

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

HONDURAS

INNOVATION LOAN

PROGRAM TO PROMOTE BUSINESS COMPETITIVENESS AND STRENGTHEN FOREIGN TRADE MANAGEMENT

(HO-0221)

LOAN PROPOSAL

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BASIC SOCIOECONOMIC DATA

For basic socioeconomic data, including public debt information, please refer to the following address:

English:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

Spanish:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

ABBREVIATIONS

CA4	Sub-Group of Central American Countries (Guatemala, Honduras, El Salvador and Nicaragua) with a specific integration agenda.
CABEI	Central American Bank for Economic Integration
CACM	Central American Common Market
CAFTA	U.S. and Central America Free Trade Agreement
CASC-H	Civil Society Advisory Council for IDB activities in Honduras
CNC	National Competitiveness Commission
ENC	National Competitiveness Strategy
ESC	Sectoral Competitiveness Strategy
FC	Competitiveness Fund
FIDE	Investment and Export Development Foundation
FONAC	National Convergence Forum
FTA	Free Trade Agreement
FTAA	Free Trade Area of the Americas
GL	Sectoral or subsectoral leadership groups
IDB	Inter-American Development Bank
INCAE	Central American Institute of Business Administration
PFC	Business Competitiveness Program
PNPE	National Export Promotion Plan
PPP	Puebla-Panama Plan
SIC	Ministry of Industry and Trade
SMEs	Small and medium-sized enterprises
UEP	Program Executing Unit
USP	Program Supervisory Unit (within the SIC)
UTPP	Public Policy Technical Unit
WTO	World Trade Organization



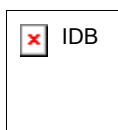
HONDURAS

IDB LOANS

APPROVED AS OF MARCH 31, 2003

	US\$Thousand	Percent
TOTAL APPROVED	2,328,987	
DISBURSED	1,878,202	80.6%
UNDISBURSED BALANCE	450,785	19.4%
CANCELLATIONS	164,203	7.1%
PRINCIPAL COLLECTED	659,075	28.3%
APPROVED BY FUND		
ORDINARY CAPITAL	535,257	23.0%
FUND FOR SPECIAL OPERATIONS	1,724,817	74.1%
OTHER FUNDS	68,913	3.0%
OUTSTANDING DEBT BALANCE	1,219,127	
ORDINARY CAPITAL	180,040	14.8%
FUND FOR SPECIAL OPERATIONS	1,038,762	85.2%
OTHER FUNDS	326	0.0%
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	294,346	12.6%
INDUSTRY, TOURISM, SCIENCE TECHNOLOGY	72,571	3.1%
ENERGY	412,125	17.7%
TRANSPORTATION AND COMMUNICATIONS	399,571	17.2%
EDUCATION	71,293	3.1%
HEALTH AND SANITATION	260,044	11.2%
ENVIRONMENT	80,002	3.4%
URBAN DEVELOPMENT	152,924	6.6%
SOCIAL INVESTMENT AND MICROENTERPRISE	327,495	14.1%
REFORM PUBLIC SECTOR MODERNIZATION	225,399	9.7%
EXPORT FINANCING	6,908	0.3%
PREINVESTMENT AND OTHER	26,308	1.1%

* Net of cancellations with monetary adjustments and export financing loan collections.



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Honduras

Tentative Lending Program

2003

Project Number	Project Name	IDB US\$ Millions	Status
HO0205	Sula Valley Citizenship Security	20.0	APPROVED
HO0221	Program to Foster Business Competitiveness	10.0	
HO0212	Poverty Reduction Sector Program	30.0	
HO0220	Poverty Alleviation and Local Dev. phase II	35.0	
HO0219	Financial Sector Program	25.0	
HO0218	Pro-Bosque Program	20.0	
Total - A : 6 Projects		140.0	
HO0208	Strengthening of Fiscal Management	15.0	
Total - B : 1 Projects		15.0	
TOTAL 2003 : 7 Projects		155.0	

2004

Project Number	Project Name	IDB US\$ Millions	Status
HO0192	Credit Global Program	30.0	
HO0202	Vocational and Technical Education Program	34.0	
HO0174	Sanitation and Water Investment Complem.	14.0	
HO0197	Poverty Reduction Program focusing on Indigenous peoples and Afro descendants	10.0	
HO0222	Social Protection Program	30.0	
HO0223	Public Finance strengthening support	25.0	
HO0224		20.0	
Total - A : 7 Projects		163.0	
HO0207	Roads Rehab and Sustainability Fase I	50.0	
HO0226	Mundo Maya	20.0	
Total - B : 2 Projects		70.0	
TOTAL - 2004 : 9 Projects		233.0	

Total Private Sector 2003 - 2004	0.0
Total Regular Program 2003 - 2004	388.0

* Private Sector Project



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HONDURAS

STATUS OF LOANS IN EXECUTION AS OF MARCH 31, 2003

(Amounts in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROJECTS	AMOUNT APPROVED *	AMOUNT DISBURSED	% DISBURSED
<u>REGULAR PROGRAM</u>				
Before 1997	4	53,900	38,900	72.17%
1997 - 1998	2	24,880	13,662	54.91%
1999 - 2000	12	206,049	51,319	24.91%
2001 - 2002	15	180,955	19,250	10.64%
2003	6	217,226	114,025	52.49%
<u>PRIVATE SECTOR</u>				
2001 - 2002	1	13,700	0	0.00%
TOTAL	40	\$696,710	\$237,157	34.04%

PROGRAM TO PROMOTE BUSINESS COMPETITIVENESS AND STRENGTHEN FOREIGN TRADE MANAGEMENT

(HO-0221)

EXECUTIVE SUMMARY

Borrower:	Republic of Honduras	
Executing agency:	Ministry of Industry and Trade, through the Program Executing Unit (UEP), with technical and operational support from the Investment and Export Development Foundation (FIDE).	
Amount and source:	IDB (FSO):	US\$10,000,000
	Local:	US\$ 1,200,000
	Total:	US\$11,200,000
Financial terms and conditions:	Amortization period:	40 years
	Grace period:	10 years
	Execution:	30 months
	Disbursement period:	36 months
	Interest rate:	1 percent for the first 10 years, 2 percent thereafter
	Inspection and supervision:	1 percent
	Credit fee:	0.50 percent per year on the undisbursed balance
	Currency:	U.S. dollars
Objectives:	The general objective of the program is to facilitate the integration of the Honduran economy into international markets, in the context of extraregional (CAFTA, FTAA, the WTO Doha process) and intraregional trade agreements (Puebla-Panama Plan, enhancement of the CACM), by strengthening the institutional capacity of foreign trade and fostering joint efforts between government, business and labor to improve the business climate, encourage cooperative partnering, enhance business productivity, and help SMEs establish linkages with the most competitive sectors. The program supplements other support from the Bank and the World Bank in the areas of export infrastructure, efficiency of the financial sector, and disaster prevention, which are also designed to make the Honduran economy more competitive.	

The specific objectives are: 1) to strengthen the government's capacity to negotiate and implement its trade policy and promote exports; and 2) to support the consensus-building process already underway between the government, the private sector and labor, as the basis for implementing strategies and projects to enhance the competitiveness of Honduran firms in foreign markets.

Rationale for an Innovation Loan:

This program was designed as an innovation loan, based on the following considerations: (i) this is the ideal instrument for supporting a participatory approach to formulating and implementing shared strategies designed to foster competitiveness and expand trade; (ii) it will put into practice a new institutional mechanism for coordination among the productive sectors, civil society and government, to promote the strategic clustering of firms and give them specialized technical assistance to help them penetrate the global market; (iii) it encourages the learning process, through mechanisms for measuring and evaluating the impact of best practices in critical areas.

Description:

The program consists of two subprograms, as described below:

Foreign Trade Subprogram (US\$2.98 million)

Activities under this subprogram are designed to: (1) strengthen the government's capacity to negotiate and administer trade agreements; (2) prepare and implement a National Export Promotion Plan, in coordination with the private sector; and (3) establish consultation and participation mechanisms to enlist the support of civil society in the process. To achieve these objectives, this subprogram includes the following three components:

Component 1. Strengthening trade negotiation management and implementation and administration of trade agreements (US\$1.52 million). First of all, this component includes activities to strengthen the technical and managerial capacity of the country to manage and participate in international trade negotiations, in particular for a Free Trade Agreement (FTA) with Central America and the United States, the negotiations now underway in the WTO Doha Round, negotiations towards the Free Trade Area of the Americas (FTAA), and other trade negotiations of strategic importance for Honduras. Second, this component will serve to strengthen the technical and managerial capacity of the country to apply and administer existing trade agreements, in particular the commitments assumed under the WTO and the Central American Common Market (CACM), as well as the FTAs signed with Mexico, Chile and the Dominican Republic, and those expected in the future

with Canada, the United States, Panama and other trading partners in the context of the FTAA and current multilateral negotiations.

Component 2. Strengthening the technical capacity to promote exports (US\$1.05 million). First, this component includes preparation and implementation of the National Export Promotion Plan (PNPE), coordinated and executed jointly by the public and private sectors. The PNPE involves the following activities: preparation of studies on exportable products; preparation of product-market fact sheets; creation and dissemination of a “country image”; and organizing specialized trade fairs. Second, this component includes development and implementation of an “export portal” that will provide up-to-date market information to current and potential producers and exporters. Third, this component includes the strengthening of human resources for export promotion, consisting of a Technical Training Plan for Export Facilitation, targeted at public officials and businesspeople in a series of specific export-related issues; implementation of the Technical Training Plan in Trade Promotion for diplomatic officials; and an internship program for university students.

Component 3. Design and implementation of a Consultation, Dissemination and Participation Strategy (US\$410,000). First, this component includes institutionalizing and implementing permanent consultation mechanisms between the public and private sectors and civil society, in support of the country’s trade negotiations, the observance of commitments, and the promotion of trade and investment. Second, this component includes a training program for journalists and communicators involved in reporting on foreign trade, so that they can deepen their analysis and write objectively about foreign trade issues, and in particular the challenges and opportunities resulting from the negotiation and signature of international trade agreements. Third, this component includes a training program for members of Congress to help them acquire the necessary knowledge about the diverse and complex range of issues in foreign trade that may enhance the effectiveness of their parliamentary work in this area.

Competitiveness Subprogram (US\$5.4 million)

As a supplement to the trade activities supported by the first subprogram, the second subprogram is designed to consolidate the dialogue between government, the private sector and labor, and to build consensus on ways to enhance business productivity, with particular attention to: (i) implementing the National Competitiveness Strategy, and formulating and implementing concrete sectoral and subsectoral strategies to deal with the problems that have been identified as barriers to raising productivity (the Bank’s program will

give priority to raising productivity in the agroindustry and forestry sectors, thereby complementing the support that the World Bank is providing for improving the business climate); (ii) supporting linkages between SMEs and clusters/sectors/subsectors with competitiveness potential; and (iii) cofinancing of the preinvestment phase for projects emerging from these clusters, consistent with the program's selection criteria. This subprogram includes the following components:

Component 1. Improving the business environment and implementation of the ENC (US\$2.31 million). This component will provide funding for: (i) implementing the National Competitiveness Strategy (ENC); (ii) developing and implementing strategies and specific action plans for the forestry, agroindustry, and tourism sectors; (iii) technical support to the Competitiveness Committee of Congress; (iv) strengthening the program's relationships with civil society; and (v) disseminating the scope and results of the program.

Component 2. Linking SMEs to business clusters (US\$1.09 million). This component will pay for studies and activities to encourage and help Honduran SMEs to join the competitiveness effort by helping them build links to clusters/sectors/subsectors with the potential to be competitive internationally in the forestry and agroindustry fields. Technical assistance will also be provided to groups organized around business development issues, and for a program with suppliers based on international best practices.

Component 3. Competitiveness Fund (US\$2 million). This component calls for: (i) creation of a Competitiveness Fund (FC) to provide cofinancing for cluster-based projects selected in accordance with program criteria; and (ii) preparation of a database on consultants eligible to provide specialized technical assistance.

The FC will cofinance projects to enhance the competitiveness (understood here as factor productivity) of beneficiary firms. FC-financed projects must contribute to meeting the objectives of the country's national competitiveness strategy. Specifically, cofinancing will be provided for technical assistance to businesses, aimed at developing and improving products and processes (including production, quality control, commercial and administrative issues) under a 70-30 subsidy scheme for groups of at least three firms.

**The Bank's
country and
sector strategy:**

This operation is highly linked to and consistent with the Bank's strategy in Honduras. That strategy is aimed at helping the government to reduce poverty by promoting sustainable, competitiveness-led growth, which in turn is one of the three strategic areas for the Bank, together with those of human capital development and of governance and institutional development. The operation is in

response to a request from the government to merge the business competitiveness development program and the trade management and export promotion program, recognizing the complementarity and consistency of their objectives and the need to simplify the execution of the Bank's portfolio in Honduras.

Coordination with other multilateral development institutions:

The program is being coordinated with the World Bank, the Inter-American Investment Corporation, and CABI. The World Bank is designing a competitiveness program to help improve the business climate. It is working with the IIC and CABI to coordinate the design of mechanisms for financing private projects emerging from the clusters participating in the program (see paragraphs 1.20, 1.22 and 1.24).

Environmental and social review:

The environmental feasibility of the operation is assured, in that: (i) it will have no direct environmental impacts; and (ii) its components include the environment so as to ensure that the activities supported will promote environmental sustainability. Moreover, the concept of "environmental competitiveness" is being introduced as a mechanism for improving the access of Honduran products to world markets.

Benefits:

The program will introduce a mechanism for generating public-private consensus on policies and programs to improve the business climate. This process will have concrete results in terms of the National Competitiveness Strategy and activities of the various clusters/sectors/subsectors that will generate investment in public, mixed and private projects for enhancing competitiveness. The program is expected to generate direct benefits through job creation and expanded output, consistent with the challenges of competitiveness and sustainability. The program beneficiaries will be Honduran businesses in general, but especially those with an international market orientation in the forestry, agroindustry, and tourism sectors.

Risks:

The program's success depends squarely on the existence of a long-term national policy for strengthening the capacity to manage foreign trade and promote exports, and on the development of a consensus-based process of strategic planning to foster business competitiveness. This will require active participation by both public and private sectors in seeking the necessary consensus. In the current environment, the government and private sector have already shown their interest in supporting the program, through their participation in the National Competitiveness Commission, which has been in operation since May 2002. To be still more effective, the program will require close coordination between formulation of the ENC and results of the strategic analysis of clusters/sectors/subsectors. The first step in the strategic planning process is now underway in the form of

workshops, coordinated by INCAE, to negotiate an initial competitiveness agenda in the context of operation ATN/SF-7671-RG. That technical-cooperation funding was used for workshops with various sectoral, regional, political and governmental groups, culminating in the March 2003 announcement of the National Strategy. As for strengthening of trade management, the government has accelerated preparations for the CAFTA negotiations. The Bank, for its part, has already provided support to the government through ATN/SF-7665-HO.

Special contractual clauses:

Prior to the first disbursement of Bank financing, the following conditions must be fulfilled: (i) a technical assistance and operational agreement between the executing agency and FIDE must be signed and in force, consistent with terms previously agreed with the Bank (paragraph 3.7); (ii) evidence that the Program Supervisory Unit has been formally established and is in operation (paragraph 3.9); (iii) evidence that the Program Execution Unit has been formally created and is in operation (paragraph 3.8); and (iv) entry into force of the Program Operating Regulations, previously agreed upon with the executing agency and the Bank (paragraph 3.16).

The Bank may reimburse up to the equivalent of US\$200,000 from the loan proceeds for expenses incurred by the executing agency between 1 February 2003 and the date of loan approval by the Bank's Board of Executive Directors, provided that Bank policies have been observed (paragraph 3.33).

Poverty-targeting and social sector classification:

This operation does not qualify as a social equity-enhancing project or as a poverty-targeted investment, as described in the Report on the Eighth General Increase in Resources of the Bank (document AB-1704). Nevertheless, it is expected to contribute to the Bank's strategy in Honduras, and in particular to the poverty reduction strategy, by fostering a better business climate, enhancing productivity and improving the competitiveness of Honduran products on world markets, which in turn will produce higher levels of employment and investment.

Exceptions to Bank policy:

None.

Procurement:

The procurement of goods and related services and the selection and contracting of consulting services will be done in accordance with pertinent Bank procedures and policies. International competitive bidding will be required for the purchase of all goods and related services where the cost is US\$250,000 equivalent or more. Procurement of goods and related services below that amount will be governed in principle by local legislation, provided it is compatible

with Bank policies. An international open call for proposals will be required for the contracting of consulting services the cost of which exceed US\$200,000 equivalent. The program does not call for construction works. The procurement plan for the program is attached as Annex II to the proposal.

I. BACKGROUND

A. The economic environment in Honduras: mixed results

- 1.1 The last 10 years have seen mixed results in the economic development of Honduras: there has been greater macroeconomic stability, with swift and successful diversification of exports, but there has been no growth in per capita GDP. Major structural problems persist, such as a chronic fiscal deficit, a foreign exchange shortage, a very low tax burden, once adjusted in terms of real GDP, and, above all, inefficient allocation of spending. Despite the efforts of the past decade, Honduras has the third-lowest income per capita in the hemisphere.
- 1.2 Reinforcing the macroeconomic situation is a necessary but insufficient condition for achieving the levels of growth that the country will need to reduce poverty. Now that trade negotiations have been launched between the CAFTA and the United States, and with the prospect that the FTAA will materialize, the main efforts to promote viable development and real economic growth in Honduras are expected to be securing permanent access to international markets, enhancing competitiveness, understood as a sustained increase in business productivity indicators, and improving the business climate, which will lead to a reduction in operating costs.

B. The foreign trade sector of Honduras

- 1.3 During the 1990s, the trade policy agenda pursued by the Government of Honduras focused on deepening regional integration and greater penetration of the Honduran economy into the international economy. Of particular importance were the adoption of the program to reduce customs tariffs, and the negotiations to bring Honduras into the General Agreement on Tariffs and Trade (GATT), which were concluded in 1994. Honduras subsequently joined the World Trade Organization (WTO) in 1995.
- 1.4 At the hemispheric level, Honduras has been an active participant in negotiations for the Free Trade Area of the Americas (FTAA) since 1998. Bilaterally, there has been significant progress, including the free trade agreement signed with Mexico in 2000. Recently, as a reflection of the provisions of the Trade Promotion Act, the Bush Administration has launched formal negotiations with five countries of the Central American Economic Integration System (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua) for signature of a Free Trade Agreement. In addition, Honduras is negotiating to join the Customs Union being promoted between El Salvador and Guatemala, and it is part of the effort to intensify regional trade within the Central American Common Market (CACM) as well as initiatives under the Puebla-Panama Plan (PPP).
- 1.5 Despite the economic importance of foreign trade for Honduras, the country still lacks a solid institutional capacity to manage it. In recent years, with the

multiplication of international trade obligations, there is clearly an urgent need to restructure and reorganize the institutional aspects of trade policy management.

C. The current competitiveness situation in Honduras

- 1.6 Honduras is the lowest-ranking country of the region on the competitiveness scale of the World Economic Forum,¹ although it is highly competitive in light manufacturing, and it has considerable untapped potential in forestry, tourism and agroindustry. These four sectors show differing degrees of development.
- 1.7 In the forestry sector, the major problems appear to be associated with uncertainties surrounding the ownership of forest lands, unsustainable resource management, low forest productivity, and incentives for illegal logging, thereby constraining the primary sector in its overall operations and in its access to raw materials. In agroindustry, major efforts have been made to strengthen the value added in subsectors such as aquaculture, but there is still an unrealized potential in several subsectors such as dairy (for example, artisanal cheese making).

D. Foreign trade: problems and opportunities

- 1.8 Given the administrative demands of the trade agreements already signed by Honduras, and the number, complexity and timing of the negotiations now underway with the United States for the FTA, there is a growing need for institutional preparation, strengthening and adjustment. There is a multitude of simultaneous tasks relating to the negotiation and administration of trade agreements and in applying them, which requires close cooperation with the private sector. The SIC is lacking in properly qualified human resources, technical means and institutional mechanisms to manage trade negotiations, implement international agreements, and promote trade.
- 1.9 When it comes to negotiations, the country faces severe limitations in its capacity to process information and analyze it in light of the methodologies used for the product negotiations, and in its capacity to evaluate the impact of trade liberalization programs on goods, services or government procurement. At the same time, budget shortages make it impossible to hire these services. There is an immediate need, furthermore, to train officials in specific aspects relating to the negotiations agenda, and in particular the FTA negotiations with the United States. In terms of the information technology available, the SIC also lacks adequate computer equipment and communication systems, as well as databases and software.

¹ Honduras ranks 74 out of 75 countries as measured by the “Microeconomic Competitiveness Index” for 2001-2002, and stands 70 out of 75 countries for the “Growth Competitiveness Index.” While these measures are open to debate, there is no doubt that there are severe limitations on the country's ability to host sectors that are strongly competitive at the regional and global level.

- 1.10 When it comes to implementing trade agreements, there are shortcomings in the areas of systems for certification, accreditation and taxation of products and services. These shortcomings impact negatively on the government's capacity to use these instruments for controlling imports, so as to protect public health and avoid non-tariff market access problems.
- 1.11 In export promotion, the government has not demonstrated an effective capacity to match its promotional efforts with the needs of the private sector and thus achieve concrete results. Little has been done for diversification of exports, which are still concentrated in limited markets, primarily the United States, the Central American Common Market, and the European Union. All of these issues point to real commercial opportunities, to take advantage of demand in the countries with which Honduras is negotiating free trade agreements.
- 1.12 The situation has been exacerbated by the lack of any formal coordination system to ensure coherent participation at the technical level by the various government agencies involved in international trade negotiations, and in applying agreements and promoting exports and investment.

E. Competitiveness: problems and opportunities

- 1.13 The challenge of greater openness. The benefits offered by access to the U.S. market, and expectations of increased direct foreign investment in the CAFTA context, the opening of other markets in the Americas in the FTAA context, and the tariff preferences that the country enjoys with the European Union, represent unique opportunities for the sustainable development of Honduras, provided it can improve the competitiveness of its economy by raising productivity in a sustained and sustainable manner, and reducing operating costs in the country. This sustained increase in competitiveness will only be possible if there is a broad national strategy, reflecting consensus among the public and private sectors and civil society, that can depoliticize the discussion of problems and possible solutions, promote the corresponding action plans and help implement them.
- 1.14 Microeconomic limitations. The productive base is constrained by the limited responsiveness and managerial capacity of Honduran firms, the country's thin presence in external markets, high transaction costs, low levels of direct foreign investment, lack of information, legal barriers, and significant levels of legal insecurity, among other problems. Among the factors affecting business competitiveness in Honduras are: (i) the weakness of the financial sector, as reflected in high interest rates and limited access to sources of financing; (ii) the poor quality of infrastructure and basic services, which keeps production and transaction costs high; (iii) vulnerability to natural disasters, which poses additional risks to investors; and above all, (iv) the lack of any coordination mechanism between the public sector and private industry, as needed to promote a national strategy, an action plan, and the development of clusters in potentially competitive

sectors. The proposed program focuses on the last of these factors, since the others are already being addressed, as explained in paragraphs 1.22 and 1.23 below.

- 1.15 The National Competitiveness Commission (CNC) needs to be reinforced and confirmed as the preferred mechanism for identifying pitfalls and barriers to competitiveness, and for formulating responses in terms of policies, programs and key investments. Efforts at the macroeconomic level to stabilize the Honduran economy frequently fail to correct microeconomic factors that undermine business productivity and competitiveness.
- 1.16 Opportunities. With creation of the CNC in May 2002, and designation of FIDE as its Technical Secretariat, a start has been made at creating an effective institutional mechanism for pooling the capacities of the government and the private sector to formulate and implement concrete and coordinated strategies and action plans. There is now an opportunity to reach consensus on policies and programs for this purpose. Yet this will only be possible with specialized technical assistance at the national level for sectors, clusters, and individual firms.

F. The Honduran government's proposal and the Bank's role

- 1.17 The government has been taking steps to strengthen its management capacity in the area of foreign trade. A nonreimbursable technical cooperation program (ATN/SF-7665-HO) is now in place to support those efforts.
- 1.18 The CAFTA negotiation process has spurred the definition of a clear policy and the design of institutional instruments for achieving the objective of improving international trade flows.
- 1.19 On 13 May 2002, the government officially launched its National Competitiveness Program, while Decree PCM-004-2002 established the National Competitiveness Commission (CNC), with senior representation from government, the private sector and labor.² The Technical Secretariat of the CNC is the Investment and Export Development Foundation (FIDE): an operational agreement was signed to this effect in May 2002, a copy of which is available on the program technical files.
- 1.20 The government has proposed to coordinate efforts to ensure that operations now being designed by the IDB and the World Bank will include complementary activities for improving the business climate and developing the four priority sectors: forestry, high value-added agroindustry, tourism, and textile manufacturing. The IDB has been designated the principal coordinator for the first two sectors, and the World Bank for the others. As well, the government requested both banks to coordinate their activities with respect to infrastructure and services

² The National Competitiveness Commission is composed of the Presidential Delegate, the Secretary to the Office of the President, the Secretary of Finance, the Secretary of Industry and Commerce, four entrepreneurs, two advisers, and a labor representative. The President of the Congressional Committee on Competitiveness also attends the sessions, as do leaders of the sectoral groups.

in support of competitiveness, such as energy (IDB) and telecommunications (World Bank).

G. The program's relationship with the Bank's country strategy

- 1.21 This operation fits very well with the Bank's strategy in Honduras (GN-2238) and with its proposed competitiveness strategy (GN-2243). That strategy is aimed at helping the government to reduce poverty by promoting greater sustainable, competitiveness-led growth, which in turn is one of the three strategic areas of Bank action, together with human capital development and governance and institutional development. The operation is in response to a request to merge the business competitiveness development program with the trade management and export promotion program, recognizing the complementarity of their objectives and the need to simplify the execution of the portfolio in Honduras.
- 1.22 This program is designed to complement other efforts of the Bank and the World Bank relating to export infrastructure, enhancing the efficiency of the financial sector, and preventing natural disasters,³ the objective of which is also to improve the competitiveness of the Honduran economy.
- 1.23 Specifically, the Bank has provided preliminary support to this process through Regional Technical Cooperation ATN/SF-7671-RG, in support of national competitiveness programs in the region. This technical cooperation is laying the basis for a participatory strategic planning process in which workshops will be held with various groups of society to validate a national competitiveness agenda. As well, Technical Cooperation ATN/SC-8003-HO, Strategy for Sustainable Forestry Businesses, is underway to help lay the ground for targeting forestry sector support within the present program and the *Pro-Bosque* program (HO-0218). The design work has been completed for the vocational and technical education operation (HO-0222), which will be enriched by the strategic planning process supported under this operation. On the financial front, the Bank is preparing the Financial Sector Program (HO-0219), to help overcome competitiveness barriers created by the existing inefficiencies in this sector. Finally, disaster prevention is being addressed through Technical Cooperation ATN/SF-8025-HO, the objective of which is to help the Government of Honduras to evaluate available information on the risks facing the country, and their possible impact on macroeconomic and fiscal performance, in order to develop a financial management strategy for reducing the overall cost of these risks, in light of the country's economic possibilities.
- 1.24 The program will help the Bank, the government, and the private sector to identify the main problems of connectivity and competitiveness in the Honduran economy, and to propose appropriate, consensus-based strategic solutions. This will lay the ground for larger-scale operations or other programs under different IDB windows (MIF, PRI, IIC), incorporating lessons from support efforts of this kind aimed at the

³ In a country with great environmental vulnerability, natural disasters are closely linked to competitiveness.

business sector, so that they can serve as the basis for designing future projects. Discussions have begun with the IIC to have that institution give priority to examining projects arising from the Competitiveness Fund (FC). This coordination effort will continue during implementation of the program. Similarly, the Credit Department of the CABI has confirmed its interest in providing a complementary line of investment for Fund projects, thereby improving the conditions for timely placement of FC resources.

H. Regional experience with competitiveness programs

- 1.25 Valuable experience has been gained from competitiveness programs in Brazil, Chile, Colombia, the Dominican Republic, Mexico, the Andean region, and all of Central America. Although the evidence is still preliminary, it suggests that programs to promote cooperative partnering among firms in a specific sector and locality can produce benefits in terms of business management, human capital accumulation, access to technical assistance, and the overall productivity of participating firms.⁴
- 1.26 Noteworthy in Central America was the assessment and development strategy pursued by the Central American Agenda for Competitiveness for the 21st Century, which lay the groundwork for joint public-private partnerships to promote national competitiveness.
- 1.27 The *Compite* program in Panama, funded by an IDB Innovation Loan (PN-0145), establishes a model for addressing the competitiveness issue through a process similar to that proposed here.
- 1.28 The lessons learned from these experiences in promoting competitiveness are mainly that: (i) strategic planning needs to be participatory (“bottom-up”); (ii) the process needs to emerge from a consensus between the public and private sectors—the private sector having driven the process, the public sector being the strategic partner that fosters business-climate reforms; and (iii) demand, not supply, is what drives the programs and makes them sustainable.

I. Rationale for an innovation loan

- 1.29 This program was conceived as an innovation loan in light of its objective to institutionalize a coordinated public/private sector dialogue and consensus-building process for the continuous development of strategies and action plans to consolidate the competitive advantages of Honduras in the context of regional integration and globalization. More specifically, the program will: (i) establish a participatory process for developing and implementing strategies to foster competitiveness; (ii) implement a new institutional mechanism for promoting the formation of

⁴ For example, the Chilean PROFO program has demonstrated high economic returns: each peso invested in this program generated 2.4 additional pesos of net benefits.

business clusters and delivering specialized technical assistance to those clusters; (iii) document lessons learned from this kind of support targeted to the business sector, on which designers of future projects can draw; and (iv) strengthen the government's capacity to improve access for Honduran goods and services to world markets, and enhance investment levels in the country.

II. DESCRIPTION OF THE PROGRAM

A. Program objectives

- 2.1 The general objective of the program is to facilitate the integration of the Honduran economy into international markets, in the context of extraregional (CAFTA, FTAA, the WTO Doha process) and intraregional trade agreements (Puebla-Panama Plan, enhancement of the CACM), by strengthening the institutional capacity of the foreign trade sector and fostering joint efforts between government, business and labor to improve the business climate, encourage cooperative partnering, enhance business productivity, and help SMEs establish linkages with the most competitive sectors. The program contains two subprograms: “Competitiveness” and “Foreign Trade.”
- 2.2 The specific objectives are: 1) to strengthen the government’s capacity to negotiate and implement its trade policy and promote exports; and 2) to support the consensus-building process already underway between the government, the private sector and labor, as the basis for implementing strategies and projects to enhance the competitiveness of Honduran firms in foreign markets.

B. Conceptual framework of the program

- 2.3 The activities proposed under the program are intended to improve conditions for access to world markets and increase foreign investment opportunities. They are also designed to enlist active participation by the private sector, in formulating and implementing strategies for improving the business climate and for enhancing the productivity and competitiveness of firms. Increased productivity is particularly important in the current context of trade liberalization, hence the synergy between the two proposed subprograms. To accomplish these aims, the program will use a cluster model as a basis for identifying strategic priorities in specific sectors, which will in turn serve as elements for targeting public investment and for formulating horizontal economic policy and strategies to improve business organization, so as to maximize the country’s economic performance.

C. Program components

- 2.4 This innovative operation consists of two subprograms, as described below:

1. Subprogram: Strengthening foreign trade management (US\$2.98 million)

a. Component 1: Strengthening trade negotiation management and implementation and administration of trade agreements (US\$1.52 million)

- 2.5 This component is intended to strengthen the government's technical and managerial capacity, particularly that of the Office of the Secretary of State for Industry and Commerce (SIC), to: (a) manage and participate in international trade negotiations, in particular the negotiations between Central America and the United States, and the regional and multilateral negotiations taking place under the FTAA and the WTO, and the negotiations underway for conclusion of the FTA between the CA4 and Canada; and (b) administer and effectively implement the commitments (rights and obligations) stemming from existing trade agreements.

(i) International trade negotiations

- 2.6 **Institutional strengthening.** The program will finance technical assistance for designing and implementing a plan to reengineer the management of trade negotiations, including: (i) establishing and launching working groups among departments involved in the same or similar issues, depending on the negotiating agenda; (ii) instituting a Statistical Analysis and Trade Unit, to prepare studies and technical analysis in support of the trade negotiations; (iii) creating a coordination mechanism among directors of the Office of the Deputy Secretary for Economic Integration and Foreign Trade (SIECE) and between them and other departments of the SIC, in order to strengthen the coordination of trade negotiations in the various forums, and to ensure consistency and coherence in the proposals and positions presented by Honduras; (iv) establishing a formal, interinstitutional coordination system for the public sector at the technical level, so as to establish working teams and integrated coordination mechanisms at the strategic policy management level of the negotiating processes; and (v) providing trade information systems (hardware and software) to improve the management of trade negotiations.
- 2.7 The program will also implement a system of paid internships for university students in their final year of study, or for recent graduates (maximum two years) in disciplines related to international trade that will serve to train new ranks of trade specialists and negotiators for the country. Interns will conduct research for the new Economic and Trade Study Unit in the following areas: market access, technical barriers to trade, agriculture, sanitary and phytosanitary measures, rules of origin, dispute settlement, trade and the environment, trade and labor rights, financial services and telecommunications. The technical criteria for selecting interns are available in the Program Operating Regulations.
- 2.8 **Specialized advisory services.** The program will finance specialized technical assistance to support the country's negotiating team in defining its negotiating

strategies and in preparing technical studies in the areas and for the fora indicated below, among others:

- a. Technical studies in support of trade negotiations with the USA, including the following specific issues: (i) evaluating the economic and commercial impact, overall and by sector, of an FTA between the USA and Honduras; (ii) analyzing the productive structure of export sectors to support the negotiations of rules of origin; (iii) formulating strategies and possible approaches for negotiating market access for priority exports for Honduras, as well as for the most sensitive products; (iv) assessing the services sector in Honduras, and reviewing existing restrictions in the USA (cost-benefit analysis and identification of potentialities and sensitivities); (v) a cost-benefit analysis for Honduras in negotiating government procurement access; (vi) analysis of U.S. trade regimes and policies relating to non-tariff measures, sanitary and phytosanitary measures and technical standards, and evaluation of the impact on Honduran exports; and (vii) analysis of the U.S. trade regimes and policies in the agriculture sector, as they affect Honduras.
- b. Technical studies to support the work of the SIC in the Doha Development Round negotiations, including the following specific areas: (i) analyzing the economic and commercial impact for Honduras of different scenarios for multilateral tariff reduction in agricultural trade; (ii) identifying and analyzing negotiating approaches and strategies in other areas of market access, farm subsidies, domestic support programs for agriculture, food aid, and export credits and insurance; (iii) defining a negotiating strategy on denominations of origin, based on the country's export potential; (iv) textile negotiations; and (v) other priority issues on the new WTO agenda planned for 2003.
- c. Technical studies to support the SIC during the FTAA negotiations, including the following specific areas: (i) market access; (ii) agriculture; (iii) dispute resolution mechanisms; (iv) analysis of trade regimes and policies of member countries of the Andean Community and MERCOSUR; (v) design and implementation of a statistical system for trade in services, based on international classification systems; and (vi) analysis of the relationship between the preferences negotiated in the FTA with the USA and those of the FTAA.
- d. Technical studies on the Central American integration process in the context of the CACM, including the following specific areas: (i) analysis of the impact for Honduras of completing the free trade area, and of tariff convergence among the countries of the CACM; (ii) a study on effective levels of protection at each stage of production; (iii) an assessment of the impact on Honduras of bilateral agreements that some CACM partners have signed with other countries, in particular with respect to tariffs and rules of origin; (iv) evaluation of existing legislation on temporary entry and free zones, and its impact on the trade liberalization process of the CACM; (v) evaluation of export incentives applied by CACM partners and preparation of a proposal for harmonizing them;

(vi) analysis and recommendations for preparing and implementing a common agricultural policy within the CACM; and (vii) an analysis of the common external tariff and customs integration.

2.9 **Training.** The program will finance the design and implementation of technical training programs in the following areas, among others:

- a. A program of general training courses, including: (i) basic concepts and tools of external trade; (ii) negotiating procedures and techniques; (iii) provisions, rules and disciplines included in the major trade agreements signed by Honduras; and (iv) methodologies for analyzing the principal variables that affect export products and markets of interest to Honduras, and for measuring the impact of the negotiations on domestic productive sectors.
- b. Development and implementation of a program of courses and seminars for specialized training in issues covered by the negotiations, in light of the country's priorities and needs.
- c. Development and implementation of a workshop program for analyzing, discussing and evaluating the various negotiations in which the country is engaged, in order to help define a national position in each of these forums.
- d. Development of ad hoc training activities, based on the needs that may arise during each of the negotiation processes.

(ii) Application and administration of agreements

2.10 The program will finance activities to strengthen technical and management capacities for applying and administering existing trade agreements, in particular the commitments assumed under the WTO and the CACM, as well as the FTAs signed with Mexico, Chile and the Dominican Republic, and those that may be concluded in future with Canada, the United States, Panama and other trading partners in the context of the FTAA and the current multilateral negotiations.

2.11 **Institutional strengthening.** The program will support the institutional and managerial strengthening of the government, and in particular the SIC, in the application and administration of trade agreements. It will provide technical assistance for designing and implementing a plan to reengineer institutional management processes for administering sanitary and phytosanitary rules and industrial quality standards; verifying rules of origin; protecting intellectual property rights; and resolving disputes and international issues. The program will also provide technical assistance for designing and implementing the computer architecture needed for applying and administering trade agreements, including the purchase of hardware, software and licenses.

2.12 **Specialized advisory technical services.** The program will pay for specialized technical assistance to conduct studies in the following thematic and functional areas of administration and implementation of trade agreements, among others:

- a. Evaluation and proposals for strengthening the animal and plant health system, in particular the system of certification and surveillance, and government laboratory capacities.
- b. Evaluation and recommendations for strengthening the preparation, certification, implementation, oversight and dissemination of technical and operating standards, laboratory operation and capacities, accreditation and control mechanisms, and participation by various agencies and private entities in the system's technical committees.
- c. Evaluation of mechanisms for certifying and verifying the origin of goods, in particular in Customs and in the certification agencies, with a view to recommending improvements.
- d. Legal analysis of cases involving trade dispute resolution.

2.13 **Training.** The program will finance the design and implementation of technical training programs in the following areas, among others:

- a. Training courses in the administration of trade treaties and agreements, to examine experiences in other countries and make recommendations for strengthening the performance of the SIC in this area.
- b. Technical courses and workshops for officials of the SIC, Customs, Ministry of Agriculture, Ministry of Health, Attorney General's Office, the judiciary and other public- and private-sector entities, designed to publicize the rules and disciplines contained in international trade agreements relating to intellectual property and existing mechanisms for enforcing them.
- c. Technical courses and workshops for customs officials relating to requirements and rules of origin, and the commitments that Honduras has assumed in this area under various agreements.

b. Component 2: Strengthening the technical capacity to promote exports (US\$1.05 million)

(i) Preparation and implementation of the National Export Promotion Plan

2.14 The program will finance the preparation and implementation of the National Export Promotion Plan (PNPE), to be coordinated and executed jointly with the private sector. The PNPE will include the following activities:

- a. **Studies of exportable products.** This will involve the following phases:
(i) assessment of the country's current and potential export possibilities, based on primary-source information on installed and utilized capacity from primary sources in the productive sectors, their technological and infrastructure level, analysis of production chains, pricing systems, export logistics and financing sources, among others, as needed for qualitative and quantitative analysis by product and by region; (ii) determining the main requirements for strengthening export firms and recommendations on export promotion policies and specific measures, consistent with the needs of productive sectors that will stimulate preparation of export products; and (iii) selecting strategic products for promotion, consisting of at least two strategic products per cluster, using the objective criteria of sustained international demand and consumer trends in target markets. These studies will be conducted through the contracting of specialized advisers who would work in close coordination with the SIC and FIDE. To achieve the most effective results possible in this activity, the work would focus on field research and visits to production centers for on-site analysis of the current and potential situation of industrial firms, farms and other production centers.
- b. **Preparation of product-market fact sheets.** This activity involves preparing product-market fact sheets for preselected products, with all the information needed for marketing them in target markets. The fact sheets will serve as a practical tool for exporting products, providing an additional element of analysis, based on concrete variables, and thereby enhance decision making for firms interested in testing international markets for their products. For each product, a product-market fact sheet will be prepared, containing at least the following information: product name; productive sectors; product description, according to the Harmonized System of Customs Classification; varieties and uses of the product; imports of the product in target markets, measured in US dollars; benchmarking study on competing markets; demand measurement and forecasting (product availability, market prospects, and windows of opportunity); market segmentation, selection and positioning; prices (price history, pricing policy and strategy, price fluctuations and trends); principal point-of-sale and distribution channels; basic marketing principles that potential exporters must respect; promotion (communication, strategies and publicity); organization of sales and credit conditions; commercial packaging for transport (standards in target markets); labeling and certifications; imports barriers; warehousing and transportation conditions; technical, phytosanitary and environmental standards; and conditions of delivery and form of payment to be used. The program will pay for advisory services by a firm specialized in marketing issues, as well as a trading company, for preparing and distributing the fact sheets. Preference will be given to firms that have experience and direct access to potential buyers in target markets.
- c. **Creating and publicizing a "country image."** This activity will involve designing and implementing a professional publicity and marketing campaign to

position the country strategically in major target markets, on the basis of preselected products. The campaign will include highlighting the comparative advantages of Honduran products, such as their environmental soundness or small-scale production, competitive prices, quality and reliability, and other elements that go into the selection of strategic products. The campaign will focus on target markets, using advertisements in specialized media, banners on strategic websites, advertising posters in airports, and other effective means of publicity and communication. The campaign will be prepared and conducted by an international advertising agency, together with the SIC and FIDE.

- d. **Specialized trade fairs.** This activity consists in organizing specialized trade fairs in Honduras, with the participation of exporters or potential exporters, as well as current and potential foreign clients. Among other criteria, these fairs will focus on sectors that offer the greatest potential for trade development over the short term, based on results of the export possibilities studies described above. The program will provide material, publicity and logistical support for organizing the fairs.

(ii) Development and implementation of the Export Portal

- 2.15 This subcomponent consists of creating and developing an Export Portal to provide up-to-date commercial information to producers and exporters, either free of charge or on a subscription basis. The Portal will provide the following information free of charge: commercial regulation in target markets, technical specifications for products, benchmark prices, demand indicators, quality standards, information on commercial facilities, directories of importers and exporters, new opportunities in strategic markets, information on current legislation governing exports (including special incentives) and imports, and trade, economic and social statistics of interest. Under the subscription modality, businesses will be able to gain access to promotional services and virtual product samples, business development services (B2B linkages, including company profiles, electronic catalogs, contacts, etc.), development of commercial networks for business opportunities in target markets, online training and other services. Revenues generated by subscriptions to the Portal will ensure the sustainability of the activity, and will be reinvested in the Portal in order to improve it and keep it up to date. The program will finance the hiring of a technical adviser for design and implementation of the Portal, and the acquisition of hardware, software and licenses. The program will finance the hiring of online business information service providers for the paid services offered by the Portal.

(iii) Strengthening human resources

- 2.16 **Export facilitation technical training plan.** This activity involves a Technical Training Plan aimed at public officials and private entrepreneurs, covering a series of specific issues related to exporting, including the following modules: administration of the temporary entry and duty drawback system; international

supply contracts;⁵ international packaging;⁶ market research and product/market methodology (see details in the program technical files); organic and environmental product certification; carrier and transportation insurance;⁷ and export project formulation and management.⁸ The training plan targets public officials responsible for export regulation and supervision, such as those of the SIC, SER, Revenue Division, the Ministry of Finance and Customs, as well as firms and private businesses that are current or potential exporters. Specific selection criteria for participants will be included in the Program Operating Regulations. The program will provide technical assistance for holding executive seminars and workshops under each of these thematic modules.

- 2.17 **Technical training plan in trade promotion for diplomats.** This activity involves preparation and execution of a technical training program in trade promotion for the directors of diplomatic offices of Honduras abroad, as well as diplomatic officials involved in commercial and economic work. The objective is to strengthen the commercial role of the country's diplomatic offices, especially those in the target markets identified in the PNPE. The program will finance various training activities, as well as preparation of a Trade Promotion Manual on CD-ROM, with technical inputs developed in the PNPE, such as studies of export possibilities, product/market fact sheets, and "country image" campaign materials. The contents of the manual will also be posted in the Export Portal.
- 2.18 **Internship program.** This activity will finance a program of paid internships for university students in their last year of study, or recent graduates (maximum two years since graduation) in disciplines relating to international trade. Students will be selected through open competition for incorporation into the work of the SIC. Interns will receive initial technical orientation, and their responsibilities will consist largely of market research and preparing the product/market fact sheets for the PNPE. The technical criteria for selecting interns are found in the Program Operating Regulations.

c. Component 3: Implementation of mechanisms for consultation and dialogue with the private sector and civil society (US\$410,000)

- 2.19 The purpose of this component is to create opportunities and channels for coordination and consultation within the public sector, and between it and the private sector and civil society, in support of the country's trade negotiations and

⁵ Includes: international sales contract, transport systems, contracting and physical distribution of goods, and payment conditions.

⁶ Includes: functions of the packaging system, product packaging and lifecycle, commercial function of the packaging system, and marketing aspects in the packaging system.

⁷ Includes: single export invoice, commercial invoice and packing list, Customs procedures, entry of foreign exchange, compulsory procedures and prior authorizations.

⁸ Includes: project identification, formulation, management and planning; project management by results; and computerized tools for project monitoring and supervision.

the subsequent application of commitments. The activity will also include dissemination and training mechanisms targeted at the private sector and civil society, to raise the level of public awareness about the growing importance of trade, and its implications and opportunities. Implementation of these activities will be supported by the Civil Society Advisory Council for IDB Activities in Honduras (CASC-H) and other civil society organizations interested in the issue.

(i) Public-private consultation mechanism

- 2.20 This subcomponent will further strengthen consultation mechanisms between the public sector and the private sector and civil society, as well as within the private sector, in support of the country's trade negotiations process, the application of commitments, and the promotion of trade and investment. The program will finance: (i) technical assistance and equipment for designing and implementing dialogue and consultation mechanisms with the private sector and civil society, including toll-free telephone lines of the 1-800 type, and an interactive web site, as channels of information and dissemination where the public can make inquiries and express concerns and interests on issues relating to international trade; and (ii) design and implementation of a nationwide Publicity Plan for informing public opinion on the importance of trade negotiations and the progress made in them, the interests at stake, the benefits for the country from trade agreements, and activities to secure greater access for Honduran exports in various international markets. The Publicity Plan will include training and participation with representatives of civil society⁹ and the private sector in the country's different cities, radio and television programs, information bulletins, presentations and discussion forums.

(ii) Training program for journalists

- 2.21 This subcomponent is intended to give journalists and public relations officers covering foreign trade the means to deepen their analysis and to write objectively about foreign trade issues, particularly the challenges and opportunities resulting from the negotiation and signature of international trade agreements. The program will finance training courses for journalists and public relations officers, with participation by national and foreign instructors. The selection criteria for beneficiaries are found in the Program Operating Regulations.

(iii) Training program for members of Congress

- 2.22 This program is intended to help members of Congress acquire an understanding of the diverse and complex range of issues involved in foreign trade, to help improve the effectiveness of their parliamentary work. The program will finance technical seminars and workshops on foreign trade topics of particular importance for the country, especially those related to the legislative agenda.

⁹ In particular, training and consultation activities will be targeted at representatives of indigenous peoples, in order to evaluate with them the potential social and cultural impacts of trade liberalization.

2. Competitiveness subprogram (US\$5.4 million)

a. Component 1: Improving the business environment and implementing the ENC (US\$2.31 million)

2.23 This component will finance implementation of the National Competitiveness Strategy (ENC), with activities to improve the business climate and reduce operating and transaction costs in the country. The ENC is in fact a platform for developing strategies for clusters, sectors and subsectors, and designing and implementing action plans at both the national and sectoral levels. The component will also finance the dissemination of the program, increase awareness among stakeholders, provide technical support to the Competitiveness Committee of Congress, and strengthen the program's relationships with civil society.

- a. **Implementing the ENC.** The initial validation of the ENC, under ATN/SF-7671-RG, will provide input for completing and formalizing that effort. Preparation of the strategy is a dynamic process that requires continuous adjustments. Consistent with this process, six priority areas have been identified, five of them relating to basic substantive issues, and one relating to interagency coordination and communication: (i) upgrading human capital, including preparation of a plan for the National Training System and modernizing labor markets; (ii) innovation and technological development; (iii) improving the quality of products and services, including metrology issues and technical standards; (iv) developing infrastructure and logistics in support of clusters/sectors/subsectors; (v) promoting competition and reducing administrative barriers; and (vi) interinstitutional coordination and communication. Among these topics, the program will give priority to preparing action plans for the topics indicated in (ii), (iv), and (v) in part, specifically as it relates to eliminating barriers at the municipal level. As well, efforts at initial implementation of those plans will be financed.
- b. **Design and validation of the Sectoral Competitiveness Strategies (ESC) and specific action plans for the forestry, agroindustry, and tourism sectors.** The component will finance specific activities for consensus-based strategic planning in priority sectors. A document will be produced for each sector, including an implementation strategy and its corresponding action plans. For the forestry sector there will be inputs from Technical Cooperation ATN/SC-8003-HO. In the agroindustry sector, work will be coordinated with the executing bodies for the various programs now underway with financing from the Bank and other regional, bilateral and multilateral development banks. In the case of the activities to be financed in the tourism sector, the strategic plans prepared by the Ministry of Tourism and related agencies will be taken into account.
- c. **Technical support to the Competitiveness Committee of Congress.** Technical studies will be financed to help the committee assess specific projects that have an impact on competitiveness. The component will also finance workshops and

awareness seminars with members of the National Congress, and technical visits for assessing competitiveness programs in other countries.

- d. **Fostering coordination with civil society.** Funding will be provided for joint activities (seminars, roundtables, workshops), with the CASC-H and other civil society organizations involved with the issue, so as to encourage active participation by civil society in the competitiveness process to the extent possible. This interaction will also help to identify priority areas for improving national competitiveness, and will give the issue of competitiveness a national dimension that goes beyond the strictly governmental or private spheres.
- e. **Program dissemination.** Financing will be provided for activities to raise public awareness about the program's purposes and activities throughout the country, including a world-class web page to serve as a permanent channel of communication and information, and to make the program more transparent by publicizing the contents of the programs and their beneficiaries, as well as the evaluations that are conducted. This page will also serve as an instrument for explaining comprehensively the benefits of investing in Honduras.

**b. Component 2: Building business linkages for SMEs
(US\$1.09 million)**

- 2.24 This component will finance studies and activities to foster and facilitate the incorporation of Honduran SMEs into the process of improving and promoting competitiveness, helping them to form clusters, sectors or subsectors that can compete internationally in the priority sectors identified in the ENC.
- a. Studies and formulation of strategies and action plans to identify solutions to the major problems facing Honduran SMEs, and the opportunities offered by the National Competitiveness Program.
 - b. Studies of the most promising production chains for SMEs and conditions for establishing linkages to clusters/sectors/subsectors. This includes the construction and implementation of a program of suppliers to leading firms or firms with high foreign investment. This subcomponent will be coordinated with Component II of the Foreign Trade Subprogram on Export Promotion.
 - c. Technical assistance and training for SMEs in the area of business development services (administration/management, marketing, upgrading productive processes) to provide tools to assess the needs of firms, and to provide funding for consultants to answer those needs. Eligibility conditions for these technical assistance and training services will be governed by the Operating Regulations, including beneficiary profiles, and the amount and nature of counterpart contributions.

c. Component 3: Competitiveness Fund (US\$2 million)

2.25 Under this component, the program will establish a Competitiveness Fund (FC), a flexible and quick-responding instrument for inducing cooperative partnering among Honduran firms in sectors of high competitive potential. The component will involve: (i) creating the FC to cofinance the preinvestment phase of projects sponsored by groups of firms; and (ii) preparing a database of eligible consultants for specialized assistance. Regulatory details of the FC are covered in the Program Operating Regulations, under the following general guidelines:

- a. Beneficiaries of the FC will be groups of firms (minimum three, maximum 50) formally constituted and based in Honduras, whose economic activities fall within the sectors identified in the ENC, whether as producers of basic and intermediate inputs or as firms engaged in production and marketing of finished products. No firm may participate in more than one group, or in more than one project.
- b. The FC will cofinance projects to enhance the competitiveness (understood here as factor productivity) of beneficiary firms. Projects must contribute to achieving the objectives of the National Competitiveness Strategy.¹⁰ Specifically, the FC will cofinance technical assistance services aimed at enhancing competitiveness, including the development and improvement of products and processes (productive processes, quality management, commercial and administrative processes) and improving the business climate. The FC will finance 70 percent of project costs, while the interested firms will cover the remaining 30 percent. Nonreimbursable cofinancing from the FC may not exceed US\$250,000 per project per group of firms, for a total project cost of US\$357,000.
- c. Interested groups of firms must prepare a project and propose a reasonable number of activities involving the contracting of technical assistance services that will make the project technically and commercially viable. The project must contain the basic elements needed for the UEP to evaluate it and recommend approval, i.e.: contact data for the firms; operating, financial and commercial backgrounds thereof; project objectives; business group strategy; identifying external services needed to implement the strategy; and selection of technical assistance suppliers and detailed presentation of terms of reference and bids. Suppliers' bids must contain at least the following information: objective and working methodology, description of activities, expected results, the level of effort and unit cost, and a schedule of activities.

2.26 The FC will involve the following players: National Competitiveness Commission, the Ministry of Industry and Commerce, Project Executing Unit, groups of

¹⁰ The ECN will be announced on 11 March 2003, at a CNC event where the scope of the National Competitiveness Program to be financed with support from various multilateral and regional institutions will be explained.

beneficiary firms and technical assistance providers. The following table shows the main responsibilities of each player.

Player	Responsibilities
National Competitiveness Commission	<ul style="list-style-type: none"> • Define strategic objectives of the fund • Approve projects recommended by the UEP
Ministry of Industry and Commerce	<ul style="list-style-type: none"> • Supervise management of the UEP • Coordinate with other government agencies
Program Executing Unit	<ul style="list-style-type: none"> • Promote the FC • Support groups of firms in identifying, preparing and executing projects • Evaluate projects and recommend approval/rejection • Sign agreements with groups of firms • Report on service providers for the firms • Contract service providers for the firms • Make payment to service providers • Collect and provide technical and financial information on FC operations
Groups of beneficiary firms	<ul style="list-style-type: none"> • Propose projects and select technical assistance providers • Sign agreements • Execute projects • Deposit counterpart contributions • Report on project results
Technical assistance providers	<ul style="list-style-type: none"> • Sign contracts • Provide services

D. Program costs

2.27 The cost of the proposed program is estimated at US\$11.2 million. The distribution by source of funding and category of investment is indicated in the corresponding table. Bank financing would amount to US\$10 million, from the FSO. The national counterpart amounts to US\$1.2 million, of which up to US\$600,000 is expected to be provided by private enterprise as part of its contribution to the projects financed by the Competitiveness Fund. In addition to the standard consulting services, training, and equipment items, the cost table includes a special item, “General Support and Services” that covers financing for various support activities. Specifically, under the foreign trade subprogram, the project will provide resources for the material, technical, and logistical support needed for Honduras to participate in various trade negotiation forums, in particular the FTA with the United States and the WTO, FTAA, and Central American Common Market negotiations. In addition, the “Program Management and Administration” item includes funds for communications, travel expenses, and other costs related to UEP operations.

- 2.28 The loan will carry the following conditions: (i) interest rate of 1 percent for the first 10 years, 2 percent for the next 30 years; (ii) credit fee of 0.5 percent per year on undisbursed balances; (iii) inspection and supervision fee of 1 percent of the loan; (iv) disbursement period of 36 months; (v) amortization period of 40 years; and (vi) grace period of 10 years.

CONSOLIDATED BUDGET BY COMPONENT				
Budgetary Category	IDB/FSO	Counterpart	Total	%
COMPETITIVENESS SUBPROGRAM				
Improving the business environment and implementing the ENC	2,169,000	145,000	2,314,000	20.7
1. Consulting Services	2,127,100	70,000	2,197,100	19.6
3. Training	41,900	75,000	116,900	1.0
Building business linkages for SMEs	1,091,010	0	1,091,010	9.7
1. Consulting Services	1,036,010	0	1,036,010	9.3
3. Training	55,000	0	55,000	0.5
Competitiveness Fund	1,398,600	600,000	1,998,600	17.8
1. Consulting Services	1,398,600	600,000	1,998,600	17.8
Subtotal	4,658,610	745,000	5,403,610	48.2
EXTERNAL TRADE SUBPROGRAM				
Strengthening trade negotiation management and implementation and administration of trade agreements	1,402,400	116,100	1,518,500	13.6
1. Consulting Services	667,000	0	667,000	6.0
2. Equipment	414,000	0	414,000	3.7
3. Training	171,400	116,100	287,500	2.6
4. General Support and Services	150,000	0	150,000	1.3
Strengthening the technical capacity to promote exports	878,900	171,500	1,050,400	9.4
1. Consulting Services	457,400	0	457,400	4.1
2. Equipment	139,000	0	139,000	1.2
3. Training	157,500	77,500	235,000	2.1
4. General Support and Services	125,000	94,000	219,000	2.0
Mechanisms for consultation and dialogue with the private sector and civil society	413,700	0	413,700	3.7
1. Consulting Services	261,200	0	261,200	2.3
3. Training	152,500	0	152,500	1.4
Subtotal	2,695,000	287,600	2,982,600	26.60
Program Management and Administration	1,236,500	36,000	1,354,500	12.20
1. Consulting Services	1,086,000	36,000	1,122,000	
2. Equipment	110,000	0	75,000	
4. General Support and Services	67,500	90,000	157,500	
Unallocated	963,845	0	963,845	8.6
1. Contingencies	963,845	0	963,845	8.6
Concurrent Costs	100,000	0	100,000	0.9
1. External Audit	50,000	0	50,000	0.4
2. Midterm & Final Evaluations	50,000	0	50,000	0.4
Subtotal	2,327,345	126,000	2,453,345	21.9
Financing Costs	319,046	41,400	360,446	3.2
1. Interest	219,046	0	219,046	2.0
2. Credit Fee	0	41,400	41,400	0.4
3. Inspection and Supervision	100,000	0	100,000	0.9
Subtotal	319,046	41,400	360,446	3.2
Total	10,000,000	1,200,000	11,200,000	100

E. Poverty-targeting and social sector classification

- 2.29 This operation does not qualify as a poverty-targeted investment (PTI) or as a social equity-enhancing project (SEQ). Nevertheless, potential benefits are expected in the form of job generation and higher incomes, through improvements to the business climate and the country's export capacity.

III. PROGRAM EXECUTION

A. Borrower and executing agency

- 3.1 The borrower will be the Republic of Honduras, which will be responsible for servicing the debt and for making timely contribution of local counterpart funding for the program. The executing agency will be the Ministry of Industry and Commerce, through the Program Executing Unit (UEP), with technical and operational support from the Investment and Export Development Foundation (FIDE).
- 3.2 Consistent with the Regulations Governing Organization, Functioning and Powers of the Executive Branch, the SIC has responsibility for the following functions: (i) formulation, coordination, execution and evaluation of policies regarding the promotion and development of industry, national and international trade in goods and services, export promotion, economic integration, private investment and business development, including: (a) promotion and channeling of domestic and foreign private investment, and technology transfer; (b) formulation of strategies and execution of policies for diversifying external markets and export products, including promotion of competitiveness for domestic products; (c) studies relating to international business procedures and formulation of national strategies; and (d) formulation, execution and evaluation of bilateral, regional and inter-regional economic and trade integration policies; and (ii) intellectual and industrial property issues.
- 3.3 The Investment and Export Development Foundation (FIDE) was created in August 1988 as a nonprofit private entity in the public interest, of indefinite duration, with its own legal personality and capital, for the purpose of contributing to the economic and social development of Honduras through education, training and services to individuals and institutions relating to business development, promotion and management. As an institution providing business development services, FIDE has played a leading role in efforts to enhance national competitiveness, and is well-placed to provide technical and operational support to the SIC in implementing the program. FIDE also has experience in executing programs financed by multilateral and regional institutions, including the Bank. Thanks to its ongoing involvement in these programs, the quality of its services has been constantly improving. The Multilateral Investment Agency (MIGA) is currently working on programs to strengthen the FIDE.
- 3.4 FIDE is composed of: (i) an Assembly of Governors; (ii) a Board of Directors; (iii) a President; (iv) Executive Committees; and (v) Affiliates, Branches, Agencies and Representative Offices.
- 3.5 The National Competitiveness Commission (CNC), created by Executive Decree PCM-004-2002, as an ad hoc advisory body to the Executive Branch on

- competitiveness issues, has the following main functions: (i) to develop a National Competitiveness Program; and (ii) to undertake initiatives, conduct research and studies relating to the program. The CNC is composed of: (i) a representative of the President of the Republic; (ii) a representative of the business sector; (iii) the Secretary of State for Industry and Commerce, and the Secretary of Finance; (iv) the Coordinator of the Economic Cabinet; (v) a labor representative; and (vi) three entrepreneurs.
- 3.6 Under that Decree, the Commission is to have the services of a Technical Secretariat, which may be provided by public institutions such as associations, corporations or foundations, legally recognized in Honduras, pursuant to an assistance and execution contract duly approved by the President of the Republic. Under a contract signed in May 2002, the CNC and FIDE agreed that the FIDE will serve as Technical Secretariat of the CNC.
- 3.7 For purposes of executing this program, the SIC will sign a technical assistance and operating agreement with FIDE, which will constitute **a special condition precedent to the first disbursement.**
- 3.8 In recognition of the positive externalities implied in having FIDE as the CNC Technical Secretariat, its expertise in competitiveness issues and its leadership within the country's private sector, and by express decision of the government, the Program Executing Unit (UEP) will be created within FIDE, and will have the necessary personnel to administer the program efficiently. It will be headed by an Executive Director. **Creation of the UEP will be a special condition precedent to the first disbursement period.**
- 3.9 The Program Supervisory Unit (USP) will be created within the SIC for purposes of program supervision and monitoring. **The creation of the USP will be a special condition precedent to the first disbursement.**
- 3.10 Constant coordination between the government and the Program Executing Unit will be assured by having a presidential appointee as President of the National Competitiveness Commission (CNC), as well as the presence of the Secretaries of Finance and of Industry and Trade as members of the CNC, and technical supervision by the USP in the SIC.

B. Execution strategy

- 3.11 In terms of design and implementation, the mechanisms for supporting and providing technical assistance to the private sector will have the required independence and flexibility to assure the program's credibility, shared accountability, and joint action to underpin the process of developing clusters/sector/subsectors. The public sector will have to take a businesslike approach to managing the competitiveness program, if it is to be successful. The proposed scheme will have to respect the levels of intervention of each institutional

body in defining their responsibilities: for example: policy definition (Presidential Delegate, SIC and CNC); formulating instruments and evaluating results (SIC); technical and financial support for establishing clusters/sector/subsectors (UEP within FIDE); and delivery of business services (consultants or independent firms).

C. Functions and activities of the participating entities

- 3.12 **Program Executing Unit.** For purposes of program execution, the UEP will have the following functions: formulate the work plan and detailed activities of the program; maintain liaison with the Bank; submit disbursement requests to the Bank; conduct bidding and allocation procedures; select consultants and approve their contracts; monitor execution and present progress reports to the Bank; authorize expenditures and other service contracts; conduct ongoing evaluations and information meetings with the Bank's Country Office; assure compliance with conditions of the loan contract, and submit program monitoring reports to the Bank, including financial statements, audited by a firm of independent public accountants acceptable to the Bank.
- 3.13 For financial and accounting administration of the program, the executing agency, through the UEP, will have the following functions: (i) managing program funds through a specific and separate bank account, for depositing and disbursing funds from the loan. The local counterpart resources will be handled through the account of the General Treasury of the Republic; (ii) implementing and updating systems for contract administration, accounting and financial administration, and internal control over program resources, in accordance with Bank policies; (iii) presenting disbursement requests and expenditure justifications in accordance with Bank requirements; (iv) maintaining original supporting documentation on eligible expenditures; (v) presenting semiannual reports on the Revolving Fund within 60 days after the close of each period; and (vi) preparing and presenting audited financial statements for the program, and other financial reports as required by the Bank.
- 3.14 The UEP will have the following functions relating to technical aspects of the program execution: (i) support the CNC as required, including the analysis to identify structural obstacles to competitiveness, proposing and evaluating solutions and recommending improvements to the policy environment; (ii) preparing implementation of the ENC, under supervision of the CNC; (iii) facilitating the establishment and implementation of clusters/sector/subsectors, and providing technical assistance to the Leadership Groups (GL) for each sector; (iv) compiling data on clusters/sector/subsectors for purposes of measuring results; (v) compiling and maintaining a directory of consultants as a guide for prompt identification of accredited providers of consulting services for clusters/sector/subsectors; (vi) contracting of short-term consultants for specialized advisory services, as needed by the program; (vii) establishing and performing administrative, accounting and contracting duties, in accordance with Bank policies and procedures, as well as administering the Competitiveness Fund; (viii) providing

- execution data to the SIC and the CNC, and standing ready to produce reports for them when so requested; and (ix) submitting disbursement applications to the Office of the Secretary of State for Finance, with a copy to the SIC, as required for program execution.
- 3.15 The UEP will consist of an Executive Director, three technical experts in the following sectors: agroindustry, forestry, and trade (hereafter the Area Managers); an expert in administration and finance; an expert in information technologies; an administrative assistant, and at most two accountants. In addition, an environmental consultant will be hired, who will have specific duties as described in point IV.C of this proposal.
- 3.16 The program will be executed through Annual Operating Plans (AOPs), to be agreed with the Bank at annual monitoring meetings, as described below. The first AOP must be submitted as an integral part of the initial report that the executing agency is to submit to the Bank pursuant to the General Conditions for loan contracts. Program activities will be regulated by specific criteria and procedures that will form part of the Program Operating Regulations. **Entry into force of the Program Operating Regulations, previously agreed with the Bank, will be a special condition precedent to the first disbursement of Bank funding.**
- 3.17 The Program's Executive Director will have the following functions:
- a. Preparation of annual operating plans.
 - b. Regular monitoring of schedules and outcomes for projects and components, in accordance with the Logical Framework, timetables and other instruments for assessing verifiable commitments under the program.
 - c. Forwarding communications from the UEP to the Bank.
 - d. Coordinating and assisting in dissemination of program objectives and progress.
 - e. Technical specifications and terms of reference for contracting professional services and equipment under each component.
 - f. Achieving the objectives and goals of each component within the stipulated timeframes and resources.
 - g. Supervising consultants' compliance with terms of reference and the results of their work.
 - h. Periodic progress reports on the program to the SIC, the CNC, and from the SIC to the Bank, based on reports of each Area Manager.
- 3.18 Technical execution of the program will be supervised directly by each of the three Area Managers of the UEP, who will report to the Executive Director. Each of the

Area Managers will work in close coordination with line authorities and technical staff of the SIC and of other program beneficiary agencies.

3.19 The Area Managers will have the following functions:

- a. Achieving the objectives and goals of the program under their specific component, within stipulated timeframes and resources.
- b. Helping in preparation of annual operating plans, semiannual activities and tasks and semiannual progress reports on the program, within their respective component.
- c. Supervising, coordinating and evaluating the performance of consultants and/or consulting firms contracted for execution of activities under their component.
- d. Specifying the technical specifications and the terms of reference for contracting professional services and equipment under each component, as agreed with the responsible line authorities.
- e. Establishing points of consultation for future users, internal or external, of the products of each component.
- f. Supervising consultants' compliance with terms of reference and the results of their work, by agreement with the corresponding line authority.
- g. Periodic progress reports on the program.

3.20 **The USP within the SIC will be responsible for program supervision.** The SIC will have a key role in implementing the program, through its liaison functions between the CNC and government ministries and institutions, both those that are members of the CNC and others. Through the USP, the SIC will supervise the activities entrusted to the UEP. In this regard, the USP will have to: (i) participate in meetings of the CNC and coordinate its activities with UEP; (ii) coordinate technical involvement by other ministries, as necessary in formulating the ENC, and provide effective technical support to the program; (iii) ensure that specific policies and activities within or relating to the ENC and its action plan are carried out; and (iv) supervise activities of the UEP and coordinate the evaluation of services offered, through surveys of beneficiaries. The USP will have a competitiveness expert and a foreign trade expert to support the SIC to monitoring and fulfilling program objectives.

3.21 The SIC will serve as the program's institutional memory, and will be the recipient and beneficiary of the lessons learned during its implementation. This is particularly important for the trade subprogram. To this end, the SIC will arrange for the UEP to commission impact studies and will disseminate the results of studies and lessons learned from the program.

- 3.22 **The National Competitiveness Commission.** As coordinator of the ENC, and given the level of its membership, the CNC will take the lead in promoting the program, achieving consensus, approving the ENC, and monitoring implementation of the action plan. The CNC consists of a Presidential delegate, cabinet members, and business and labor leaders.¹¹ The principal functions of the CNC are: (i) to identify structural obstacles to competitiveness and recommend the necessary studies and strategic assessments; (ii) analyze possible strategies and promote the ENC, in consultation and participation with interested sectors; (iii) approve the ENC action plan, including investments, reforms and policies needed to foster competitiveness and present recommendations on priorities and sources of financing; (iv) send proposals to the Executive Branch on competitiveness policy instruments and regulatory reforms needed to meet, in a timely and suitable manner, the goals and objectives established in the national strategy; and (v) monitor performance of the ENC and its action plan on a quarterly basis.
- 3.23 **Functions and activities of the Leadership Groups.** In each sector, subsector or cluster that is part of the program, a Leadership Group (GL) has been identified, drawn from business and academic sectors, to coordinate and guide ongoing activities. These groups were created at government request, in recognition of the business and technical leadership of their members, and their contributions to the sectors identified. The GLs will provide for liaison with: (i) government authorities and international financing agencies, for arranging support and financing for investment projects identified by the cluster/sector/subsector; and (ii) the CNC, to which they will present recommendations for improving and reforming public policies affecting productive development, and the investment climate and public investment projects required in support of the cluster/sector/subsector. Finally, with support of the UEP, they will be responsible for executing the ESCs, preparing working programs, and continuously monitoring the program and its overall performance.

D. Procurement of goods and services

- 3.24 The procurement of goods and related services and the selection and contracting of consulting services will be done in accordance with pertinent Bank procedures and policies. International competitive bidding will be required for the purchase of all goods and related services where the cost is US\$250,000 equivalent or more. Procurement of goods and related services below that amount will be governed in principle by local legislation, provided it is compatible with Bank policies. An international open call for proposals will be required for the contracting of consulting services the cost of which exceed US\$200,000 equivalent. The program does not call for construction works. The procurement plan for the program is attached as Annex II to the proposal.

¹¹ See footnote 3.

E. Monitoring and evaluation

- 3.25 The Bank's Country Office in Honduras, with support from the headquarters team, will be directly responsible for supervising and monitoring the program.
- 3.26 Program funds will be used to hire external consultants for two evaluations, a midterm and a final evaluation. The terms of reference for these evaluations will be prepared by the SIC, with the Bank's nonobjection. These evaluations will measure levels of execution, progress, and the impact of the visible results of the program, on the basis of the AOP and the logical framework. The midterm evaluation will be conducted when 50 percent of Bank funds has been disbursed, or at least 15 months after the loan contract comes into effect, whichever occurs first. The final evaluation will be conducted when 90 percent of Bank funds has been disbursed. The external consultants will report on performance of the program and the possibility of replicating or expanding it through other Bank programs. To this end, they will take into account lessons learned, and analyze data on the program's impact.
- 3.27 Program monitoring also calls for periodically calculating the indicators in the logical framework (see Annex I) and compliance indicators under the contract with the UEP. During the program, the SIC will evaluate the work of the UEP by surveying participants in the clusters/sectors/subsectors, to assess their satisfaction with services provided by the UEP itself and by the consultants and firms it has contracted. These elements will be used to make adjustments to the program during its execution.
- 3.28 Monitoring includes designing and using instruments to measure results, both quantitatively and qualitatively, to ensure the achievement of the program's objectives and the quality of its services. Funding will be provided to design a methodology and a system for monitoring: (i) the quality of services provided by consultants and firms contracted through the Competitiveness Fund; (ii) the quality of UEP's services under the program; and (iii) the impact of its activities on productivity and on the production of goods and services by firms that make up the clusters/sector/subsectors, and the activities proposed under the ENC action plan.
- 3.29 The program is expected to produce various effects, from improving relations between businesses within a production chain, to improvements within individual firms (financial, managerial, human resources, product quality, marketing, production). This will require development of a tool that, with a minimum basis of anonymous and aggregated data, can be used to analyze program results. Control groups will also be selected as a basis for comparison. The evaluation will include: (i) the design and implementation of the impact measuring system; (ii) identification of the target group within the clusters/sector/subsectors and the control groups; (iii) compiling data; and (iv) an independent evaluation of impact at the end of the program. The results and the lessons learned will be published in reports and studies that will be available on the Web site.

F. Disbursement schedule

- 3.30 The execution period will be 30 months, and the disbursement period will be 36 months. To ensure that Fund resources are disbursed within the program period, the Operating Regulations will require the UEP to stop accepting new commitments prior to termination of the program, and projects approved must have a completion deadline compatible with the life of the program.

G. Audit and transparency

- 3.31 The UEP will keep separate accounting and financial records for the program, so as to: (i) identify financial transactions using program funds, independent from other funds managed by FIDE; and (ii) prepare financial statements for the program.
- 3.32 The UEP, through the SIC, will present annual financial statements for the program to the Bank, audited by an independent firm of public accountants acceptable to the Bank within 120 days after the close of each fiscal period. The cost of the audit will be covered by the Bank loan. To ensure transparency in use of the Fund's resources, the program calls for publishing a list of its users, via the media and at the program web site.

H. Reimbursement of expenses from the loan

- 3.33 With the Bank's agreement, up to the equivalent of US\$200,000 from the financing may be used for reimbursement of program-related expenses, for the establishment of the UEP and for the activities included in component 1 of the subprogram for strengthening foreign trade management. Such expenses must have been incurred prior to the date of approval of the loan but after 1 February 2003, provided that requirements substantially similar to the ones established in the contract have been met.

IV. BENEFITS, RISKS AND FEASIBILITY

A. Benefits

- 4.1 The program will equip the government of Honduras with greater capacity to manage foreign trade and promote exports, thereby consolidating the process of gaining access to international markets.
- 4.2 The program will introduce a mechanism for generating public-private consensus on the strategic formulation of policies and programs to improve the business climate. This process will have concrete results in terms of the National Competitiveness Strategy and activities of the various clusters/sectors/subsectors that will generate public, mixed and private investment projects the execution of which will boost competitiveness. The program is expected in this way to generate direct benefits in terms of employment creation and expanded output, consistent with the challenges of global markets and international competitiveness.
- 4.3 Establishing a participatory process for strategic planning, and the preparation of a consensus-based ENC, will bring with them intangible but significant benefits, in the form of a comprehensive vision of development and the building of national social capital.
- 4.4 Also as a result of the process, the program may become a fundamental tool for the Bank's programming with the government, allowing for the identification of new projects and structural reforms on which there is broad consensus between the public and private sectors.
- 4.5 Finally, experience with the structure and operation of the institutional mechanism introduced in this program will offer significant lessons for future activities of the Bank and the government in these areas.

B. Risks

- 4.6 The program's success depends squarely on the existence of a long-term national policy for strengthening the capacity to manage foreign trade and promote exports, and on the development of a consensus-based process of strategic planning to foster business competitiveness. This will require active participation by both public and private sectors in seeking the necessary consensus. If the program comes to be seen as exclusively a government activity, it risks being politicized and confined to a short-term focus.
- 4.7 In the current environment, the government and private sector have already shown their interest in supporting the program, through their participation in the National Competitiveness Commission, which has been in operation since May 2002. To be still more effective, the program will require close coordination between

formulation of the ENC and results of the strategic analysis of clusters/sectors/subsectors. The lack of such coordination between the SIC, the CNC, the GLs and the UEP would reduce the benefits of the program as an instrument for fostering competitiveness.

- 4.8 A first step in the strategic planning process is now underway in the form of workshops, coordinated by INCAE, to negotiate an initial competitiveness agenda in the context of ATN/SF-7671-RG. Under that technical cooperation operation, workshops were conducted with various sectoral, regional, political and governmental groups, culminating in the announcement of the National Competitiveness Strategy.
- 4.9 At the same time, the identification and selection of clusters/sectors/subsectors at the outset of the process will give them a more active role in defining the elements of the national strategy.
- 4.10 For the trade management segment, the government has accelerated preparations for the CAFTA negotiations. The Bank, for its part, has already provided support to the government through ATN/SF-7665-HO.
- 4.11 The World Bank is preparing a complementary operation to finance a project under the National Competitiveness Program. Although that operation will have no significant sectoral activities, it is essential to improve the mechanisms for coordination and dialogue between the IDB, the World Bank, and the government. In addition, FIDE, as technical secretariat of the CNC, will be responsible for monitoring both operations and preventing possible duplications. An interinstitutional body is proposed to advise the CNC, and to serve as a coordination forum for the multilateral institutions and development agencies involved in the National Competitiveness Program.

C. The environmental and social management program

- 4.12 The program's concept of competitiveness includes the quality and protection of productive resources, comprehensive and equitable social services for workers, and environmental stewardship consistent with competitiveness. Since the program itself will have no direct environmental and social impacts, the Environmental and Social Management Program will focus on the potential for minor, indirect impacts that could arise in the course of activities to be financed. For this reason, the program will pay to hire an international expert to ensure the inclusion of innovative approaches to the concept of "environmental competitiveness" in all program activities. The Operating Regulations will also include the environmental variable, to ensure that projects arising from the clusters/sectors/subsectors will seek and promote the sector's social and environmental sustainability, and that the program does not finance projects that are environmentally unsustainable.

- 4.13 The concept of “environmental competitiveness” driving the program focuses on promoting and applying environmental criteria within the private sector (through clusters/sectors/subsectors), to help improve strategic positioning in national and international markets. The program will look for and reward projects that promote the “green option” so as to make products and/or production processes in the industry’s production chain more “attractive” to major buyers and consumers, and to reduce operating, maintenance and waste disposal costs, facilitating compliance with environmental standards through specific incentives (e.g. agreements between the private sector and the Ministry of Environment, etc.).
- 4.14 The benefits expected from applying the concept of “environmental competitiveness” are, among others: inclusion of the environmental variable in the enhanced business climate and in the action plans to be developed as part of the ENC, constant upgrading of products and services, the strategic impact of cost reduction and a better public image, promoting “organic products”, and fostering sustainable development of priority sectors, etc.
- 4.15 More specifically, the program calls for incorporating the environmental and social variables at three levels. First, in the process in defining national structural actions; secondly, in strategies and action plans for the clusters/sectors/subsectors; and third, in monitoring and measuring the program’s impact. For example, environmental and social variables will be highlighted in studies focused on productive activities in the agroindustry and forestry sectors. It is also expected that beneficiary firms under the Competitiveness Fund will apply methodologies such as ISO 9000 and ISO 14000, and other indicators of environmental sustainability such as organic certification, the “blue flag” system, and “corporate responsibility” when they join an ECC, etc. For this reason, the list of consultants prepared by the UEP will place special stress on these areas of specialization.
- 4.16 Thus, the environmental and social feasibility of the operation will be assured by the contracting of a specialist in environmental competitiveness who will fulfill several functions: (a) develop and integrate the environmental variable into the National Competitiveness Strategy; (b) provide ongoing support to the clusters/sectors/subsectors and the area managers in identifying, quantifying and implementing possible actions to promote or foster inclusion of the environmental competitiveness concept (e.g. in the “business plans”) of the sectoral clusters; and (c) develop mechanisms and incentives between the private and public sectors to streamline the processing of environmental permits (as a form of public-sector recognition of the private sector’s efforts to build environmental competitiveness into its activities). The program will include funds for monitoring and measuring the impact of incorporating the environmental variable at all these levels. Moreover, the program will recognize and reward business plans emerging from the clusters/sectors/subsectors under the ECC that are environmentally and socially feasible, or that include relevant activities.

- 4.17 The Program Operating Regulations include the proposed Environmental and Social Management Program.

D. Institutional feasibility of the program

- 4.18 The program structure delimits the roles and functions of each institution and attempts to specify the delegation of functions to the most appropriate institutions. For example, through the technical and operational assistance agreement with FIDE, the program will derive benefits from a streamlined and flexible institutional apparatus for responding to the needs of clusters/sectors/subsectors and participating firms.
- 4.19 The trade subprogram is designed to reinforce the institutional capacity of the SIC to continuously and successfully address the challenges inherent in managing trade and promoting exports.
- 4.20 The competitiveness subprogram does not call for any fixed or permanent institutional structure for delivering technical assistance services to the clusters/sectors/subsectors, nor for formulating strategies. However, having FIDE as the executing agency will enhance the likelihood that the program can escape the vagaries of politics. It is possible that some activities under the institutionalized process will survive over time: for example, the CNC could continue its functions of monitoring the implementation of action plans and the activities of clusters/sector/subsectors that may be established even after the program is completed. The commitment and leadership of the private sector will be the best guarantee of continuity.

SUMMARY LOGICAL FRAMEWORK
Program to Promote Business Competitiveness and Strengthen Foreign Trade Management
COMPETITIVENESS SUBPROGRAM

NARRATIVE SUMMARY	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
END			
To help Honduran businesses, particularly those in the forestry and agroindustry sectors, to improve their linkages to international markets, enhancing the business climate and the factors that increase productivity.	The program implements the National Competitiveness Strategy, and helps link SMEs with competitive sectors through the promotion of partnering and clustering.	Midterm and final evaluation reports find improvements in the business climate, in the competitiveness of firms participating individually or grouped in clusters, and cooperative partnering of SMEs.	<ol style="list-style-type: none"> The selected sectors have a broad impact on the competitiveness of Honduran firms Macroeconomic stability is maintained.
PURPOSE			
Implement a participatory process for formulating strategies and projects to enhance business competitiveness	<ul style="list-style-type: none"> Agreement of the National Competitiveness Commission on areas of activity for improving the competitiveness of Honduran firms during the course of execution. Sectoral/Subsectoral Competitiveness Strategies (ESC) prepared by each sector/subsector within six months of its formation. Successful experience in supporting clusters, with 70 percent of cluster participants satisfied with services provided by the end of the project. Enhanced competitiveness (sales, production, productivity) for firms in clusters supported by the program, at the end of execution (base year data and goals will be defined at the outset.) 	<ul style="list-style-type: none"> ENC published on the Web site and distributed in hardcopy. Semiannual monitoring reports on activities proposed in the ENC and its action plan. (USP-SIC). ESC received and evaluated by the UEP and the Bank. Evaluations of the services provided by FIDE and the contracted consultants (USP-SIC). Study of the impact of the program on the output of firms (SIC). 	<ul style="list-style-type: none"> The public and private sectors can maintain a dialogue on competitiveness. The group/sectors can show results within a relatively short period of 30 months Stakeholders and institutions support and carry out the recommended changes.
Competitiveness subprogram Component 1: Improve the business climate and implement the ENC	<ul style="list-style-type: none"> ENC published and distributed with the action plan for implementation within three months after program startup (CNC/UEP). Key themes of the ENC implemented at the end of the program 	<ul style="list-style-type: none"> Publication of the program at the Web site and distribution of hardcopy publications. Master list of members of clusters updated quarterly (GL/UEP). 	<ul style="list-style-type: none"> The ENC receives support from most stakeholders (politicians, businesses, civil society groups). The clusters prepare bankable projects within the agreed timeframe.

NARRATIVE SUMMARY	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>Component 2: Linking SMEs to the clustering process</p>	<ul style="list-style-type: none"> Between 3 and 6 clusters are formed and are implementing their ESCs with productive activities developed at the end of the program (CNC/GL-UEP). ESCs published and distributed with their action plans within five months after program startup The Congressional Competitiveness Committee receives technical assistance to speed legislation to improve the business climate FONAC-CASC-H take part under the program 	<ul style="list-style-type: none"> ENC published at the Web site and distributed in hardcopy. 	<ul style="list-style-type: none"> Firms share sufficient data for estimating the program's impact.
<p>Component 3: Competitiveness Fund in operation</p>	<ul style="list-style-type: none"> Diagnostic studies of SME problems completed within three months after program startup Studies of the industries with the greatest potential to foster connectivity The suppliers' program begins operations within six months after program startup. Forty percent of the technical assistance funds committed within 12 months after program startup and 90 percent disbursed within 24 months. Forty percent of funds committed within 12 months after program startup and 75 percent of funds disbursed within 24 months. 	<ul style="list-style-type: none"> CNC-CASC-H published on the Web site Studies published Evaluation and Monitoring Reports. Financial statements of the Competitiveness Fund submitted to the Competitiveness Group, UTPP and the Bank. Quarterly monitoring reports, interim evaluation report, and final impact report on execution. (UTPP) 	

*The detailed logical framework is available on the technical files of the project

LOGICAL FRAMEWORK
Program to Promote Business Competitiveness and Strengthen the Foreign Trade Management
FOREIGN TRADE SUBPROGRAM

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
END			
To help create incentives and opportunities for increasing Honduran exports and the flows of foreign direct investment to Honduras.	At the end of the program the country has the institutional capacity to deal effectively with the demands of international trade negotiations and the application and administration of trade agreements.	Final evaluation report by external experts confirms: the country is participating more actively in international trade negotiation forums; the country is undertaking more initiatives and specific steps to promote trade abroad; and civil society and the private sector are participating more actively in formulating and implementing foreign trade policies.	The government continues to give priority to an economic growth model based on expanding exports and investment.
PURPOSE			
Strengthen the institutional and management capacity of the foreign trade sector, integrating public sector entities responsible for foreign trade as well as the private sector and civil society in formulating and implementing trade policies.	Changes in government management and working procedures relating to trade negotiations and application and administration of agreements, based on systematic economic, commercial and legal analysis of strategic issues, and interinstitutional coordination.	Final evaluation report	The program is a catalyst for the public sector, private sector and civil society to participate increasingly in formulating and implementing foreign trade policies.
1) Government management of trade negotiations and administration of agreements is strengthened	The level of government management of trade negotiations and administration of agreements is established.	Re-engineering proposal for the SIC and annual operating plans are prepared and agreed upon	Honduras remains willing to negotiate free trade agreements with the U.S., FTAA, CACM, the WTO Doha round
2) New government mechanisms for trade information, dissemination and promotion are installed and operating.	Increase in the number of export opportunities for Honduran firms.	International promotion media, including specialized publications, trade fairs, websites confirm the presence of Honduras.	The private sector supports the PNPE and adopts its strategic agenda
3) Permanent new mechanisms are institutionalized for consultations between the public sector, the private sector and civil society.	Increase in transparency, access and participation by civil society and the private sector in formulating and implementing trade policy.	The Export Portal and the 0800 line record greater numbers of consultations (by the private sector, the media and civil society organizations) dealt with by public officials	The program is a catalyst for the public sector, private sector and civil society to participate increasingly in formulating and implementing foreign trade policies.

Honduras
PROGRAM TO PROMOTE BUSINESS COMPETITIVENESS AND STRENGTHEN THE CONDUCT OF FOREIGN TRADE (HO-0221)

Subprogram 2: Promoting Competitiveness						
Main Procurement Items by Component	Total	Type of Contract	Method of Bidding	Period		
				1	2	3
Component 2.1: Improving the Business Climate and Execution of the ENC	1,866,750			971,200	655,450	240,100
1.1.1 Implementation of the National Competitiveness Strategy	1,285,000			630,400	470,400	184,200
Analysis of Infrastructure and Logistics	280,000	Int/National Consulting	IPI & IPN	255,000	20,000	5,000
Improvement Action Plans	240,000	Int/National Consulting	IPI & IPN	90,000	120,000	30,000
Simplification of Municipal Administration	312,000	Int/National Consulting	IPI & IPN	109,500	154,500	48,000
Equipment purchases	400,000	Equipment	ICB	160,000	160,000	80,000
Training	53,000	Int/National Consulting	IPI & IPN	15,900	15,900	21,200
1.1.2. Design & validation of Sectoral Strategies and Specific Action Plans for Forestry and Agroindustry	316,500			207,000	107,500	2,000
Design of action plans in the Forestry Sector	45,675	Int/National Consulting	IPI & IPN	30,150	15,525	0
Design of action plans in the Agroindustry Sector	213,150	Int/National Consulting	IPI & IPN	140,700	72,450	0
Design of action plans in the Tourism Sector	45,675	Int/National Consulting	IPI & IPN	30,150	15,525	0
Training	12,000	Int/National Consulting	IPI & IPN	6,000	4,000	2,000
1.1.3 Technical Support to the Congressional Committee on Competitiveness	170,250			81,300	54,050	34,900
Specialized consulting services, short and long-term	120,250	International Consulting	IPI	47,300	40,050	32,900
Training	50,000	International Consulting	IPI	34,000	14,000	2,000
1.1.4 Promoting Coordination with Civil Society	45,000			22,500	13,500	9,000
Specialized consulting services, short and long-term	20,000	International Consulting	IPI	10,000	6,000	4,000
Training	25,000	International Consulting	IPI	12,500	7,500	5,000
1.1.5 Program Dissemination	50,000			30,000	10,000	10,000
Specialized consulting services, short and long-term	50,000	National Consulting	IPN	30,000	10,000	10,000
Component 2.2: Linking SMEs to the clustering process	1,535,000			592,500	627,000	315,500
2.2.1 Studies, strategies, action plans and opportunities for SMEs	304,500			131,500	100,500	72,500
Diagnosis, strategy and action plan for the Forestry Sector	101,500	Int/National Consulting	IPI & IPN	43,833	33,500	24,167
Diagnosis, strategy and action plan for Agroindustry	101,500	Int/National Consulting	IPI & IPN	43,833	33,500	24,167
Diagnosis, strategy and action plan for the Tourism Sector	101,500	Int/National Consulting	IPI & IPN	43,833	33,500	24,167

Main Procurement Items by Component	Total	Type of Contract	Method of Bidding	Period		
2.2.2 Studies of the most promising production chains and connectivity conditions	337,500			171,000	100,500	66,000
Analysis of Production Chains in the Forestry Sector	112,500	Int/National Consulting	IPI & IPN	57,000	33,500	22,000
Analysis of Production Chains in Agroindustry	112,500	Int/National Consulting	IPI & IPN	57,000	33,500	22,000
Analysis of Production Chains in the Tourism Sector	112,500	Int/National Consulting	IPI & IPN	57,000	33,500	22,000
2.2.3 Technical Assistance to SMEs	761,250			230,500	381,000	149,750
TA model for SMEs	101,250	International Consulting	IPI	32,500	51,000	17,750
TA to SMEs in business development	625,000	Equipment/TA		187,500	312,500	125,000
Training	35,000	National Consulting	IPN	10,500	17,500	7,000
2.2.4 Suppliers Program	131,750			59,500	45,000	27,250
Design and implementation of the Suppliers' Program	111,750	International Consulting	IPI	55,500	37,000	19,250
Training	20,000	National Consulting	IPN	4,000	8,000	8,000
Component 2.3: Competitiveness Fund	1,998,000			612,000	990,000	396,000
Preparation of database on eligible consultants	18,000	National Consulting	IPN	18,000	0	0
TA to clusters for project preparation	1,980,000			594,000	990,000	396,000
PROJECT EXECUTION	1,125,500			407,667	360,166	357,667
Project Administration	918,000	National Consulting	IPN	306,000	306,000	306,000
Equipment Purchases	50,000	Equipment		50,000	0	0
Support and Logistics	157,500			51,667	54,166	51,667

COMMENTS AND NOTES

1. Equipment procurement for 1.1.1 includes communication and computer equipment for municipalities hosting clusters. May also include communications equipment for innovation centers supporting clusters directly. Average cost is assumed to be \$40,000 for 10 centers or municipalities.
2. Amounts in 1.1.2 are reduced because Forestry and Tourism studies have already been designed and validated. A reduced amount is left for analyzing export opportunities through diversification, etc. The Agroindustry sector remains nearly the same, because of the number of subsectors that must be analyzed before selecting products under the project.
3. The value of 2.2.1 is increased to include strategies and action plans for specific municipalities or regions hosting clusters. Assumes 10 municipalities at an average cost of \$10,000
4. The value of 2.2.2 was increased to include analysis of specific product chains or clusters. Assumes 10 clusters at an average cost of \$11,000

KEY:

ICB: International competitive bidding

Major Procurement Items by Component	Amount	Type of Contract	Method of Bidding	Timing
Component I: Strengthening Conduct of Trade Negotiations and Administration of Agreements				
Subcomponent 1: International Trade Negotiations				
Re-engineering the trade negotiation process	34,000	International consulting	IPI	I/2003
Re-engineering internships	76,000	National consulting	IPN	II/2003 to II/2005
Equipment purchases	207,000	Equipment	ICB	II/2003 to II/2004
Specialized consulting services, short and long term	360,000	International consulting	IPI	II/2003 to II/2005
Training	267,000	International consulting	IPI	II/2003 to II/2005
Subcomponent 2: Application & Administration of Agreements				
Re-engineering application and administration of agreements	39,000	International consulting	IPI	I/2003
Equipment purchases	207,000	Equipment	ICB	II/2003 to II/2004
Specialized consulting services, short and long term	150,000	International consulting	IPI	II/2003 to II/2005
Training	129,000	International consulting	IPI	II/2003 to II/2006
Component II: Strengthening Export Promotion Capacity				
Subcomponent 1: National Export Promotion Plan				
Exportable goods study	63,400	International consulting	IPI	I/2003
Product-Market Fact Sheets	60,000	International consulting	IPI	I/2004
Creation & Dissemination of Country Image	155,000	International consulting	IPI	II/2003 to II/2004
Participation in Specialized Fairs	#REF!	International consulting	IPI	II/2003 to II/2005
Subcomponent 2: Trade Information System				
Design and implement Single Window for Exporters	#REF!	Int/national consulting	IPI & IPN	II/2003 to II/2005
Equipment purchases	53,000	Equipment	LP	II/2003 to II/2004
Design and implement Export Portal	185,000	Int/national consulting	IPI & IPN	II/2003 to II/2005
Equipment purchases	53,000	Equipment	LP	II/2003 to II/2004
Subcomponent 3: Strengthening Human Resources				
Technical Training Plan in Export Facilitation	155,000	International consulting	IPI	II/2003 to II/2005
Technical Training for Diplomats	160,000	International consulting	IPI	II/2003 to II/2005
Equipment purchases	80,000	Equipment	LP	II/2003
Internship remuneration	87,000	National consulting	IPN	II/2003 to II/2005
Component III: Consultation, Dissemination and Participation Strategy				
Mechanism for dialogue and consultation	161,200	International consulting	IPI	II/2003 to II/2005
Equipment purchases	100,000	Equipment	LP	II/2003
Training for Members of Congress	155,000	International consulting	IPI	II/2003 to II/2005
Training for Journalists	150,000	International consulting	IPI	II/2003 to II/2005
PROJECT EXECUTION				
	126,000	International consulting	ICB	I/2003 to I/2006
	60,000	National consulting	IPN	I/2003 to I/2006