social Protection. Such financing will be for the amount of up to US\$30,000,000, or its equivalent in other currencies, except that of Honduras, which are part of the resources of the Bank's Fund for Special Operations, and will be subject to the "Financial Terms and Conditions" and the "Special Contractual Conditions" of the Executive Summary of the Loan Proposal.