

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK AND IDB INVEST

## HONDURAS

### IDB GROUP COUNTRY STRATEGY WITH HONDURAS 2019-2022

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[Republic of Honduras: Country Vision 2010 – 2038 and National Plan 2010-2022](#)

[Plan of the Alliance for Prosperity in the Northern Triangle](#)

[Fiduciary technical note](#)

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## ABBREVIATIONS

BANHPROVI	Banco Hondureño para la Producción y la Vivienda [Honduran Bank for Production and Housing]
BCH	Banco Central de Honduras [Central Bank of Honduras]
BVM	Bono Vida Mejor [“Better Life Voucher”]
CABEI	Central American Bank for Economic Integration
COPECO	Comisión Permanente de Contingencias [Permanent Contingency Commission]
DARA	Dirección Adjunta de Rentas Aduaneras [Deputy Directorate for Customs Revenue]
ECI	Externally caused injury
ENDESA	Encuesta Nacional de Demografía y Salud [National Demographic and Health Survey]
ENEE	Empresa Nacional de Energía Eléctrica [National Electric Power Company]
EPHPM	Encuesta Permanente de Hogares de Propósitos Múltiples [Permanent Multipurpose Household Survey]
FRP	Fondo de Solidaridad y Protección Social para la Reducción de la Pobreza [Solidarity and Social Protection Fund for Poverty Reduction]
GDP	Gross domestic product
IDB Lab	Multilateral Investment Fund
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
INE	Instituto Nacional de Estadísticas [National Statistics Institute]
IPSAS	International Public Sector Accounting Standards
MER	Mercado Eléctrico Regional [Regional Electricity Market]
MGD	Modelo de Gestion Descentralizada [Decentralized Management Model]
MSMEs	Micro, small, and medium-sized enterprises
NFPS	Nonfinancial public sector
ONADICI	Oficina Nacional de Desarrollo Integral del Control Interno [National Integrated Internal Control Development Office]
ONCAE	Oficina Normativa de Contratación y Adquisiciones del Estado [Regulatory Office of State Contracting and Procurement]
PAPTN	Plan de la Alianza para la Prosperidad del Triángulo Norte [Plan of the Alliance for Prosperity in the Northern Triangle]
PBL	Policy-based loan
PNLOG	National Freight Logistics Plan
RMI	Risk Management Index
SAR	Servicio de Administración de Rentas [Revenue Administration Service]
SEDUC	Ministry of Education
SEFIN	Ministry of Finance
SESAL	Ministry of Health
SICA	Sistema de Integración Centroamericano [Central American Integration System]
SIEPAC	Sistema de Interconexión Eléctrica de los Países de América Central [Central American Electric Interconnection System]
SINAGER	Sistema Nacional de Gestion de Riesgos [National Risk Management System]

SMEs	Small and medium-sized enterprises
SNIPH	Sistema Nacional de Inversión Pública de Honduras [Honduran National Public Investment System]
TFFP	Trade Finance Facilitation Program
TSC	Tribunal Superior de Cuentas [National Audit Office]
UNAH	Universidad Nacional Autónoma de Honduras [National Autonomous University of Honduras]
USAID	United States Agency for International Development

## EXECUTIVE SUMMARY<sup>1</sup>

### **Social and economic context**

Between 2010 and 2017, the country grew at an average annual rate of 3.7%, surpassing the rest of Latin America and the Caribbean (2%). However, the positive performance of the Honduran economy, driven by a sounder macroeconomic framework, a major effort at integration, and a favorable external context, has not led to an increase in the potential growth rate, a significant reduction in poverty, or a process of change in the country's production and employment structure. Economic activity continues to be tied to the production of primary goods and low-value-added manufactures, while factor productivity has stayed relatively stagnant. In addition, poverty and inequality levels remain high with respect to the rest of the region, with marked urban-rural gaps. The challenge for Honduras is to boost productivity and shore up economic growth and inclusiveness.

### **The IDB Group in Honduras**

During the 2015-2018 country strategy period, the Bank's strategy focused on five pillars: (i) fiscal consolidation; (ii) sustainability and competitiveness in the energy sector; (iii) road infrastructure for regional integration; (iv) social inclusion with a geographic focus on western Honduras; and (v) sustainable development of the Central District. Seventeen sovereign guaranteed loan operations were approved for a total of US\$1.0578 billion, of which US\$718 million was in investment loans and US\$339 million in policy-based loans (PBLs). IDB Invest approved 42 non-sovereign guaranteed operations for US\$246.7 million, while IDB Lab approved 17 operations for a total of US\$39.9 million.

### **Priority areas**

The central objective of the country strategy for the 2019-2022 period is to promote stronger and more inclusive growth. To this end, the Bank will organize its interventions around three pillars: (i) strengthening of fiscal institutions and expenditure efficiency; (ii) human capital accumulation; and (iii) expansion of sustainable production opportunities. The strategy will incorporate actions that promote women's empowerment and diversity, climate change adaptation, and the use of new technologies to achieve greater impact from interventions. Institutional strengthening and the targeting and coordination of interventions for the benefit of low-income groups and territories will be key aspects of implementation. The country strategy is aligned with the Update to the Institutional Strategy 2016-2019 and with IDB Invest's Business Plan 2017-2019, as updated (document CII/GA-77-4).

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<sup>1</sup> This strategy is valid from its approval date until 31 December 2022.

- Lending framework** Subject to the allocation of the Bank's concessional Ordinary Capital resources, annual approvals are projected at around US\$168 million, and average annual disbursements at US\$225 million.<sup>2</sup> IDB lending for the 2019-2022 period is projected at US\$671 million in new sovereign guaranteed approvals and US\$901 million in total disbursements.
- Risks** The main risks to implementation of this strategy are: (i) macroeconomic, associated with a potential deterioration of the external context and with the fiscal consolidation process; (ii) weakening of the country's capacity to execute Bank resources; and (iii) the country's vulnerability to natural disasters. Mitigation and monitoring actions are envisaged.

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<sup>2</sup> The estimate of IDB lending for the 2019-2022 period is based on the allocation of the Bank's Ordinary Capital resources for the period 2019-2020, which currently amounts to US\$167.8 million per year, and is subject to future adjustments related to the biannual allocation for the 2019-2020 and 2021-2022 periods. The financial scenario considers the country's absorption limitations and the quotas arising from the explicit mandates of the Fiscal Responsibility Law.

## I. SOCIOECONOMIC CONTEXT

- 1.1 Honduras is a small, open, lower-middle-income economy. In 2017, the gross domestic product (GDP) per capita at current prices was US\$2,594, the third lowest in Latin America and the Caribbean, surpassing only Haiti's and Nicaragua's. From 2010 to 2017, annual growth averaged 3.7%, on a par with the rest of Central America and outpacing the rest of Latin America and the Caribbean (2%). Over the same period, annual growth per capita was 1.51%, well below the 2.48% rate of Central America and the Dominican Republic.<sup>3</sup>
- 1.2 In the last four years, the country took important steps to strengthen macroeconomic stability in the context of a Stand-by Arrangement with the International Monetary Fund (IMF).<sup>4</sup> As a result, the nonfinancial public sector (NFPS) deficit fell from 7.5% of GDP in 2013 to 0.8% of GDP in 2017. In addition, the public debt stopped growing,<sup>5</sup> tax pressure increased from 14.8% to 17.9% of GDP, and public expenditure declined from 24.9% to 23.2% of GDP, primarily due to a reduction in payroll from 8.7% to 7.0% of GDP.<sup>6</sup> The country's risk rating improved, coming into line with its Central American peers and second only to Panama's.<sup>7</sup> In sector terms, Honduras reformed the regulatory framework for energy and succeeded in reducing the losses of the National Electric Power Company (ENEE),<sup>8</sup> and it supported institutional strengthening of the Bono Vida Mejor (BVM) program,<sup>9</sup> which also helped to improve public finance.
- 1.3 However, the positive performance of the Honduran economy, underpinned by a solid macroeconomic framework, a major effort at integration,<sup>10</sup> and a favorable external context of low hydrocarbon prices, low interest rates, and dynamic performance by its main trade partner, the United States, has failed to produce a jump in the potential growth rate or trigger a process of change in the country's production and employment structure. Economic activity remains closely linked to the production of primary and manufactured goods with low value added, and factor productivity has remained relatively stagnant, accounting for only 5% of the

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<sup>3</sup> International Monetary Fund. 2018. World Economic Outlook.

<sup>4</sup> The Stand-by Arrangement signed in December 2014 for a term of 36 months established fiscal, monetary, and exchange rate policy objectives as well as adjustments to the National Electric Power Company (ENEE) and strengthening of the financial regulatory framework.

<sup>5</sup> NFPS debt went from 25% of GDP in 2010 to 39.4% of GDP in 2014. As of year-end 2017, NFPS debt was 40.3% of GDP. Source: Central Bank of Honduras (BCH) and the International Monetary Fund (IMF).

<sup>6</sup> Capital expenditure rose from 2013 to 2017. Source: BCH.

<sup>7</sup> From 2015 to 2017, Standard & Poor's upgraded Honduras' rating from B to BB-, placing the country on a par with Costa Rica, Guatemala, and the Dominican Republic and above El Salvador and Belize.

<sup>8</sup> Management improvements in the electricity sector reduced the sector's government-financed losses from 1.8% of GDP in 2014 to 0.7% of GDP in December 2017. This loss reduction was also partly due to a decline in international hydrocarbon prices.

<sup>9</sup> Bono Vida Mejor (BVM) is a conditional cash transfer program aimed at fostering a better quality of life for families living in extreme poverty.

<sup>10</sup> As part of its development and global integration strategy, Honduras has made strides in its regional integration process. The country is a member of the Central American Integration System (SICA), which is the largest market for Honduran exports after the United States. In addition, steps have been taken with Guatemala to implement a deep integration process, with a view to achieving free movement of goods and people between the two nations.

- growth of the past 20 years, compared with the 50% that can be attributed to physical capital accumulation and the 45% that can be attributed to labor.<sup>11</sup>
- 1.4 Beginning in 2012, poverty trended downwards, but this trend reversed course in 2017 and the rate is now higher than the level prior to the 2009 crisis. The economic boom that preceded the international crisis of 2009 reduced poverty from 64.8% of households in 2002 to 59% of households in 2008. The crisis, coupled with internal political conflicts that destabilized the economy, pushed poverty back up to 67% of households by 2012. Stabilization efforts, economic recovery, and social programs,<sup>12</sup> in turn, brought about a decline in moderate and extreme poverty to 61% and 38.4%, respectively, by 2016. However, poverty rose again in 2017, to 64.3%, with a particularly sharp increase (from 62.9% to 69.3%) in rural areas. These fluctuations indicate that many Hondurans live on the edge of the poverty line and are vulnerable even to moderate changes in their environment. In addition, the rural-urban gap remains high,<sup>13</sup> with poverty rates that are similar across gender lines.<sup>14</sup> Despite an improvement in income distribution (the Gini having gone from 0.56 in 2002 to 0.52 in 2017),<sup>15</sup> the country remains one of the most unequal in Latin America and the Caribbean (0.50).<sup>16</sup>
- 1.5 In terms of citizen security, Honduras has witnessed a significant decline in violence levels since 2013. From 2013 to 2017, the homicide rate went from 79 to 43.6 per 100,000 inhabitants,<sup>17</sup> partly due to an ambitious institutional reform of the police force which, combined with improvements in training, has led to a greater response to reports of crime and strengthened the force's investigative capacity. Despite these results, Honduras continues to be one of the most violent countries in the world.<sup>18</sup>
- 1.6 Honduras is one of the countries in the hemisphere with the largest proportions of youth in the population, and its working-age segment is poised to experience a long period of growth.<sup>19</sup> This is taking place in an economy that continues to be heavily rural,<sup>20</sup> with low productivity and limited capacity to create quality jobs. Although the unemployment level in 2017 was 4% (compared with 7% in Latin

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<sup>11</sup> Calculations developed by the Bank's Country Department Central America, Panama, Haiti, Mexico, and Dominican Republic (CID/IDB) with data from the Central Bank of Honduras (BCH) and the International Monetary Fund (WEO, April 2017).

<sup>12</sup> The Solidarity and Social Protection Fund for the Reduction of Extreme Poverty (FRP) was created in 2013 to address the challenges of poverty and inequality. Its principal program is Bono Vida Mejor (BVM).

<sup>13</sup> In 2017, the gap between rural and urban poverty was 8.8 percentage points, compared with 3.4 percentage points in 2016.

<sup>14</sup> Female-headed households report poverty levels similar to those of male-headed households (64.2% and 64.3%, respectively).

<sup>15</sup> National Statistics Institute (INE), Permanent Multipurpose Household Survey (EPHPM) 2017.

<sup>16</sup> World Bank. LAC Equity Lab. Available at: <http://www.bancomundial.org/es/topic/poverty/lac-equity-lab1/overview>.

<sup>17</sup> Data from the National Violence Observatory of the National Autonomous University of Honduras (UNAH).

<sup>18</sup> United Nations Office on Drugs and Crime. Available at: <https://dataunodc.un.org/crime/intentional-homicide-victims>.

<sup>19</sup> It is estimated that the working-age population will grow to a year-on-year average of 5% until it reaches its peak in 2040 (IDB, 2017).

<sup>20</sup> According to 2017 INE data, 46% of the Honduran population lives in rural areas.

America and the Caribbean), underemployment is 44.4% and the informal sector<sup>21</sup> accounts for more than 80% of the workforce. Notably, informal employment is more prevalent in the population with less than a primary school education (98.2% versus 30% for postgraduate education) and in the rural sector (94.3% versus 73.1% of urban employment).<sup>22</sup> Women's participation in the workforce is low (48% compared with 58% in Latin America and the Caribbean), and young people who neither study nor work account for 26% of the 15-to-24 age group, a higher percentage than in Latin America and the Caribbean (15.5%). The agricultural sector, which is the largest source of employment, has seen productivity declines and has limited export diversification.<sup>23</sup> Other sectors with growth and job creation potential, such as tourism, have not succeeded in attracting the investments needed for their proper development. Anemic productivity growth and limited investment to support productive diversification and foster job creation reflect a weak institutional context and weak regulatory frameworks,<sup>24</sup> inadequate financing,<sup>25</sup> low human capital levels,<sup>26</sup> deficient infrastructure and connectivity, high rates of violence, and insufficient investment in innovation.<sup>27 28</sup>

- 1.7 In addition, Honduras is highly vulnerable to climate change. The various challenges listed above could become exacerbated by the country's susceptibility to natural disasters and the adverse impacts of climate change,<sup>29</sup> posing a future risk to the country's productive structure, poverty reduction efforts, and fiscal accounts. Agricultural sector losses associated with climate-related phenomena up to 2100 could range from 4% to 19% of GDP,<sup>30</sup> depending on the severity of climatological

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<sup>21</sup> The informal sector refers to those who work and earn income outside the control of the State's taxation system (individuals between the ages of 18 and 65 who do not contribute to any social security institution, pension fund, trade union, or workers' association). Source: CID/IDB with data from the EPHPM 2017.

<sup>22</sup> In 2017, the informal employment rate for women was 80.6%, compared with 83.2% for men. Source: CID/IDB with data from the EPHPM 2017.

<sup>23</sup> Since 2010, bananas, coffee, and palm oil have accounted for 40% to 52% of the country's total exports. Source: BCH.

<sup>24</sup> According to the World Bank governance indicators, Honduras performs far below the average for Latin America and the Caribbean on issues such as protection of property rights, effectiveness and transparency of public administration, judicial independence, physical security, business ethics, and corporate governance.

<sup>25</sup> In 2018, more than 400 million lempiras were disbursed in SME loans through the Honduran Bank for Production and Housing (BANHPROVI) and the government program Crédito Solidario as a way of facilitating credit for small businesses.

<sup>26</sup> As shown by Prat and Lopez (2018), the Honduran population has an average of less than seven years of schooling. The results of Pisa 2013 place the country among the four worst performers in Latin America and the Caribbean.

<sup>27</sup> For a more detailed analysis, see the IDB document: [Honduras: Country Development Challenges 2018 \(Annex I\)](#).

<sup>28</sup> At the company level, the capacities for technological innovation and adaptation are insufficient and only 7.4% of businesses allocate resources to research and development activities, compared with 21.5% for the Latin America and Caribbean region as a whole. Inadequate access to financing, prevalence of the informal sector, and an unskilled labor force are cited as the main constraints on business performance. [Enterprise Surveys, World Bank](#). 2016.

<sup>29</sup> According to the Germanwatch Global Climate Risk Index 2018, from 1997 to 2016 Honduras was one of the world's three countries most affected by extreme climate events.

<sup>30</sup> Estimates based on an assessment of the projected cumulative economic impacts of climate change on the agricultural sector by 2100. Source: J. L. Ordaz, J. Mora, A. Acosta, B. Serna Hidalgo, and D. Ramirez (2010). *Honduras: efectos del cambio climático sobre la agricultura*. ECLAC.

variations. Economic fragility, coupled with an expanding working-age population, high informal employment levels, violence, and poverty, has spurred Hondurans to emigrate, primarily to the United States.<sup>31</sup> Under the Plan of the Alliance for Prosperity in the Northern Triangle (PAPTN),<sup>32</sup> developing human capital and stimulating the productive sector to discourage irregular migration, generate a sense of belonging, and reduce poverty are identified as strategic pillars.

- 1.8 In order to embark on a path of stronger growth and poverty reduction, Honduras will need to adopt and sustain measures to raise productivity and create quality jobs, particularly in rural and urban fringe areas, which have the highest poverty levels. This will require consolidating the country's fiscal, institutional, and sector achievements and designing and implementing structural policies to hasten human capital accumulation, address shortcomings in productive and logistic infrastructure, improve access to financing, and boost resilience to climate change.
- 1.9 The Honduran government's policies, reflected in the National Plan and Country Vision 2010-2038,<sup>33</sup> the Honduras 2020 plan,<sup>34</sup> and the PAPTN are aimed at overcoming the aforementioned challenges.<sup>35</sup> The new IDB Group country strategy will be implemented in an environment marked by significant advances in the macroeconomic and fiscal areas and in the institutional framework and management capacity of the social protection, electricity, transportation, and security sectors, as well as by a strategic government vision that prioritizes consolidation of these achievements. The international context, while remaining favorable, will pose risks for the country arising from oil price movements and uncertainty regarding the undocumented migrant population in the United States.<sup>36</sup>

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<sup>31</sup> Approximately 630,000 Hondurans lived in the United States in 2016. Of these, close to 378,000, or 60%, were undocumented. Forty percent of these migrants are in the 15-to-29 age bracket, and 58% have migrated to the United States in the last 15 years (American Community Survey 2016).

<sup>32</sup> In 2014, the governments of El Salvador, Guatemala, and Honduras formulated the PAPTN to address the causes of irregular migration to the United States and Mexico, focusing on fostering rootedness and productive opportunities. The countries have agreed on coordinated actions based on four strategic pillars: (i) stimulate the productive sector; (ii) foster human capital accumulation, with a focus on education, health, and social protection; (iii) improve citizen security and access to the justice system; and (iv) strengthen institutions and enhance transparency. From 2016 to 2018, Honduras allocated US\$2.883 billion in budget resources for the implementation of the PAPTN.

<sup>33</sup> The plan establishes 11 priority pillars: (i) sustainable development of the population; (ii) democracy, citizenship, and governance; (iii) poverty reduction and creation of assets and equality of opportunities; (iv) education and culture as a means of social emancipation; (v) health as a basis for improvement in living conditions; (vi) security as a prerequisite for development; (vii) regional development, natural resources, and environment; (viii) productive infrastructure as a driver of economic activity; (ix) macroeconomic stability as a basis for domestic savings; (x) competitiveness, country image, and development of productive sectors; and (xi) climate change adaptation and mitigation. <http://www.sefin.gob.hn/?p=284>.

<sup>34</sup> Honduras 2020 is a production development plan that arose as a private-sector initiative, supplemented by the public sector, to foster the country's socioeconomic development. It prioritizes tourism, textile manufacturing, intermediate manufacturing, outsourced business services, low-income housing, and agroindustry.

<sup>35</sup> A more detailed analysis of these challenges may be found in the IDB document "Honduras. Country Development Challenges. 2018."

<sup>36</sup> This refers to migrants who reside in the United States without a legal residence or work permit. Recent changes in United States immigration policy, such as removal of the Temporary Protection Status (TPS), may result in a flow of returned migrants and a fall in remittances. Remittance flows account for 28% of household income (source: EPHPM 2017) and 18.7% of GDP (US\$4.438 billion, 2017). Source: BCH.

## II. THE IDB GROUP IN HONDURAS

### A. Implementation of the strategy

- 2.1 The primary objective of the Bank's country strategy for 2015-2018 was to support the government's efforts to boost stagnant production and low growth; reduce gaps in the generation and accumulation of human capital, particularly in rural areas, and achieve real social inclusion; and improve the quality of life and standard of living in urban areas. The strategy set five key priority areas: (i) fiscal consolidation; (ii) sustainability and competitiveness in the energy sector; (iii) road infrastructure for regional integration; (iv) social inclusion with a geographic focus on western Honduras; and (v) sustainable development in the Central District. It also worked on the crosscutting issues of climate change and disaster risk management, and gender and identity development. To implement the strategy, the Bank used a combination of loan instruments, technical cooperation operations, and dialogue to support advances on all pillars of action. This in turn solidified the Bank's position as the country's leading strategic partner and primary source of multilateral funding.
- 2.2 During the 2015-2018 country strategy period, **the Bank approved 17 sovereign guaranteed loan operations for a total of US\$1.0578 billion**, of which US\$718 million was in investment loans<sup>37</sup> and US\$339.8 million in policy-based loans (PBLs). In the area of fiscal consolidation, the Bank approved US\$87 million in loans to support strengthening of tax collection, public expenditure efficiency, and transparency mechanisms, as well as to improve budget management. In the area of energy sector sustainability and competitiveness, the Bank approved US\$268 million to support financial sustainability and strengthening of the ENEE's operational capacity while improving its regulatory framework. In the area of road infrastructure for regional integration, the Bank approved US\$319 million for national and regional corridors and to lower operating and transportation costs in the country. In the area of social inclusion, the Bank approved US\$278 million to narrow the gaps in human capital creation and accumulation, particularly in rural areas, and attain effective social inclusion through a cross-sector territorial approach based on interventions complementary to and consistent with the Vida Mejor Social Protection Strategy. In the area of sustainable development of the Central District, the Bank approved US\$105 million to address the basic infrastructure deficit and promote citizen security and civic harmonies in the poorest neighborhoods.<sup>38</sup> Disbursements totaled US\$587.2 million,<sup>39</sup> with a positive net cash flow to the Bank of US\$486 million.
- 2.3 **IDB Invest approved 42 non-sovereign guaranteed operations for US\$246.7 million**<sup>40</sup> in the areas of financial markets and services, energy,

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<sup>37</sup> Of this US\$718 million, US\$579 million is the amount approved as of 30 October 2018 under the allocation of concessional funds for the 2015-2018 period; US\$134 million is for the reformulation of loan operation HO-L1037, Puerto Cortés Expansion and Modernization Program, originally approved in 2010; and US\$5 million is for the Scaling up Renewable Energy Program (SREP).

<sup>38</sup> Amounts from the approval date of the country strategy to 31 October 2018.

<sup>39</sup> Includes disbursements from the legacy portfolio at the time of approval of the 2015-2018 country strategy. This portfolio included 21 loan operations for US\$900 million and an available balance of US\$466.2 million as of December 2014.

<sup>40</sup> This amount includes 38 approvals of loans and guarantees under TFFP lines for US\$220.7 million (as of 31 August 2018).

manufacturing, and trade, while IDB Lab approved 17 operations for a total of US\$39.9 million: 5 equity operations for US\$29.1 million, 3 loan operations for US\$4 million, and 9 technical cooperation operations for US\$6.8 million.

- 2.4 In addition, the Bank approved **52 nonreimbursable technical cooperation operations for US\$20 million** in the areas of social protection, education, health, fiscal management, electricity, production development, and competitiveness, as well as **8 investment grants for US\$17.7 million** aimed at supporting loan operations in forest sustainability, energy, and security. On regional issues, the Bank provided technical support to the Central American Electric Interconnection System (SIEPAC), which interconnects the electricity systems of Panama, Costa Rica, Nicaragua, Honduras, El Salvador, and Guatemala,<sup>41</sup> and to the implementation of the PAPTN.

## **B. Main outcomes under the 2015-2018 country strategy**

- 2.5 The IDB Group's interventions<sup>42</sup> achieved significant progress on the five pillars of the strategy. In the area of **fiscal consolidation**, the Bank's support<sup>43</sup> helped to improve revenue collection levels, as reflected in an increase in tax collection from 14.8% of GDP in 2013 to 17.9% of GDP in 2017. The improvement in budget management helped to reduce deviations in the executed budget with respect to the approved budget from 11.8% in 2013 to 4.5% in 2017.<sup>44</sup> This process of fiscal consolidation, supported by the Bank, led to a narrowing of the NFPS deficit from 7.5% of GDP in 2013 to 0.8% of GDP in 2017. In addition, the Bank supported institutional reforms in the electricity sector and in the BVM program to enhance the transparency and effectiveness of expenditure.<sup>45</sup>
- 2.6 In the area of **energy sector sustainability and competitiveness**, the Bank addressed the sector's technical and financial challenges.<sup>46</sup> With a view to improving the efficiency and quality of electricity service, diversifying the energy mix, and expanding access to electricity service, the Bank supported the implementation of institutional reforms and strategic investments in transmission and generation. This process led to: (i) an improvement in the institutional structure of the sector,<sup>47</sup> resulting in greater independence for the electricity market regulators and greater legal certainty; (ii) strengthening of the financial and operating management of the ENEE, which has helped to reduce its fiscal burden from 1.8% of GDP in 2014 to

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<sup>41</sup> SIEPAC is a window for electricity exports for private-sector companies and is able to: (a) operate as a mechanism for obtaining more competitive electricity rates for the Honduran consumer, resulting in an increase in GDP; and (b) provide electricity for export if the network's transmission and access infrastructure is improved.

<sup>42</sup> Includes outcomes of the support provided by the Bank through the legacy portfolio as well as the approvals made during the strategy period.

<sup>43</sup> Fiscal and Municipal Management Consolidation Program (HO-L1015), Tax Administration Institutional and Operational Strengthening (HO-L1108), and Fiscal Consolidation Support Program (HO-L1103).

<sup>44</sup> Ministry of Finance (SEFIN) and the Central Bank of Honduras (BCH).

<sup>45</sup> Central Bank of Honduras (BCH) and the International Monetary Fund (IMF).

<sup>46</sup> Support for the Integration of Honduras in the Regional Electricity Market (HO-L1039), Cañaveral-Río Lindo Hydropower Complex Rehabilitation and Upgrading Project (HO-L1102), Programmatic Support for Structural Reforms in the Electricity Sector (three loans: HO-L1070, HO-L1118, HO-L1189).

<sup>47</sup> As a result of these reforms, the sector has a governing entity responsible for setting energy policy (Ministry of Energy), a regulatory agency responsible for formulating regulations and resolutions for sector development (Electric Power Regulatory Commission), and a system operator (ENEE).

0.7% of GDP as of December 2017 and its total electricity distribution losses from 32% in 2014 to 27.4% in 2018;<sup>48</sup> (iii) the adoption of energy policies aimed at diversifying the energy mix, which enabled an increase in the share of renewable energy, from 41% of the total in 2013 to 59% in 2017, and greater participation in the Regional Electricity Market (MER); and (iv) expansion of national electricity coverage, from 72.3% in 2014 to 78.1% in 2018.<sup>49</sup>

- 2.7 In the area of **road infrastructure for regional integration**, the Bank focused its financing on works to improve the physical condition and security of three road corridors in the country<sup>50</sup> with a view to enhancing territorial and regional integration. In the Agricultural Corridor, a highway that links the Atlantic coast to the country's central region, the Bank invested in widening and upgrading 136.7 kilometers between Tegucigalpa – Puerto Castilla and the access to Trujillo. This has fostered increased domestic tourism to the departments of Colón and Olancho while also improving access to the national market for agricultural producers in the area. In the Pacific Corridor, 97 kilometers were rehabilitated in the El Amatillo – Júcaro Galán – Choluteca – Guasaule section, enabling a better cross-border connection with El Salvador and Nicaragua. In the Logistics Corridor, which connects the country's southern and northern regions and supplements port services and the transfer of goods from the Atlantic to the Pacific Ocean, the Bank financed the rehabilitation and maintenance of 70 kilometers between Tegucigalpa and Puerto Cortés, and the addition of two lanes (for a total of four) to the second ring road of San Pedro Sula, which in turn connects with Puerto Castilla and the Agricultural Corridor. These interventions reduced travel times (by 31.2% in the Logistics Corridor and by 51% in the Agricultural Corridor) and vehicle operating costs (by 1% in the Logistics Corridor and by 45% in the Agricultural Corridor).<sup>51</sup> The Bank also assisted in developing the country's National Freight Logistics Plan (PNLOG), identifying an immediate action plan and institutional reforms to reduce the high logistics costs and improve the competitiveness of the country's most important foreign trade hubs. In addition, the Bank assisted in providing the customs facility at Puerto Cortés with greater control and security capacity and improved infrastructure and equipment, which helped to reduce logistics costs in the country's main port. The customs station at the El Amatillo border crossing, which links Honduras to El Salvador, was also rehabilitated.<sup>52</sup>
- 2.8 In the area of **social inclusion with a geographic focus on western Honduras**, the Bank supported the consolidation of the BVM's institutional structure and territorial strategic targeting to improve the program's efficiency and coverage of families living in extreme poverty. In addition, the Bank provided financial and technical support to address the gaps in minimum consumption, human capital accumulation, and child health through coordinated investments revolving around

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<sup>48</sup> National Electric Power Company (ENEE), 2017.

<sup>49</sup> Idem.

<sup>50</sup> Regional Road Integration Program (HO-L1104), Infrastructure Program for the San Pedro Sula Logistics Corridor (HO-L1018), Tegucigalpa-Puerto Castilla Agricultural Corridor Road Program (HO-L1033).

<sup>51</sup> Project completion report for the Tegucigalpa-Puerto Castilla Agricultural Corridor Road Program (2155/BL-HO,1412/OP-HO) and project completion report for the Infrastructure Program for the San Pedro Sula Logistics Corridor (2017/BL-HO, ATN/OC-11025).

<sup>52</sup> Modernization of Customs at Puerto Cortés (HO-L1055).

the BVM program, prioritizing sector-specific investments in education and health in the western part of the country, where a large percentage of the population lives in extreme poverty.<sup>53</sup> This helped the BVM reach more than 330,000 households, representing 53% of the country's rural population living in extreme poverty (compared with 37% coverage in 2013). The impact evaluations show a continuous improvement in the design and effectiveness of the BVM.<sup>54</sup>

- 2.9 In the area of **education**, the Bank financed efforts to expand the availability of the third cycle of basic education (seventh, eighth, and ninth grade), increasing the percentage of children who attend school from 20.1% in 2013 to 53.8% in 2016 in the beneficiary areas. The program also helped to reduce the number of over-age students, bringing them in line with their appropriate school level based on age.<sup>55</sup>
- 2.10 In the area of **health**, the Salud Mesoamérica Initiative financed hospital infrastructure and equipment and supported implementation of a decentralized management model for healthcare services in 5 hospitals and 94 of the country's 104 poorest municipios, encompassing slightly more than 1.5 million inhabitants, with an emphasis on mother and child services. As a result of these interventions, improvements were observed in obstetric-neonatal services<sup>56</sup> and in healthcare services for children under 5.<sup>57</sup>
- 2.11 In the area of **sustainable development of the Central District**, the Bank's operations focused on addressing the basic infrastructure deficit and promoting citizen security and civic harmony in the poorest neighborhoods of this district.<sup>58</sup> In this regard, the Bank financed infrastructure for the delivery of water, sanitary sewage, drainage, and public lighting services, benefiting more than 3,500 households and reaching 100% coverage in the prioritized neighborhoods. At the same time, the Bank supported citizen security through the implementation of local security observatories and the development of community prevention programs.
- 2.12 The Bank also made a contribution through specific **citizen security** interventions at the national level. In particular, the Bank financed strengthening of the crime prevention and crime-solving capacity of the Honduras National Police and

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<sup>53</sup> Mother and Child Hospital Network Strengthening Program (HO-L1072), Program for Improved Accessibility and Quality of Health Services and Networks (HO-L1090), Social Protection System Support Program (two policy-based loans: HO-L1093 and HO-L1087), Program to Support Health Sector Reform (HO-L1182).

<sup>54</sup> Final Impact Evaluation Report on the Bono Vida Mejor Cash Transfer Program. 12 December 2017 (<https://sedis.gob.hn/sites/default/files/Informe-final-de-EI-FEB-7.pdf>).

<sup>55</sup> Idem.

<sup>56</sup> The following is worth noting: (i) the percentage of pregnant women receiving checkups prior to their 12<sup>th</sup> week of pregnancy increased from 51% to 90%; (ii) prenatal checkups increased from 23.7% to 94.1%; (iii) institutional childbirth increased from 68.6% to 84.7%; (iv) postnatal care in the first three days increased from 67% to 91%, and in the first seven days from 47% to 60%; and (v) standard-based care of neonatal complications increased from 7% to 43% and care of obstetric complications increased from 11% to 63%. Idem.

<sup>57</sup> Reporting for checkups at healthcare centers increased by 11.3 percentage points (+45%), acute diarrheal disease decreased by 3.8 percentage points (-22%), respiratory infections decreased by 4.6 percentage points (-12%), and overall malnutrition decreased by 1.8 percentage point (-17,6%) (weight for age). Idem.

<sup>58</sup> Integration and Urban Coexistence Program (HO-L1088), Program of Support for the Implementation of the Comprehensive Civic Coexistence and Public Safety Policy (HO-L1083).

- modernization of equipment and infrastructure.<sup>59</sup> These actions were core components of the government's strategy for addressing the problem of safety, and their implementation led to a reduction in the homicide rate and a decline in the rate and number of murders of women over the period, from 14.6 to 8.6 (from 636 to 389 female victims).<sup>60</sup>
- 2.13 The implementation of the strategy addressed **resilience to climate change** both in crosscutting fashion and through specific interventions. The designs of the operations that financed road and energy infrastructure incorporated measures to reduce the vulnerability of investments to natural disasters, such as the use of hurricane-resistant foundations for transmission lines and the selection of land for works based on safety criteria in the event of disasters. The addition of renewable energy sources and the optimization of the transmission infrastructure led to a reduction of more than 1,025,500 tons of carbon dioxide in greenhouse gas emissions between 2014 and 2017.<sup>61</sup> At the same time, the Bank worked with the country's Permanent Contingency Commission (COPECO) and institutions in the National Risk Management System (SINAGER) to strengthen risk management at the national level. This resulted in an improvement in disaster risk management performance as measured by the Risk Management Index (RMI),<sup>62</sup> which went from 30.24 in 2010 to 40.33 in 2016. In parallel, the Bank fostered sustainable forest management for climate change mitigation.<sup>63</sup>
- 2.14 With regard to **gender**, the Bank's operations in the area of social inclusion and citizen security and coexistence have paid special attention to this issue, deploying major efforts to improve mother and child health and reduce domestic violence, femicide, and adolescent pregnancies. In addition, the Bank financed the construction and outfitting of two women's comprehensive care centers, Ciudad Mujer, designed to improve the delivery of services related to sexual and reproductive health, employment, gender violence, and adolescent pregnancy. In a year and a half of operations, Ciudad Mujer has benefited more than 35,000 women.
- 2.15 During the strategy period, IDB Invest channeled financing to renewable energy generation projects (photovoltaic solar and biomass energy) for self-sufficiency in companies. These projects expanded the country's installed power generation capacity by 20 megawatts, generating approximately 138 gigawatt-hours of clean

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<sup>59</sup> The Bank financed the rehabilitation of more than 60 police stations at the community level, equipment to reinforce the investigative capacity of the National Police, and infrastructure for the Instituto Técnico Policial [Institute of Police Technology], introducing a new curriculum and training more than 7,000 new police officers under a community policing approach.

<sup>60</sup> Data from the National Violence Observatory of the National Autonomous University of Honduras (UNAH), 2017. Note: Data include homicide victims of all age groups.

<sup>61</sup> IDB calculations based on information from the statistical bulletins issued by the ENEE Planning Department and the Honduras Electricity Network's greenhouse gas emissions factor.

<sup>62</sup> The RMI is a set of indicators related to the country's risk management performance, reflecting the country's organization, capacity, development, and institutional action to reduce vulnerability, reduce losses, prepare to respond in the event of a crisis, and recover efficiently. The technical note is available at <http://dx.doi.org/10.18235/0000123>.

<sup>63</sup> The operation Sustainable Forest Management (HO-L1179) supports forest management in the context of climate change and is expected to raise the forest and agroforest productivity of small producers through training in reforestation and sustainable forest management.

energy per year.<sup>64</sup> In addition, operations were approved in the financial sector with a view to expanding SME access to financing, and 42 foreign trade operations were supported through the Trade Finance Facilitation Program (TFFP). These included 146 underlying transactions that mobilized an additional US\$41 million through the participation of six international investors. These funds facilitated the financing of Honduran exports, primarily coffee and shrimp, and imports of machinery, cardboard, resin, fuel, vehicles, and textiles. At the local level, IDB Lab financed productive infrastructure and provided technical assistance to attain productive inclusion of agricultural and aquaculture enterprises, benefiting more than 25,000 families. These activities enabled the adoption of new technologies and processes and sustainable practices in energy efficiency, primarily in the coffee, sweet potato, okra, pumpkin, tilapia, and shrimp chains.

- 2.16 The technical cooperation operations approved by the IDB played an essential role in the reform program. In the fiscal sector, they made it possible to contribute to the fiscal consolidation process through institutional and operational strengthening of the tax administration. They supported the development of the new human talent policy of the Revenue Administration Service (SAR), enabling the recruitment of more than 1,000 new officers and elevating the professionalization level of the agency.<sup>65</sup> In the energy sector, the technical cooperation operations supported the ENEE institutional reform and strengthening process. They also included a study that identifies the areas with greatest production and social potential by using a regional spatial strategy that will serve as the basis for the new country strategy's territorial approach.

### C. Portfolio in execution and lessons learned

- 2.17 **Portfolio status.** As of 31 October 2018, the IDB Group portfolio in Honduras consists of 19 sovereign guaranteed loan operations for US\$939.6 million and an undisbursed total of US\$678.1 million, concentrated in the following sectors: 33% in energy; 33% in social protection, health, and education; 17.8% in transportation; 8.8% in security; 3.3% in environment and natural disasters; 2.4% in fiscal consolidation; and 1.7% in gender. In addition, there are 53 nonreimbursable operations for US\$36.3 million, 8 of which are investment grants for US\$17.9 million. IDB Invest has an active portfolio of 15 operations with a total exposure of US\$127.8 million,<sup>66</sup> concentrated in the financial, energy, and manufacturing sectors. As of 30 September, the IDB Lab portfolio is comprised of 24 operations for US\$50.8 million in the areas of agricultural value chains, SMEs, renewable energy, climate-smart agriculture, and rural microfinance.
- 2.18 **Lessons learned.** At the *strategic* level, the following conclusions may be drawn: (i) the Bank's firm commitment to fiscal consolidation in Honduras translated into support for policy reforms and investments that enabled various public-sector agencies to boost their efficiency and reduce losses, helping to achieve a substantial reduction of the fiscal deficit; (ii) the use of various financial instruments—investment loans, policy-based loans, investment grants, and

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<sup>64</sup> Replacing the use of fossil fuels was equivalent to not emitting approximately 87,000 tons of greenhouse gases annually.

<sup>65</sup> HO-T1220; HO-T1309. 58% of the SAR staff has higher education and 6.4% has completed graduate studies.

<sup>66</sup> Includes exposure to loans and guarantees and TFFP lines (as of 31 August 2018).

- technical cooperation operations—linked to the strategic objectives at the sector level made it possible to maximize the impact of the Bank interventions; and (iii) geographically targeting social inclusion operations to the areas with the widest development gaps yielded results in terms of minimum income, human capital accumulation, and child health.
- 2.19 At the **operational** level, the following is worth noting: (i) in investment operations, which involve a long commitment of budget resources, it is essential that the design provide for multiyear budgeting and a continuous progress evaluation to enable efficient and transparent use of the resources; (ii) having a comprehensive vision of project execution in line with the formulation of the State budget cycle enables timely decision-making in the event of a setback; (iii) in preparing interventions that require social and environmental consultations, such as in the energy sector, it is essential to work with realistic time frames in order to achieve an operating schedule that better matches actual preparation needs and optimize the use of biannual allocation of concessional resources; (iv) the “design-build” format<sup>67</sup> is a useful strategy for complex infrastructure works, although it requires an executing agency with solid capacity to manage this type of contract; (v) early identification of land in operations that envisage the construction of infrastructure mitigates the risk of delay, since such operations involve actions that can hold up the start of work (titling, soil studies, water quality analysis, etc.); (vi) the procurement of sophisticated equipment subject to continuous technological improvement poses the risk of premature obsolescence; accordingly, this type of procurement should involve expert staff who can incorporate measures designed to extend the useful life of this equipment; (vii) working on infrastructure with highly specialized executing agencies familiar with the Bank’s relevant processes and policies, such as INVEST-H,<sup>68</sup> has contributed to a more efficient and transparent execution;<sup>69</sup> and (viii) better monitoring of operations with financial intermediaries, so as to measure the evolution of the relevant portfolio at each institution, increases the effectiveness and efficiency of IDB Invest interventions.
- 2.20 The 2019-2022 country strategy takes into account OVE’s recommendations offered in the Country Program Evaluation 2015-2018: (i) continue and step up efforts to support investment in rural areas and in lower income groups to improve their access to economic opportunities, taking into account government priorities, the work of the country’s other development partners, and the areas of long-term Bank support; (ii) step up efforts to identify niches for private sector support, offering financial and nonfinancial additionality and synergies among the windows of the IDB and IDB Invest; and (iii) take steps to include in the priority areas of future country strategies any actions and objectives of the existing loan portfolios with the country that align with the Bank’s medium-term lines of work in the sector,

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<sup>67</sup> Water and Sanitation Investment Program (HO0174, closed in 2015) and Ciudad Mujer (HO-L1177, currently in portfolio).

<sup>68</sup> Management unit for strategic development projects and programs under the General Government Coordination Office. It executes Millennium Challenge Corporation, IDB, CABEL, and USAID projects.

<sup>69</sup> Ciudad Mujer (HO-L1177), Regional Road Integration Program (HO-L1104), Infrastructure Program for the San Pedro Sula Logistics Corridor (HO-L1018), Tegucigalpa-Puerto Castilla Agricultural Corridor Road Program (HO-L1033).

with the aims of facilitating their execution, monitoring and tracking of results, as well as maintaining the respective dialogue.

### III. PRIORITY AREAS

- 3.1 **Strategic approach.** The country strategy for 2019-2022 will support the Honduran government's policies aimed at addressing the constraints on achieving stronger and more inclusive growth. To this end, the Bank will structure its interventions around three pillars: (i) strengthening of fiscal institutions and expenditure efficiency; (ii) human capital accumulation; and (iii) expansion of sustainable production opportunities.<sup>70</sup> Taking into account the lessons learned and in view of the limited fiscal headroom, the strategy will emphasize coordinating actions in geographic areas affected by poverty and making institutional and management improvements in the sectors supported by the Bank during this strategy period. The implementation of this strategy will take the form of new interventions, IDB Group portfolio operations, coordination of public-private actions to achieve a greater impact on the priority sectors, and use of complementarity with other donors to maximize the impact of international cooperation on the wellbeing of the Honduran population. The 2019-2022 country strategy is aligned with the Bank's Update to the Institutional Strategy 2016-2019 and the IDB Invest Business Plan 2017-2019.

#### **Strengthening of fiscal institutions and expenditure efficiency**

- 3.2 Honduras has made improvements in its fiscal institutions in recent years. The approval of the Fiscal Responsibility Law in 2016 was a milestone on the path to the country's objective of safeguarding the sustainability of public policies. The goals of deficit reduction and debt containment have been crucial in supporting Honduras' macroeconomic stability and have spurred reforms to improve expenditure efficiency and effectiveness in sectors such as energy, social protection, health, and education. The creation in 2013 of the Solidarity and Social Protection Fund for Poverty Reduction (FRP) and its financing through indirect general taxes have created room for programs to enhance the redistributive effect of fiscal policy on inequality.<sup>71</sup> However, in order to continue to move forward on this agenda to support sustainable and more equitable growth in a context of fiscal tightening, the country needs to address the risks associated with the quality of its budget institutions, tax oversight, the financial sustainability of the ENEE, and the efficiency and transparency of social spending, particularly on the social protection programs financed through the FRP.
- 3.3 The index of budget institution strength ranks Honduras below the average for Central America and the Dominican Republic as well as for Latin America and the

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<sup>70</sup> These pillars are based on the main challenges identified in the IDB study Honduras: Country Development Challenges (Annex I).

<sup>71</sup> Despite these strides, the redistributive effect of fiscal policy on inequality in Honduras is insignificant. N. Lustig (2016). "El impacto del sistema tributario y el gasto social en la distribución del ingreso y la pobreza en América Latina: Argentina, Brasil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, México, Perú y Uruguay."

Caribbean. This is due to insufficient management of fiscal risks,<sup>72</sup> weak results-based budgeting, and the absence of a medium-term budget framework.<sup>73</sup> Investment is based on an annual horizon, affecting the continuity of strategic initiatives as well as their monitoring and evaluation processes.<sup>74</sup> Investment effectiveness is also subject to risks associated with misspending in public procurement, which in Honduras exceeds the average for Latin America and the Caribbean.<sup>75</sup> This is the result of a public procurement process that lacks reliable information systems and adequate staff and funding.<sup>76</sup>

- 3.4 On the tax side, the oversight function has weaknesses associated with shortcomings in the management of tax information due to technological obsolescence and lack of integration across systems,<sup>77</sup> particularly among SAR, DARA, and SEFIN; databases that fail to provide timely information; and computer systems that lack adequate data validation. On the expenditure side, despite achievements in the financial status of ENEE, this entity remains one of the main contributors to the persistent public sector deficit, generating a deficit of 0.7% of GDP (December 2017), and is a source of fiscal risk. Financial and operating management problems, which started to be addressed with the reform process initiated in 2013, have not been fully overcome. Specifically, what is required is continuity of action to reduce electricity losses, decrease the dependence on thermal power generation from petroleum products,<sup>78</sup> improve the capacity for administration and monitoring of operating contracts, adjust the rate schedule, and better target subsidies.<sup>79</sup>
- 3.5 Efficiency gains in redistributive social spending are also needed, particularly in the use of FRP resources.<sup>80</sup> The government initiative to establish the FRP with the mandate to support a social protection system for redistributive interventions was a significant step toward creating a stable, budget-funded source of financing for interventions aimed at reducing poverty. However, the FRP lacks regulations governing the use of its resources or the eligibility of programs to be financed. For

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<sup>72</sup> Honduras should periodically and systematically analyze and manage the primary risks to public finances, including: (i) guarantees provided by the State to back public credit operations; (ii) public-private partnerships; (iii) judicial actions against the State; (iv) municipal indebtedness; (v) natural disasters; and (vi) financial risks of State-owned enterprises. While SEFIN has developed methodologies for most of these risks, it should regularly disclose its risk analysis and strengthen its monitoring and management process for effective decision-making throughout the public sector.

<sup>73</sup> Prepared by the IDB based on IMF (2014) Budget institutions in G-20: an update; and Gupta et al. (2017) Budget institutions in low-income countries.

<sup>74</sup> IDB: Honduras: Country Development Challenges (see Annex 1).

<sup>75</sup> Better spending for better lives. IDB. 2018.

<sup>76</sup> Marco A. Hernandez Ore, Liliana Do Couto Sousa, and J. Humberto Lopez. 2017. Honduras - Unlocking economic potential for greater opportunities: systematic country diagnostic (Vol. 2) (Spanish). Washington, DC. World Bank.

<sup>77</sup> In 2017, 68% of tax returns were filed electronically. The figure in 2016 was 68% (the same as in 2017); in 2015 it was 64%, and in 2014 it was 55%. Source: SAR.

<sup>78</sup> It currently accounts for 41% of the energy mix, rendering the sector very vulnerable to changes in oil prices and introducing a major fiscal risk.

<sup>79</sup> A more detailed diagnostic assessment of sector advances and challenges may be found in Programmatic Support for Structural Reforms in the Electricity Sector (HO-L1189). IDB.

<sup>80</sup> The FRP receives around US\$100 million per year from the sales tax. Legislative Decree 278-2013. Settlement Statement for the General Government Revenue and Expenditure Budget. [SEFIN 2017](#).

example, the BVM program is at present the only program to have been evaluated and where the evidence supports its effectiveness in increasing human capital and alleviating extreme poverty.<sup>81</sup> Yet in 2017 this program received only 4.7% of the FRP's resources. Improving the management and efficiency of these resources requires developing FRP regulations that include selection criteria aimed at better targeting and greater coverage of social programs to reduce poverty; updating the mechanisms for geographic targeting<sup>82</sup> and targeting of households living in extreme poverty;<sup>83</sup> and revising the methodology for measuring poverty and inequality. In addition, territorial coordination of these programs with the delivery of basic services has been shown to have positive effects on their impact on poverty.<sup>84</sup>

- 3.6 Under this pillar, the IDB Group will support the country in the design and implementation of actions to introduce a more strategic management of the budget, reinforce the information systems needed for improving tax oversight, and enhance the quality, transparency, and efficiency of public spending,<sup>85</sup> particularly in the energy and social protection sectors. The Bank's collaboration on these issues will be aimed at improving public investment management through activities to strengthen multiyear planning and scheduling of investments and the capacities for monitoring, evaluation, and transparency of investment expenditure. Similarly, the Bank will work with the Regulatory Office of State Contracting and Procurement to implement measures aimed at ensuring transparent and competitive compliance with the existing regulatory framework, applying improvements to HonduCompras.<sup>86</sup> In the tax area, the Bank will continue to support the tax and customs authorities in their technological reform and modernization process, assisting in the consolidation of the new Deputy Directorate for Customs Revenue (DARA) and its effective coordination with SAR, with a view to reinforcing and enhancing the effectiveness of the tax collection system.<sup>87</sup> In the energy area, the Bank will continue to support the implementation of the sector reforms with a view to consolidating its financial and operating sustainability and minimizing fiscal risks. In the social protection area, emphasis will be placed on setting the regulations needed to achieve a more efficient and equitable allocation of the FRP's resources. Taking into account the interest of the authorities in moving forward on a digital agenda to improve management,

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<sup>81</sup> <https://sedis.gob.hn/sites/default/files/Informe-final-de-EI-FEB-7.pdf>.

<sup>82</sup> The current poverty map for geographic targeting of the programs is based on the 2001 population census, although there is a more up-to-date map based on the 2013 census.

<sup>83</sup> While the current algorithm for identifying households living in extreme poverty has proven to be one of the most effective in the region, this algorithm is five years old and has shown signs of wear, particularly in urban areas.

<sup>84</sup> Recent studies for Central America and the Dominican Republic highlight the importance of a territorial approach in improving the quality and efficiency of public spending, concluding that areas with a greater prevalence of rurality and social gaps tend to display lower rates of spending productivity. M. Ardanaz and P. Gutierrez (2016). "Evolución del gasto social y resultados: un enfoque territorial." This has been the Bank's experience through the BVM program and interventions in health and education in Honduras during the 2015-2018 country strategy period.

<sup>85</sup> Improvement in public expenditure will be addressed in crosscutting fashion through institutional strengthening of the sectors supported by the Bank.

<sup>86</sup> These initiatives in the fiscal sector are currently being supported through the loan operation Tax Administration Institutional and Operational Strengthening (HO-L1108).

<sup>87</sup> The loan operation Tax Administration Institutional and Operational Strengthening (HO-L1108) is supporting modernization of the tax technology system and interoperability of the SAR, DARA, and SEFIN systems.

transparency, and service to the public, these activities will strive to incorporate good practices in the use of information and communication technologies (ICTs) that are relevant to the specific fiscal and spending efficiency problems that the country seeks to solve.

- 3.7 The IDB Group's support in this area is aligned with the Bank's Update to the Institutional Strategy 2016-2019 in terms of seeking to strengthen the capacity of the State, establish suitable institutional frameworks, and create a more effective fiscal policy. It is also aligned with the Plan of the Alliance for Prosperity in the Northern Triangle (PAPTN), specifically in the area of strengthening institutions and the action lines of strengthening the tax administration and improving the transparency and effectiveness of public spending.

#### **Human capital accumulation**

- 3.8 Coordinating the expansion of basic services and BVM program coverage by geographic area and household income, coupled with institutional and operating improvements in the BVM program, in education, and in health, has made it possible to impact both the income and the education and health indicators of the beneficiary population.<sup>88</sup> The BVM program reaches one third of the country's households living in extreme poverty, and its geographic coverage has been closely coordinated by implementing the Decentralized Management Model (MGD)<sup>89</sup> for healthcare and by expanding the coverage of the third basic education cycle. The main challenges faced in consolidating this model, strengthening its effectiveness for human capital accumulation, and expanding coverage to those living in extreme poverty in both rural and urban areas are to achieve institutional reinforcement and financial sustainability of the BVM program and improve the coverage, quality, and territorial targeting of the education and health services. In addition, the problem of security poses a challenge in terms of retaining human capital and primarily affects the young.
- 3.9 The challenges involving the **BVM program's** financial sustainability and predictability of its available resources,<sup>90</sup> combined with the program's separate urban and rural management structures, impair the program's effectiveness by affecting its allocation of resources and preventing it from delivering a better operating performance.<sup>91</sup> With regard to funding, the FRP allocates a very small fraction of its resources to the program (4.7% to cover 15% of the BVM program's needs in 2017), rendering the program dependent on external resources. The program's divided operating structure leads to differences in accountability and internal control criteria as well as a duplication of functions.
- 3.10 In **education**, while net primary school coverage is in excess of 95%, coverage of the third basic education cycle drops to 45.3%, one of the lowest in Latin America,

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<sup>88</sup> Final impact evaluation report on the Bono Vida Mejor Cash Transfer Program. 12 December 2017. Available at: <https://sedis.gob.hn/sites/default/files/Informe-final-de-EI-FEB-7.pdf>.

<sup>89</sup> The MGD covers 92 of the country's 104 poorest municipios, identified under the Mesoamerica Health Initiative.

<sup>90</sup> Currently, the rural BVM program is financed with IDB, and to a lesser extent World Bank, resources. For urban areas, the program receives funding from the FRP (4.7% of the FRP).

<sup>91</sup> Evaluation of the solidarity and social protection fund for extreme poverty reduction in Honduras - HO-T1170-SN3. Gerenssa, July 2016.

with marked urban-rural differences (64% and 32% coverage, respectively) and differences by income decile (73% and 24% coverage, respectively, for the wealthiest and poorest quintiles).<sup>92</sup> In the western part of the country, which has a high concentration of poverty and indigenous population groups, gross coverage of the third cycle is lower (58.2%) than in the rest of the country (69%).<sup>93</sup> Honduras also exhibits one of the highest secondary school dropout rates (50%), higher than the rate for Latin America and the Caribbean as a whole (42%). The problems in completing ninth grade become a bottleneck for the educational advancement of the country's most vulnerable youth. In addition, the quality of learning is poor<sup>94</sup> and has little relevance to the job market.<sup>95</sup> The truncated educational advancement and low performance levels are primarily the result of unmet demand, especially in rural areas, where only 11% of students have access to third-cycle education in their communities, coupled with economic hardship, limited availability of educational materials, lack of interest, and academic failure. Moreover, the Ministry of Education (SEDUC) has limited management capacity, with information systems that do not allow for analyses aimed at results-based decision-making, making it difficult to address the above-mentioned access, retention, and quality challenges. The expansion of third-cycle basic education coverage to support the BVM program in the country's western region<sup>96</sup> depends entirely on external resources and is outsourced, introducing an element of instability in the delivery of this service.<sup>97</sup> In the medium term, this expansion should be carried out by the SEDUC.

- 3.11 In **health**, the country faces accessibility and quality challenges. The accessibility gaps are more pronounced in rural areas, limiting the speed at which improvements can be implemented. From 2010 to 2015, while the maternal mortality rate in urban areas went from 58 to 43 per 100,000 live births, in rural areas it went from 85 to 79.<sup>98</sup> The internal inequities are reflected in the rate of childbirths involving assistance from specialized staff, which is 94% in urban areas and 62% in rural areas. In addition, 42% of Honduran mothers report not having planned their pregnancy or wanting it later.<sup>99</sup> There is a significant gap in access to family planning services, particularly for the poorest population (55% for the lowest quintile versus 69% nationwide). Honduras has one of the highest adolescent fertility rates in the region: 72 births per 1,000 women aged 15-19, compared with an average of 62 births for this age bracket in Latin America and

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<sup>92</sup> Prat and Lopez (2018).

<sup>93</sup> SEDUC 2016.

<sup>94</sup> National tests reflect this poor quality: only 34% of ninth-grade students attained satisfactory reading scores and a mere 7% attained satisfactory math scores (MIDEH, 2016).

<sup>95</sup> In 2014, more than 50% of employers stated that the greatest obstacle to hiring staff is related to soft skills, and the main reason for dismissal is employee behavior. World Development Indicators. (2016). World Bank.

<sup>96</sup> This expansion covers some 11,000 students, 75% of whom are BVM program beneficiaries.

<sup>97</sup> For example, the 2018 school year for the 11,000 students in the western part of the country began in March instead of early February, as the formal academic calendar requires.

<sup>98</sup> In 2015, 47% of maternal deaths occurred during the initial 24 hours after childbirth, which is associated with low quality of care and complications. Study of Maternal Mortality Rate, Estudio RAMOS, 2015.

<sup>99</sup> ENDESA 2011-2012.

- the Caribbean.<sup>100</sup> Furthermore, 24% of young girls aged 15-19 have been pregnant, and this proportion rises to 35% in the low-income population.<sup>101</sup>
- 3.12 Public spending on health is limited<sup>102</sup> and inefficient, stemming from poor targeting to results and limited accountability, dispersion of resources and poor coordination between initiatives of the various agencies, and the model's curative (rather than preventive) approach.<sup>103</sup> The low-income population has poor financial protection,<sup>104</sup> affecting access to quality services. The institutional weaknesses accentuate these problems. For example: (i) there is no integrated information system to coordinate and organize the series of information subsystems that have been created; (ii) the production of services is not digitized and the information obtained is neither complete nor timely; and (iii) healthcare services lack technological applications designed to improve their efficiency and quality and facilitate patient management. The MGD has been deployed with a view to addressing some of these problems by implementing a results-based financing model to improve efficiency, quality, access, and coverage. While the MGD has yielded significant results, there is a lag in its institutional consolidation, particularly in terms of the parameters for managing those responsible for providing services, monitoring and evaluation arrangements, and the responsibilities of the various authorities at the Ministry of Health (SESAL) with regard to the model's performance.
- 3.13 Despite advances in **security**, supported by an ambitious institutional reform of the police force, Honduras continues to be one of the world's most unsafe countries, and one in which violence especially affects the young. Twenty percent of murder victims in 2017 were between 15 and 24 years of age.<sup>105</sup> In addition, while most murder victims are men, in 2017 Honduras was ranked 2nd out of 17 countries in femicides, with a rate of 8.8 per 100,000 women over the age of 15, compared with a rate of 2.4 in Latin America and the Caribbean.<sup>106</sup> Moreover, 22% of Honduran women between the ages of 15 and 49 have experienced domestic violence of some type (psychological, physical, or sexual).<sup>107</sup> The economic cost of violence is estimated at 6.5% of GDP, the highest in Latin America and the Caribbean.<sup>108</sup> Despite recent progress in reducing homicide rates, there has been a rise in young adult mortality as a result of the high levels of interpersonal violence and traffic accidents. These problems contribute to the

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<sup>100</sup> World Development Indicators. (2016). World Bank.

<sup>101</sup> ENDESA 2011-2012.

<sup>102</sup> Spending per person is US\$212, compared with US\$696 for Latin America and the Caribbean as a whole.

<sup>103</sup> In addition, the high levels of informal employment have limited the viability of creating insurance systems for the population through contributory arrangements.

<sup>104</sup> In 2017, 44% of health spending in Honduras comes from out-of-pocket expenses, primarily by the country's poorest two quintiles. Source: World Bank.

<sup>105</sup> Data from the National Violence Observatory of the National Autonomous University of Honduras (UNAH). 2017.

<sup>106</sup> Gender Equality Observatory for Latin America and the Caribbean. United Nations. ECLAC. 2016. Available at: <https://oig.cepal.org/es/indicadores/feminicidio>.

<sup>107</sup> National Health and Demographic Survey (ENDESA) 2011-2012 Honduras.

<sup>108</sup> L. Jaitman, 2017. The costs of crime and violence: New evidence and insights in Latin America and the Caribbean, IDB.

leading cause of death in the country, i.e., externally caused injury (ECI),<sup>109</sup> while ECI has become the second-leading cause of public hospital admissions.<sup>110</sup> In addition, the cost of violence is even higher if the country's loss of human capital due to emigration is taken into account.<sup>111</sup> Although emigration is the result of various factors, Honduras' high crime and violence rates, coupled with an absence of opportunities, are part of the structural causes behind this phenomenon, which is an obstacle to human capital accumulation and growth. These factors are compounded by outstanding challenges in police effectiveness, which are due to poor training of the police force, fragmented and low-quality information on crime, and obsolete technology.

- 3.14 In response to this situation and in the framework of the PAPTN, Honduras has prioritized actions to improve social protection, education, health, and security. The results have been significant, making it necessary to continue with the reform and investment prioritization and management processes in these sectors.
- 3.15 In the 2019-2022 country strategy period, the IDB Group will support the country in reinforcing human capital accumulation by prioritizing the strategic objectives of improving the quality and coverage of education and health services for vulnerable population groups as well as the safety of at-risk youth and the availability of specialized services for women. The actions under these objectives will address institutional issues in key sectors and programs supported by the Bank: the BVM

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<sup>109</sup> The main causes of "years of life lost" due to premature death in Honduras are: ECI (intentional or unintentional personal injury due to fall, bullet wound, knife wound, traffic accident, hit-and-run, domestic violence, and others), at a rate of 15.3% (an increase of 133% over the last 20 years), followed by ischemic heart disease (10%) and childbirth complications (6.5%). Global Burden of Disease for Latin America and the Caribbean. Institute of Health Metrics and Evaluation (IHME). 2016.

<sup>110</sup> However, only 83% of ECI-related emergencies arriving at health facilities can be treated.

<sup>111</sup> The cost of emigration for Honduras in terms of lost human capital (measured by local wages not earned) can be significant: it has been estimated at roughly 1.5% of GDP. This estimate does not distinguish among the various underlying causes of emigration (violence, lack of opportunities, family reunification, and others). Giselle Eugenia Del Carmen Hasbun and Liliana Do Couto Sousa. 2018. Human capital outflows: selection into migration from the Northern Triangle (English). Policy Research Working Paper; No. WPS 8334. Washington, D.C.: World Bank.

program,<sup>112</sup> education,<sup>113</sup> health,<sup>114</sup> and citizen security.<sup>115</sup> In addition, to improve the effectiveness of the interventions, the Bank will continue to apply a territorial approach, prioritizing the areas most affected by poverty, particularly the country's western region. Furthermore, the Bank will evaluate the use of information technologies based on the relevance of the proposed solutions in addressing the country's specific problems and characteristics.<sup>116</sup> Through the portfolio in execution and new operations, the Bank expects to contribute to a reduction in extreme poverty and mother-child morbimortality, an improvement in the quality and coverage of the third basic education cycle, a reduction in adolescent pregnancies, and a decline in the rates of violence against youth and women. The actions to be carried out under this pillar will seek synergies with the country's initiatives in the framework of the PAPTN.

- 3.16 The interventions in this area are aligned with the Bank's Update to the Institutional Strategy 2016-2019 in terms of the challenge of social exclusion and inequality and the objective of eliminating extreme poverty, and with the priority segments outlined in the IDB Invest Business Plan 2017-2019, as updated (document CII/GA-77-4), particularly the segment of supporting the development of social infrastructure. Similarly, these interventions are aligned with the PAPTN, under the areas of developing human capital and improving citizen security and access to justice.

#### **Expansion of sustainable production opportunities**

- 3.17 Achieving stronger and more inclusive growth requires supplementing the investments in the first two pillars with actions that address constraints on the country's productivity, especially in areas with high poverty rates and low income-generating capacity. Deficient physical connectivity, low penetration of ICTs, limited electricity service coverage, difficult access to credit, and poor technological innovation and adaptation capacities hinder the creation of production

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<sup>112</sup> The Bank has been supporting the BVM program, and in this new stage will focus on ensuring its institutional and financial sustainability, in addition to optimizing its operating management. The first operation under the 2018 Program to Support Social Protection Reforms (HO-L1193) focuses on these issues.

<sup>113</sup> In education, the Bank will continue to expand access to the third cycle and learning quality, with an emphasis on the country's western region. At the national level, through the competitiveness agenda and the objective of poverty reduction, the Bank will evaluate interventions in middle school with a view to developing relevant life and job skills that can yield a better employability profile for young people graduating from the school system. In addition, the Bank will work on strengthening the technical capacities of the SEDUC to improve the quality of education. The portfolio operation Improving Educational Quality to Develop Skills for Employment: Project Youth (HO-L1188) seeks to assist in developing job and life skills in Honduran youth by improving access to and the quality of learning in the third basic education cycle.

<sup>114</sup> The Bank will continue to support the authorities in ensuring the institutional structure of the MGD and will evaluate interventions to improve the hospital care network that more effectively address the needs of the population. The 2018 operations Project to Improve the Management and Quality of Maternal-Neonatal Health Services (HO-L1195) and Comprehensive Strengthening of Tegucigalpa's Trauma and Emergency Care Network (HO-L1199) will help to expand and improve the quality of the country's hospital network. At the same time, the Mesoamerica Health Initiative will continue to serve as an important instrument for making progress on the indicators.

<sup>115</sup> The Bank will continue to support prevention actions at the community level and reinforce the institutional structure of the National Police through operation HO-L1187.

<sup>116</sup> For example, given the growth prospects of the youth segment of the population, the use of information technologies and social media will be evaluated with a view to spurring changes in habits to address problems such as adolescent pregnancy and others.

- opportunities. In turn, these problems are exacerbated by the population's high vulnerability to the effects of climate change, particularly in rural areas.
- 3.18 Honduras faces a series of **transportation infrastructure and logistics** challenges that limit the country's potential growth. According to the National Logistics Plan, the available infrastructure and specialized logistics services are poorly developed.<sup>117</sup> The country is ranked 106th out of 160 countries in the Logistics Performance Index, where it is in last place in the region in terms of infrastructure, customs, and logistics competence.<sup>118</sup> In addition, there are only limited services at border crossings,<sup>119</sup> affecting international trade competitiveness and costs.<sup>120</sup> In effect, Honduras has the highest import and export costs in Central America and the Dominican Republic,<sup>121</sup> with ground transportation being the main cost component. This is due to both road density and road quality problems. Road density (0.30 kilometer/square kilometer) is the lowest in Central America and the Dominican Republic, while in terms of quality, only 24% of the 15,000 kilometers of road network are paved. Furthermore, territorial coverage is not balanced, marked by inequities among the various departments of the country, and there is limited connectivity to markets in rural, agricultural production, and forestry areas, as well as deficient access to areas with tourism potential.<sup>122</sup> This situation stems from management weaknesses in the sector, particularly with regard to planning, prioritization, execution and maintenance of investments, and proper allocation of resources.<sup>123</sup>
- 3.19 The physical connectivity challenges are compounded by the country's digital gap. **Digital connectivity** is one of the lowest in the region, hindering the development of alternative models to improve access to services and limiting productivity improvements in economic sectors such as agriculture and tourism, affecting the

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<sup>117</sup> The National Logistics Plan identifies the following limitations: (i) the ports lack areas for logistics support activity; (ii) the Toncontin international airport does not have a cargo terminal or cold rooms; (iii) the agricultural logistics support infrastructure has insufficient warehousing systems and facilities for the cold chain; and (iv) there is no specialized logistics infrastructure at the borders or formal logistics areas to support transporters. In view of this, infrastructure investment in Honduras averages 1.2% of GDP (2015), the third-lowest in Latin America, where the average is 2.5% of GDP (Infralatam).

<sup>118</sup> World Bank 2018. Connecting to compete 2018: trade logistics in the global economy- the logistics performance index and its indicators. World Bank, Washington DC. Available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/29971/LPI2018.pdf>

<sup>119</sup> There are inefficiencies in cross-border processes as well as lack of infrastructure and equipment. The wait time in customs facilities and inspection stations is 15% to 20% of the total shipping time on international routes. Moreover, there is no single window arrangement, since the existing window processes exports but not import permits, for which all procedures have to be performed manually. Osborne et al., 2014.

<sup>120</sup> World Bank (2014). Doing Business in Central America and Dominican Republic 2015. Washington, D.C.: World Bank Group.

<sup>121</sup> Idem.

<sup>122</sup> See [Honduras: Country Development Challenges 2018](#) and [National Freight Logistics Plan, Honduras 2018-2030](#).

<sup>123</sup> Resources for maintenance of the paved and unpaved road network have been reduced by approximately 70%.

country's rural areas in particular.<sup>124</sup> According to the 2017 Information and Communication Technology (ICT) Development Index, Honduras is ranked 32nd out of 35 countries in the continent, and 129th out of 176 countries globally. In addition, only 30% of Honduran households have Internet access, compared to 57% in Latin America and the Caribbean.<sup>125</sup> The low penetration of these technologies, resulting from insufficient investment in broadband infrastructure, limits the ability to expand the number of household subscriptions to mobile services. Unless corrected, the digital gap will tend to widen with respect to Central America and the Dominican Republic and the rest of Latin America and the Caribbean, restricting potential advances in the country's productivity.

- 3.20 The **energy** sector reports electricity losses equal to 27.3% of the total power in the grid. Despite having declined, this loss percentage is the highest in Central America and the Dominican Republic. Honduras is the region's country with the lowest coverage<sup>126</sup> and close to 55% of the population (88% in rural areas) uses firewood in the home.<sup>127</sup> Technical losses stem from inadequately designed facilities, lack of maintenance, or inadequate equipment, which are the result of low investment and operation and maintenance failures. Nontechnical losses are related to illegal connections, nonpayment, or billing errors. Power generation in Honduras is costly and highly dependent on hydrocarbons, and although the country has resources for hydroelectric development, the sector lacks the institutional structure needed to manage complex projects that require adequate social and environmental management and to move forward on diversifying the power sources.<sup>128</sup> The management and planning weaknesses of the ENEE and of the sector's institutional framework explain these results. Continuing to strengthen the sector and ENEE's management capacity will be essential for achieving sustainable development of the sector with a view to closing the current coverage gaps, improving quality, reducing the fiscal contingency, and covering the country's future needs.<sup>129</sup>
- 3.21 In **access to financing**, the financial system has high costs and a limited supply of products. This makes it difficult to channel resources to certain segments of the production sector, particularly agriculture and SMEs (especially rural SMEs), as

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<sup>124</sup> César Calderón and Luis Servén, "The Effects of Infrastructure Development on Growth and Income Distribution". Policy Research Working Paper No. 3400, World Bank (September 2004). Marianne Fay and Mary Morrison, *Infrastructure in Latin America and the Caribbean: Recent Developments and Key Challenges*. World Bank (Washington DC: 2005). K. M. Vu (2011). "ICT as a Source of Economic Growth in the Information Age: Empirical Evidence from the 1996–2005 Periods." *Telecommunications Policy*, 35(4), 357-372. European Commission. (2006). *i2010 E-Government Action Plan: Accelerating E-Government in Europe for the Benefit of All*. Brussels, European Commission. Available at <http://ec.europa.eu/idabc/servlets/Doc92d2.pdf?id=25286>.

<sup>125</sup> World Development Indicators. (2016). World Bank.

<sup>126</sup> The rate is 75% according to 2016 comparative data. While the situation has improved and national coverage in 2018 is 78%, the urban-rural gaps remain in place: 65% coverage in rural areas versus 82% in urban areas.

<sup>127</sup> The 2017 Global Energy Architecture Performance Index ranks Honduras in 82nd place out of 127 countries (5th lowest ranking in Latin America and the Caribbean). This index measures the ability of countries to deliver secure, affordable, and sustainable energy.

<sup>128</sup> Honduras. Programmatic Support for Structural Reforms in the Electricity Sector. Third Tranche (HO-L1189), Honduras: Country Development Challenges 2018 (see Annex I), and ENEE <http://www.enee.hn/index.php/electrificacion-nacional/generacion>. At the same time, through its nationally determined contribution (NDC), Honduras has made a commitment to reducing greenhouse gas emissions by 15% by 2030 with respect to the passive scenario, and identifies renewable energy as one of the key sectors.

<sup>129</sup> In the last five years, demand for electric energy in Honduras has grown at an average annual rate of 3.83%.

well as toward the adoption of innovations and good disaster risk management practices. Despite its economic importance, agriculture accounts for a mere 7.5% of bank loans.<sup>130</sup> Similarly, the Honduran Bank for Production and Housing (BANHPROVI), a development bank tasked with supporting the production and housing sectors, allocates less than 20% of its portfolio to agricultural activities. Problems associated with producers' high risk of harvest losses due to natural disasters and insecurity of property rights to the land,<sup>131</sup> coupled with limited innovation in financial products, affect access to credit for micro, small, and medium-sized enterprises (MSMEs).<sup>132</sup>

- 3.22 The country's capacities for **technological innovation and technology adoption** are low, particularly in the agricultural sector. This prevents productivity gains and faster adaptation to climate change, thereby limiting the rural population's opportunities to improve its income in sustainable fashion.<sup>133</sup> The country's stagnant productivity in recent years is due to factors such as limited budget spending on services that support the technological capacities of the sector,<sup>134</sup> a sector policy bias in favor of maintaining the prices obtained by producers, and problems of access to financing and limited infrastructure. Improving the technology services is essential for mitigating the effects of **climate change** on production,<sup>135</sup> employment, and the quality of life of the population. Honduras has witnessed how prolonged periods of drought tend to have effects that go beyond immediate or short-term impacts. For four consecutive years (2014-2017), the area known as the Dry Corridor<sup>136</sup> experienced negative impacts on food production and on business opportunities for the vulnerable population.<sup>137</sup>
- 3.23 The adoption of good practices based on the available technology has become particularly critical in the forestry sector, considering that forests are highly vulnerable to climate change. Fifty percent of Honduran territory is covered in forests, 36.7% of which are pine forests. Estimates indicate that 72% of pine forests are degraded,<sup>138</sup> rendering them more susceptible to the effects of climate

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<sup>130</sup> UNAH 2018. Situación económica actual y perspectivas para 2018.

<sup>131</sup> According to the Land Governance Assessment Framework of the Instituto de la Propiedad de Honduras [Honduran Property Rights Institute] (2014), 80% of private land in rural areas and 30% in urban areas has titling problems.

<sup>132</sup> In all, 63% of MSMEs report difficulties in obtaining access to credit. 2017 MSME Finance Gap, World Bank.

<sup>133</sup> The sector accounts for almost half of all exports and employs one third of the workforce nationwide and 60% in rural areas.

<sup>134</sup> Investment in agricultural research in Honduras is the lowest among 17 countries in Latin America and the Caribbean (Stads et al. 2016).

<sup>135</sup> Unless steps for adaptation are taken, climate change models project a decline in the yield of the staple grains produced in the country, such as corn, beans, and rice. These grains will on average have a yield decline of -11% to -14% by 2030, and of -19% to -24% by 2050, with repercussions in terms of food availability and prices and food security, particularly affecting the rural population. ECLAC (2016). "La economía del cambio climático en Honduras: mensajes clave 2016." Mexico City, Mexico.

<sup>136</sup> Area consisting of the pre-mountainous central region of El Salvador, Guatemala, Honduras, Nicaragua, Guanacaste in Costa Rica, and the Dry Arc of Panama.

<sup>137</sup> World Food Programme, Food Security Update, Central America – July 2017.

<sup>138</sup> It is estimated that 72% of pine production forests in Honduras are degraded. Ernesto Flores and R. Mairena, 2005. Diagnóstico de la situación forestal en bosques de pino en Honduras [Diagnostic assessment of the status of pine forests in Honduras].

change on epidemic pest outbreaks.<sup>139</sup> Bark beetle attacks, which between 2012 and 2016 destroyed more than 500,000 hectares of pine forest (10% of the country's forest cover), were the result of, among other causes, a low adoption of adequate sustainable forest management and fire control techniques and shortcomings in the prevention, early warning, and timely direct control systems.<sup>140</sup> This situation has direct repercussions on the income-generating capacity of the low-income households associated with these areas and on the forest and agroforest productivity of small producers,<sup>141</sup> while it increases the threat of a decline in the availability of water in the country.<sup>142</sup>

- 3.24 To contribute to the country's initiatives aimed at creating sustainable production opportunities, the IDB Group will prioritize interventions that improve logistic performance for production chains based on greater connectivity within Honduran territory and between Honduras and the regional market;<sup>143</sup> increase access to financing for agricultural SMEs; and shore up the efficiency, coverage, and quality of the electricity service<sup>144</sup> and the economy's capacity for innovation and for climate change adaptation. For implementation, the IDB Group will promote a territorial approach based on reducing poverty and achieving inclusive growth, mobilizing private resources in close coordination with public investment initiatives to promote strategic projects for inclusive and sustainable infrastructure,<sup>145</sup> and addressing issues associated with climate change. The portfolio operations and new programs will be aligned to attain better infrastructure coverage and quality, increased rural connectivity, increased financing for small agricultural producers,<sup>146</sup> broader coverage of electrification services, particularly in rural areas,<sup>147</sup> and greater forest resilience to climate change.<sup>148</sup>

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<sup>139</sup> Ronald Billings, B. Locatelli, and M. Milton, 2010. Climate change and outbreaks of Southern Pine Beetle *Dendroctonus frontalis* in Honduras.

<sup>140</sup> Ronald Billings, 2016. Evaluación del Programa de Control Directo de la Plaga del Gorgojo del Pino y Establecimiento de un Programa Permanente de Sanidad Forestal [Review of the Southern Pine Beetle Direct Control Program and Establishment of a Permanent Forest Health Program].

<sup>141</sup> Losses of forest-related jobs have been estimated at 120,000, while the economic losses associated with the value of the lumber amount to some US\$57 million per year. Instituto de Conservación Forestal [Forest Conservation Institute]. 2016.

<sup>142</sup> It is estimated that for sub-basins in Honduras with a 10% loss of pine forest cover due to the bark beetle (this being the average nationwide loss per sub-basin), annual flows in the low-water period could decline by 1.5%. The economic impacts on the population include costs associated with the treatment of diseases related to the water shortage as well as the cost of resorting to alternative sources of water to make up for the insufficient supply. IDB, 2016.

<sup>143</sup> The Bank will support the development and connectivity of the transportation network through improvements in the logistics corridors and rural roads.

<sup>144</sup> Manitoba Hydro International (2017).

<sup>145</sup> The Financing and Risk Mitigation Program for Strategic Investments in the Northern Triangle Countries (RG-O1667) seeks to support these lines of action.

<sup>146</sup> The IDB Group will support innovation in financial products, modernization of the institutions that provide financing to the production sector, and evaluation of the existing legal and/or administrative provisions that hinder the channeling of funds to rural sector activities, particularly to small agricultural producers and tourism.

<sup>147</sup> The 2018 program Support for the National Electricity Transmission Program (HO-L1186) will assist in expanding electricity coverage. IDB Invest will seek to support private-sector participation in the electricity industry through, for example, self-generation and technological innovation.

<sup>148</sup> As part of its nationally determined contribution (NDC), Honduras has committed to the forestation/reforestation of one million hectares of forest by 2030.

- 3.25 The interventions in this area are aligned with the challenge of low productivity and innovation, and the objective of improving regional infrastructure and inserting firms into value chains, of the Bank's Update to the Institutional Strategy 2016-2019. The interventions are similarly aligned with the priority segments of supporting infrastructure development, capacity-building to support the corporate segment, and leveraging resources through the financial system to support priority intervention areas and crosscutting themes under the IDB Invest Business Plan 2017-2019, as updated (document CII/GA-77-4). This pillar envisages strategic lines included in the PAPTN area of catalyzing the production sector.
- 3.26 **Crosscutting issues.** The crosscutting issues for this country strategy period include (i) climate change adaptation; (ii) women's empowerment and diversity; and (iii) innovation and use of new technologies to achieve greater relevance and efficiency in interventions. Climate change adaptation and mitigation will be incorporated in interventions aimed at supporting production activities, including appropriate designs for resilient infrastructure, lines of credit to improve adaptation among producers, and management of key natural resources for the agriculture, tourism, and energy sectors. Interventions in the social, production,<sup>149</sup> and fiscal management areas will include elements that strengthen the gender and cultural relevance associated with indigenous and Afro-descendant peoples.<sup>150</sup> The IDB Group will devote special attention to expanding digital connectivity and incorporating ICTs into the three pillars, fostering the digitalization of processes and services in the context of a digital government agenda and, as the case may be, evaluating the creation of civic participation mechanisms for women and indigenous and Afro-descendant peoples.<sup>151</sup>
- 3.27 **Dialogue areas.** In the water and sanitation sector, there are significant gaps<sup>152</sup> that will require both institutional and operational management interventions aimed at achieving good water management, sustainability, and service quality and access. Under this country strategy, the Bank will continue to provide technical support and foster dialogue in the sector to identify priorities related to institutional strengthening and investment gaps with a view to improving the quality and coverage of these

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<sup>149</sup> For example, the operation Honduras Transportation and Freight Logistics Sector Reform Program (HO-L1198) will seek to expand women's job participation in the transportation and freight logistics sector, helping to increase household income and providing additional benefits.

<sup>150</sup> On gender issues, the operation Project to Improve the Management and Quality of Maternal-Neonatal Health Services (HO-L1195) is aimed at reducing maternal-neonatal mortality in the country's poorest municipios by improving the quality, management, and responsiveness of healthcare services. The operation Ciudad Mujer (HO-L1117) is also relevant. In addition, the Civic Coexistence and Neighborhood Improvement Program (HO-L1187) introduces the dimension of femicide and care services for female victims of gender violence as well as prevention of this type of crime. With regard to cultural relevance, for indigenous and Afro-Honduran peoples this relevance is closely linked to the environment, in part because these groups are the most vulnerable to climate change by virtue of their geographic location. Operations such as HO-X1019, HO-T1245, and HO-G1243 have promoted energy production from alternative and renewable sources, educating youth on climate change, and climate change adaptation among small agricultural producers.

<sup>151</sup> This is within the framework of Honduras' National Strategy of Innovation for Competitiveness, which is comprised of five pillars: society and innovation; knowledge economy; productivity for sustainable economic growth; development of human capital capacities and competence; and institutional structure and governance.

<sup>152</sup> While the country has water and basic sanitation coverage rates of 92% and 80% respectively, the lack of data on water quality prevents estimating how much is due to safe management of the water service. The continuity of water service is rather limited: only 54% in urban areas and 66% in rural areas. Moreover, only 1% of wastewater is treated. CID/IDB with data from EPHPM 2017.

services. Advances in this dialogue could enable more active participation by the Bank in this sector. Similarly, sector dialogues will be held for the tourism and agriculture sectors to identify sector-specific actions that, coupled with the priorities identified in the three pillars of this country strategy, will catalyze growth. In addition, in its role as the technical secretariat of the PAPTN, the Bank will address the issues of prioritizing actions to create greater rootedness and reintegration of migrants.

#### IV. ESTIMATED LENDING FRAMEWORK

- 4.1 According to the Medium-term Budget Framework 2018-2021, the central government's annual gross financing needs<sup>153</sup> in the medium term will be 6.1% of GDP and will be mostly funded by external loan disbursements, which are projected at 2.9% of GDP for the period 2019-2022.
- 4.2 In this context and subject to the allocation of the Bank's concessional Ordinary Capital resources,<sup>154</sup> annual approvals are projected at approximately US\$168 million, and average annual disbursements at US\$225 million.<sup>155</sup> Thus, IDB lending for the 2019-2022 period is projected at US\$671 million in new sovereign guaranteed approvals and US\$901 million in total disbursements. According to this scenario, the Bank's exposure would be equivalent to 27% of the country's total debt and 41% of the country's public external debt<sup>156</sup> at the end of the country strategy period (see Annex III).

#### V. STRATEGY IMPLEMENTATION

- 5.1 **Territorial approach.** Greater coordination of interventions that are focused on specific geographic areas and targeted to poverty will be a priority in identifying and implementing actions under this strategy. The Bank will continue to develop a production and poverty map with the authorities that can guide investment decisions based on the specific needs of these areas to expand income-generating opportunities for the population.
- 5.2 **Institutional strengthening and public management.** Institutional weaknesses exist across a wide spectrum of the Honduran public sector. In response, the Bank has been developing an approach with the country that consists in supporting institutional changes while building management capacities and improving the delivery of services through a combination of instruments. This approach yielded

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<sup>153</sup> Include financing of the after-grants fiscal deficit and payment of internal and external public debt amortizations. The reference unit is the central government. Source: IMF 2018.

<sup>154</sup> Implementation of multilateral debt relief and the Bank's concessional financing reform. Proposal for the Implementation of a Debt Sustainability Framework and Enhanced Performance-based Allocation (document GN-2442), IDB, 2007 and Proposal for Sustaining Concessional Assistance by Optimizing the IDB's Balance Sheets (document AB-3066-2), IDB, 2016.

<sup>155</sup> The estimate of IDB lending for the 2019-2022 period is based on the allocation of the Bank's Ordinary Capital resources for the period 2019-2020, which currently amounts to US\$167.8 million per year, and is subject to future adjustments related to the biannual allocation for the 2019-2020 and 2021-2022 periods. The financial scenario considers the country's absorption limitations and the quotas arising from the explicit mandates of the Fiscal Responsibility Law.

<sup>156</sup> Estimates using the sovereign guaranteed debt amount.

strong results in various sectors during the previous strategy period and will continue to be applied under the new strategy.

- 5.3 **Strengthening of country systems.** At present, the Bank uses the budget, treasury, accounting and reporting, and procurement information country systems. The Bank will continue to support the Honduran government in strengthening other systems and in closing the existing gaps with international standards.
- 5.4 Based on the results of the latest fiduciary assessments, work will continue in the following areas: (i) internal and external control, through the National Integrated Internal Control Development Office (ONADICI) and the National Audit Office (TSC), on implementing international standards; (ii) accounting, on adopting International Public Sector Accounting Standards (IPSAS); (iii) public investment, on improving the implementation process for the Honduran National Public Investment System (SNIPH); and (iv) procurement, on supporting institutional reinforcement of the Regulatory Office of State Contracting and Procurement (ONCAE) in its efforts to position itself as a robust lead agency for public procurement in the country, preparing and launching the new electronic platform, and implementing the improvement plan resulting from the self-diagnostic assessment performed in 2017 using the MAPS methodology.

**Table of country systems**

Financial management	2017 use	2022 target	Planned actions during the strategy period
<b>Budget</b>	100%	100%	Support improvements of the SIAFI-Ges
<b>Treasury</b>	100%	100%	Support improvements of the SIAFI-Ges
<b>Accounting and reporting</b>	100%	100%	Continue with UEPEX support and improvements
<b>Internal audit</b>	0%	10%	Continue to strengthen ONADICI and the internal audit units of the executing agencies
<b>External control</b>	5%	20%	Continue to support the TSC's Audit Office for International Agency Projects (DAPOI)
<b>Procurement</b>			
<b>Information system</b>	100%	100%	Support improvements in the information system HonduCompras
<b>Shopping</b>	0%	100%	Review the validated documents to introduce updates
<b>Individual consulting</b>	0%	0%	Review the validated consulting contract with ONCAE to introduce updates
<b>Partial NCB</b>	0%	0%	Review the validated standard documents to introduce updates
<b>Advanced NCB</b>	0%	0%	Review the validated standard documents to introduce updates

Note: The calculation only considered the investment loan portfolio.

Source: <http://idbnet.iadb.org/sites/FMP/SitePages/Grupo%20de%20Trabajo%20UCS.aspx>, Historical Overview of Use of Country System Indicator, UCS Indicator 2017.

- 5.5 **Coordination with other donors.** Through the G16 (Stockholm Declaration Follow-up Group) and the Roundtable on Effectiveness in Cooperation for Sustainable Development in Honduras (MECEH), the Bank has a high level of coordination with

- all development cooperation agencies active in Honduras, enabling a targeted and synergistic dialogue with both bilateral and multilateral development agencies.
- 5.6 Specifically, the Bank will coordinate on: (i) social protection with the World Bank; (ii) health with the Pan American Health Organization (PAHO), Global Fund, United Nations Population Fund (UNFPA), and Clinton Health Access Initiative (CHAI); (iii) energy with Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ), Japan International Cooperation Agency (JICA), World Bank, United States Department of State, and Climate Investment Fund; (iv) education with the United States Agency for International Development (USAID), JICA, GIZ, Kreditanstalt für Wiederaufbau (KfW), UNICEF, and Organization of Ibero-American States (OEI); (v) water and sanitation with the World Bank, Swiss Agency for Development and Cooperation, JICA, and Development Promotion Fund (FONPRODE); (vi) transportation with the Central American Bank for Economic Integration (CABEI) and the OPEC Fund for International Development (OFID); (vii) citizen security with the Swiss Agency for Development and Cooperation, JICA, and USAID; (viii) environment and climate change with the Global Environmental Facility, Green Climate Fund, and NDF; and (ix) fiscal issues with the IMF to ensure the complementarity of interventions. In addition, the IDB Group will seek to capitalize on its comparative advantages to complement existing operations by other development cooperation agencies so as to maximize the impact of cooperation agencies on the development of Honduras.
- 5.7 **IDB Group coordination.** Coordination between the Bank, IDB Invest, and IDB Lab will abide by the following parameters in the implementation of this strategy: (i) maximize operating and knowledge-related synergies; (ii) plan joint missions, especially to discuss policy reforms in sectors with a potential for private participation; and (iii) organize dissemination activities.

## VI. RISKS

- 6.1 **Macroeconomic risks.** Possible macroeconomic risks to strategy implementation include: (i) shocks to external sustainability; and (ii) shocks to fiscal sustainability. Although the main indicators of external sustainability point to relatively moderate sustainability risks,<sup>157</sup> the Honduran economy is highly vulnerable to external shocks. The balance-of-payments trade account has run a deficit of more than 14% of GDP since 2016. This deficit has been financed by sizeable remittance flows (equivalent to 18% of GDP) and foreign direct investment (equivalent to 5% of GDP). In both cases, the flows come primarily from the United States, so a slowdown in that economy and in remittance flows would present real risks for consumption, investment, and production. Meanwhile, the country is heavily dependent on oil imports for transportation and electricity (equivalent to 14.5% of GDP in 2017),<sup>158</sup> so international price hikes for crude oil could exacerbate the imbalance in the trade account, undermine the stability of domestic prices, and further weaken the financial position of the ENEE. The main fiscal threats are potential deviations from the government's fiscal consolidation program, which could affect the dynamic of borrowing, perception of risk, and fiscal headroom for making public investment. If

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<sup>157</sup> As of August 2018, international reserves cover over five months of imports (US\$4.769 billion).

<sup>158</sup> BCH.

both shocks were to occur, public and private financing capacity could decline, affecting the implementation and scope of the actions proposed in the country strategy. As a mitigation measure, the Bank will continue to work in coordination with the Honduran government and the IMF on the design and execution of measures to help maintain fiscal balance and reduce the incidence of contingent liabilities.

- 6.2 **Execution risks.** The main risk is a weakening of the country's capacity for execution of Bank resources. To mitigate this risk, the Bank plans to continue with the good execution practices identified in the previous strategy. In particular, the Bank will promote working with highly specialized executing agencies, such as INVEST-H, familiar with the Bank's processes and policies on infrastructure. In addition, the Bank will work on including actions for institutional strengthening of other executing agencies. The Bank will monitor these risks by implementing an ongoing portfolio review process.
- 6.3 **Natural disaster risks.** Honduras is among the countries in the region that are highly exposed to natural disaster risks. Natural disasters could adversely affect attainment of the expected results of the strategy. To try to mitigate these risks in the short term, the Bank has instruments in place to assist in the event of an emergency.<sup>159</sup> To moderate this risk in the medium term, the Bank's interventions will include specific actions to enhance resilience to these phenomena.

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<sup>159</sup> The Bank can respond to climate-related eventualities through its US\$100 million Contingent Loan for Natural Disaster Emergencies (HO-X1016).

### ANNEX I: STRATEGY RESULTS MATRIX

Government priority	Priority area	Strategic objective	Expected results	Indicator	Baseline (source and measurement year)
Stability and confidence in the country. Transparency and accountability.	Strengthening of public management and institutional structure	Improve budget management	Increase in the use of results-based budgeting practices	Percentage of national budget prepared on a results basis	0 (SEFIN and SCGG Office of Results-based Management, 2018)
			Increase in the availability and quality of budget information	Open budget index (OBI) - Transparency index (0-100)	54 (International Budget Partnership, 2017)
		Improve the quality and efficiency of public expenditure	Improvement in the targeting of redistributive programs	Percentage of the FRP allocated to programs subject to evaluation	4.7% (SEFIN, 2017)
			Reduction of the fiscal burden of the electricity sector	Fiscal deficit of the electricity sector as a percentage of GDP	0.60% (Ministry of Finance, 2017)
			Increase in the use of information and communication technologies in the public sector	United Nations E-Government Development Index	0,4474 (United Nations E-Government Development Index, 2018)
		Increase the efficiency of the tax system	Increase in the digitalization of tax revenue processes	Percentage of tax returns filed electronically	68% (Revenue Administration Service, 2017)
Education and health for growth; security	Human capital accumulation	Reduce poverty and improve education and health services for the vulnerable population	Reduction in monetary poverty	Monetary poverty index	64.3% (INE Permanent Multipurpose Household Survey, 2017)
			Reduction in infant mortality in rural areas	Infant mortality rate in rural areas	23 per 1,000 live births (ENDESA-2011-2012)
			Increase in the third-cycle graduation rate	Percentage of children between 12 and 14 years who successfully completed the third cycle	22% (School Administration System & National Statistics Institute, 2017)
			Increase in learning quality in the third cycle	Average results of standardized tests for third-cycle students (targeted geographic areas)	Mathematics: 228/500 Reading: 277/500 (SEDUC, 2015)
		Improve the security of at-risk youth	Reduction in the youth homicide rate	Homicide rate for 20-24 age group, men (deaths per 100,000 homicides)	166.6 (National Violence Observatory of the National Autonomous University of Honduras, 2017)
		Increase in coverage of specialized services for women	Reduction in violence against women	Homicide rate, women (deaths per 100,000 homicides)	8.6 (UNAH National Violence Observatory, 2017)

Government priority	Priority area	Strategic objective	Expected results	Indicator	Baseline (source and measurement year)
			Reduction in maternal mortality in rural areas	Number of women's deaths due to pregnancy- and childbirth-related causes per 100,000 live births (per calendar year) in rural areas	79 (Maternal Mortality Rate Study, Estudio RAMOS, 2015)
			Reduction in adolescent pregnancy	Births per 1,000 women from 15 to 19 years of age	72 (World Development Indicators, World Bank, 2016)
Innovation for growth. Honduras as a logistics platform. Access to credit.	Expansion of sustainable production opportunities	Improve logistics performance	Improvement in infrastructure coverage and quality	Percentage of integration corridors in good condition (IRI<=3)	48% (Ministry of Infrastructure and Public Services, 2015)
				Logistics Performance Index for Honduras	2.60 (World Bank, 2018)
			Increase in connectivity for small producers	Percentage of rural households with Internet access	13.6% (INE EPHPM, 2017)
		Expand credit access for agricultural MSMEs	Increase in financing for agricultural sector producers	Percentage of the rural population that obtained credit from a financial institution	9.8% (World Bank Findex, 2017)
		Improve the efficiency, coverage, quality, and sustainability of the electricity service	Increase in the operating efficiency of the sector	Reduction of total electricity distribution losses	27.4% (ENEE Planning Department, 2017)
			Improvement in the quality and reliability of the transmission network in the central and northern areas of the country	Power not supplied due to transmission failures in the central and northern areas in one year (megawatt hour, MWh).	1,028 MWh (north) 1,713 MWh (central) (ENEE Planning Department, 2017)
			Increase in the share of renewable sources in the energy mix	Percentage of power generation from renewable sources	59% (ENEE Planning Department, 2017)
			Increase in electricity coverage in rural areas	Percentage of electricity coverage in rural households	66.96% (ENEE Planning Department, 2017)
		Expand the country's forest cover and resilience to climate change	Increase in the control of pest outbreak events at the national level	Percentage of southern pine beetle outbreaks controlled (number controlled/number active detected) nationwide.	43% (Forest Conservation Institute, 2016)

### COUNTRY SYSTEM MATRIX

Strategic objective	Expected results	Indicator	Unit of measure	Base-line	Base year	Main target	Timing	CRF alignment
Increase the use of country systems	Increase in the use of the internal audit subsystem	Active portfolio using the internal audit subsystem	Percentage of the active portfolio	0%	2017	10%	At the end of the strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
	Increase in the use of the external control subsystem	Active portfolio using the external control subsystem	Percentage of the active portfolio	5%	2017	20%	At the end of the strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
	Increase in the use of the shopping subsystem	Active portfolio using the shopping subsystem	Percentage of the active portfolio	0%	2017	20%	At the end of the strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
	Support in the drafting of a new public procurement law in Honduras	Proposal for the new law	Report on proposal for the new law	0	2017	1	At the end of the strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
Improve the operating efficiency of the Bank portfolio	Proposal for validation of the SIAFI/UEPEX/SNIP H country systems in Bank-financed operations	Validation proposal prepared	Report on validation proposal	0	2017	1	At the end of the strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality

Source: <http://idbnet.iadb.org/sites/FMP/SitePages/Grupo%20de%20Trabajo%20UCS.aspx>, Historical Overview of Use of Country System Indicator, UCS Indicator 2017.

## ANNEX II: MAIN ECONOMIC AND SOCIAL INDICATORS

	2011	2012	2013	2014	2015	2016	2017
<b>Social indicators</b>							
Population (millions)	8.2	8.4	8.6	8.4	8.6	8.7	8.9
Overall poverty rate (% households)	61.9	66.5	64.5	62.8	63.8	60.9	64.3
Extreme poverty rate (% households)	41.6	46.0	42.6	39.7	40.0	38.4	40.7
Gini coefficient	0.55	0.57	0.54	0.52	0.51	0.52	0.52
Unemployment rate (%, ages 18-65)	3.2	2.6	3.0	4.0	5.2	5.2	4.6
Nominal GDP (US\$ billions)	17,703	18,514	18,498	19,745	20,971	21,624	23,001
Nominal GDP per capita (US\$)	2,155	2,208	2,228	2,342	2,445	2,480	2,594
<b>Real sector (Δ%)</b>							
Nominal GDP	11.9	7.9	4.2	10.1	11.0	7.3	9.2
Real GDP	3.8	4.1	2.8	3.1	3.8	3.8	4.8
Nominal GDP per capita (US\$)	9.5	2.5	0.9	5.1	4.4	1.4	4.6
Consumer price index	6.8	5.2	5.2	6.1	3.2	2.7	3.9
<b>Public finance (% of GDP)</b>							
Total central government revenue	11.5	16.7	17.0	18.7	19.6	20.1	20.4
<i>Tax</i>	10.0	14.5	14.8	18.0	17.2	17.9	17.9
<i>Nontax</i>	1.5	2.2	2.3	0.8	2.3	2.2	2.5
Total central government expenditures	14.6	22.7	24.9	23.1	22.6	22.9	23.1
<i>Primary current</i>	11.5	18.3	19.8	17.9	18.0	17.8	17.8
<i>Capital</i>	3.1	4.4	5.1	5.2	4.6	5.0	5.4
<i>Interest</i>	0.8	1.5	2.1	2.3	2.5	2.4	2.5
Primary balance (NFPS)	-2.5	-3.8	-7.5	-3.9	-0.9	-0.5	-0.8
Overall central government balance	-4.6	-6.0	-7.9	-4.4	-3.0	-2.8	-2.7
Public debt (NFPS)	25.5	30.2	38.6	39.3	39.0	39.9	40.3
Central government debt	32.8	37.2	45.8	46.9	46.0	48.2	50.0
<b>External sector (% of GDP)</b>							
Current account	-8.0	-8.5	-9.5	-6.9	-4.7	-2.7	-1.7
Balance of goods and services	-20.2	-19.5	-20.6	-17.2	-16.2	-14.3	-14.1
<i>Exports</i>	45.1	45.2	42.2	41.1	39.2	36.7	37.7
<i>Imports</i>	62.8	61.4	59.2	56.1	53.3	48.8	49.2
Foreign direct investment	5.7	5.7	5.7	7.2	5.7	5.3	5.2
Family remittances	15.8	15.6	16.7	17.0	17.4	17.8	18.7
Net international reserves (US\$ billions)	2,821	2,571	3,056	3,516	3,822	3,888	4,786
<b>Monetary &amp; foreign exchange indicators</b>							
Nominal exchange rate (annual average, L/US\$)	19.0	19.6	20.5	21.1	22.1	23.0	23.7
Inflation rate (period end)	5.61	5.44	4.92	5.82	2.36	3.32	4.73

Source: Central Bank of Honduras (BCH), Ministry of Finance (SEFIN), National Statistics Institute (INE), and International Monetary Fund (IMF). Note: Nonfinancial public sector (NFPS).

**ANNEX III: ESTIMATED SOVEREIGN DEBT SCENARIO-2019-2022**  
US\$ MILLIONS

	Country strategy 2015-2018 <sup>2/</sup>				Country strategy 2019-2022				Total 2019-2022 <sup>4/</sup>
	2015	2016	2017	2018	2019	2020	2021	2022	
<b>Approvals<sup>1/</sup></b>	<b>170</b>	<b>100</b>	<b>160</b>	<b>478</b>	<b>168</b>	<b>168</b>	<b>168</b>	<b>168</b>	<b>671</b>
Total disbursements	216	135	168	382	254	221	205	221	901
Repayments	20	25	36	46	51	56	61	65	233
<b>Net loan flow</b>	<b>197</b>	<b>110</b>	<b>132</b>	<b>336</b>	<b>203</b>	<b>165</b>	<b>144</b>	<b>156</b>	<b>668</b>
Subscriptions	2	2	0	1	1	1	1	1	4
Interest and charges	33	42	44	51	56	60	63	66	245
<b>Net cash flow</b>	<b>162</b>	<b>66</b>	<b>88</b>	<b>283</b>	<b>146</b>	<b>104</b>	<b>80</b>	<b>89</b>	<b>419</b>
									<b>Average</b>
IDB debt balance <sup>3/</sup>	1,710	1,819	1,951	2,287	2,490	2,655	2,799	2,955	2,725
IDB/ Total debt (%)	17	17	18	22	23	24	26	27	25
IDB/ External public debt (%)	29	30	27	32	34	36	38	41	37
IDB/ Multilateral (%)	45	46	46	54	56	58	59	60	58

<sup>1/</sup> Biannual amounts determined in the allocation of concessional Ordinary Capital resources. The estimate of IDB lending for the 2019-2022 period is based on the allocation of the Bank's Ordinary Capital resources for the period 2019-2020, which currently amounts to US\$167.8 million per year, and is subject to future adjustments related to the biannual allocation for the 2019-2020 and 2021-2022 periods. The scenario will be reviewed once the Bank's Board of Executive Directors completes the approval process for the 2019-2020 allocation and subsequently based on the 2021-2022 allocation.

<sup>2/</sup> For purposes of comparing the two country strategy periods for this annex, the data for the 2015-2019 period have been estimated as of 31 December 2018. Accordingly, they are not identical to the data shown in paragraph 2.2, where the cutoff date is 31 October 2018.

<sup>3/</sup> Sovereign guaranteed debt.

<sup>4/</sup> Differences with respect to aggregates are due to rounding.

## ANNEX IV: DEVELOPMENT EFFECTIVENESS MATRIX

COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX	
<p>In August 2008, the Board of Directors approved the Development Effectiveness Framework (document GN-2489) to increase the evaluability of all Bank development products. The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the “Good Practice Standards for Country Strategy and Program Evaluation.”</p>	
<p><b>COUNTRY STRATEGY: HONDURAS</b></p>	
<p><b>STRATEGIC ALIGNMENT</b></p> <p><i>Refers to the degree to which the design and objectives of the CS are consistent with the country development challenges and with the government’s development plans and priorities.</i></p>	
<p><b>EFFECTIVENESS</b> <i>Measures whether the country strategy is likely to achieve its intended objectives, through an examination of three dimensions: (i) the quality of the diagnostics on which Bank action is based in each area of work; (ii) the quality of the results matrix for the strategy; (iii) the use and build-up of country systems.</i></p>	
<p>Effectiveness dimensions</p>	
<b>I. Country Diagnosis - Country Development Challenges (CDC)*</b>	Yes/No
- The CDC is comprehensive / holistic / complete	Yes
- The CDC clearly identifies the main development challenges	Yes
- The CDC presents magnitudes of the main development challenges that are based on empirical evidence	Yes
<b>II. Priority Areas Diagnostics</b>	%
- That clearly identify and dimension, based on empirical evidence, the priority area's specific constraints and challenges	100%
- That clearly identify and dimension, based on empirical evidence, the main factors or causes contributing to the specific constraints and challenges	100%
- That provide corresponding policy recommendations	100%
<b>III. Results matrix**</b>	%
- The strategic objectives are clearly defined	100%
- The expected outcomes are clearly defined	100%
- The strategic objectives and expected results that are directly related to the main constraints identified in the Diagnosis	100%
- The indicators are outcome indicators and are SMART	100%
- The indicators have baselines	100%
<b>IV. Vertical logic</b>	Yes /No
- The CS has vertical logic	Yes

\* This analysis includes any potential diagnostic document used to inform.

\*\* The Results Matrix is comprised of indicators that are meaningful to, and capture progress towards, the expected results. The expected results stem from the strategic objectives.

**CS diagnostic:**

As part of the Country Strategy 2019-2022, a country development challenges diagnostic was presented, under the title "Honduras: Country Development Challenges." The CS diagnostic is comprehensive and based on empirical evidence. On the basis of this diagnostic and the dialogue process with the country, the country strategy will focus on three development challenges: (i) strengthening of the fiscal institutional structure and expenditure efficiency; (ii) human capital accumulation; and (iii) expansion of sustainable production opportunities.

- The diagnostic clearly identifies and dimensions, based on empirical evidence, 100% priority areas' specific constraints and challenges.
- The diagnostic clearly identifies and dimensions, based on empirical evidence, the main factors or causes contributing to the specific constraints and challenges for 100% of the priority areas.
- The diagnostic provides a policy framework and a sequence for Bank actions, which are based on empirical evidence, for 100% of the priority areas.

**Results matrix:** The Results Matrix includes 10 strategic objectives for Bank action and 23 indicators to measure progress.

- 100% of the strategic objectives are clearly defined.
- 100% of the expected outcomes are clearly defined.
- 100% of the CS Objectives are directly related to the main constraints identified in the Diagnosis.
- 100% of the indicators used are outcome indicators and are SMART.
- 100% of the indicators have baselines.

**Country systems:** During the new CS period, the IDBG will continue to work in the following areas: (i) in internal and external control, through the ONADICI and the TSC, on implementing international standards; (ii) in accounting, on adopting IPSAS; (iii) in public investment, on improving the implementation process for the SNIPH; and (iv) in procurement, on supporting institutional reinforcement of the ONCAE in its efforts to position itself as a robust lead agency for public procurement in the country, preparing and launching the new electronic platform, and implementing the improvement plan resulting from the self-diagnostic assessment performed in 2017 using the MAPS methodology.

**Vertical logic:** The CS has vertical logic.

**RISKS** Measures three dimensions: (i) identification of factors that actually do or might affect attainment of the proposed objectives; (ii) definition of mitigation measures; and (iii) monitoring mechanisms:

The CS identifies three risks: (i) macroeconomic risks; (ii) execution risks; and (iii) natural disaster risks. Mitigating measures have been identified for all the risks.

**ANNEX V: MANAGEMENT'S RESPONSE TO THE COUNTRY PROGRAM EVALUATION:  
HONDURAS 2019-2022**

OVE recommendation	Management's response
<p><b>Recommendation 1. Continue and step up efforts to support investment in rural areas and in lower income groups to improve their access to economic opportunities, taking into account government priorities, the work of the country's other development partners, and the areas of long-term Bank support.</b> Implementation of this recommendation signifies continuing to offer the Honduran government support for improving the coverage and effectiveness of the Bono Vida Mejor program and providing good-quality health care and education services in rural and marginal urban areas. It also signifies increased access to electricity, strengthening of the institutional framework for the delivery of water and sanitation services, expansion and upgrading of infrastructure in marginal urban areas and secondary roads in rural areas, and support for adapting rural productive activities to climate change, by leveraging and channeling nonreimbursable resources from bilateral and multilateral donors. Where necessary, the use of comprehensive, geographically-targeted approaches can be explored to determine the scope of the interventions, according priority to the areas lagging farthest behind.</p>	<p><b>Agreed.</b></p> <p><b>Actions proposed by Management</b></p> <p>Management agrees with OVE regarding the need for the Bank to continue supporting initiatives that seek to provide better opportunities to the population living in poverty. Accordingly, the focus on rural areas and the low-income population will continue to be a core element of the new country strategy. Specifically, the Bank:</p> <ul style="list-style-type: none"> <li>(i) Already supports such targeting in social protection, education, health, and electrification for rural areas. In urban areas, the Bank's efforts in this regard focus on improving vulnerable neighborhoods. Based on the progress made and outcomes obtained in these areas, the Bank will reach agreement with the authorities on new interventions.</li> <li>(ii) Will coordinate interventions in geographic areas with a greater concentration of poverty. This was included among the Bank's strategic objectives during the previous country strategy period with the aim of enhancing the effectiveness of sector operations. By using the Bono Vida Mejor program as a mechanism of coordination, important results were attained in the beneficiary population's health and education indicators. The new country strategy will build on those efforts. However, in order for this geographical targeting to be successful, baselines and tracking mechanisms will be needed to guide decision-making. Likewise, capacity to coordinate with many agencies of the Honduran government will also be necessary. With a view exploring the use of geographically-targeted approaches with other sectors in the new country strategy, the Bank is promoting activities that can generate the information needed to coordinate multisector interventions in areas with high productive potential—and in poverty reduction, especially in rural areas.</li> </ul> <p>In terms of the implications involved in implementing this recommendation, however, it is Management's view that the range of sectors to be covered under the new country strategy and the instruments used to that end should be the result of the IDB Group's dialogue with the country, which takes into account, <i>inter alia</i>: the government's priorities; the development challenges identified by the Bank; fiscal headroom; the overall state of the sector; the institutional capacity of the relevant agencies; and the actions of Honduras's other development partners.</p>

OVE recommendation	Management's response
<p><b>Recommendation 2. Step up efforts to identify niches for private sector support, offering financial and nonfinancial additionality and synergies among the windows of the IDB and IDB Invest.</b> IDB Invest discovered an important niche of opportunities in non-sovereign guaranteed operations for the energy sector. Investment projects were identified in the sector requiring terms that were unavailable on the market, and supplementary financing and guarantees were mobilized to facilitate subsequent financing for investments of this kind. Emulating the experience in the energy sector and given the country's sufficient financial architecture, the work of the IDB and IDB Invest can help deepen financial inclusion, particularly through long-term loans to the productive sector and SMEs in sectors that are strategic for the country.</p>	<p><b>Agreed.</b></p> <p><b>Actions proposed by Management</b></p> <p>The IDB Group shares OVE's view regarding the need to continue identifying opportunities for private sector support and promoting synergies between the different windows of the IDB Group. During implementation of the country strategy with Honduras 2015-2018, these synergies were evident in the Group's support—which included IDB Lab support—to the energy sector. The updating of the system of electricity rates for the industrial sector, an effort supported by the IDB Group's public-sector windows, created incentives for the sector to seek out alternatives for reducing its energy costs, which included investing in renewable energy projects, supported by both IDB Invest and IDB Lab.</p> <p>During the new country strategy period, and as part of a productivity and competitiveness agenda to prioritize inclusive growth, the IDB Group will promote:</p> <ul style="list-style-type: none"> <li>(i) Interventions that facilitate access to finance for the productive sector, especially the agriculture and SME sector, through actions that support innovative financial products, the modernization of institutions that provide financing for the productive sector, and the evaluation of legal and/or administrative provisions that inhibit the channeling of resources to sectors with job-creation potential; and</li> <li>(ii) The coordination of public-private actions to catalyze infrastructure investment, with the aim of growing the rural economy. To that end, the Bank has made headway in the design of an infrastructure investment platform for the Northern Triangle.</li> </ul> <p>Moreover, the IDB Invest Action Plan for Micro, Small, and Medium-sized Enterprises (MSMEs) was approved in May 2018. It incorporates OVE's recommendations for supporting this sector. Activities that support the financial inclusion of MSMEs in Honduras will continue under the Plan's framework.</p> <p>To support the implementation of these actions and facilitate public-private synergies, an IDB Invest staff member has been assigned to the Country Office in Honduras.</p>

OVE recommendation	Management's response
<p><b>Recommendation 3. Take steps to include in the priority areas of future country strategies any actions and objectives of the existing loan portfolios with the country</b> that align with the Bank's medium-term lines of work in the sector, with the aims of facilitating their execution, monitoring and tracking of results, as well as maintaining the respective dialogue.</p>	<p><b>Agreed.</b></p> <p><b>Actions proposed by Management</b></p> <p>Management shares OVE's view regarding the need to include, under the priority areas of future country strategies, development objectives that support the portfolio, especially those addressing the medium-term lines of work. Accordingly, the country strategy guidelines established in 2015 (document GN-2468-9) include identifying the contribution of the "legacy portfolio" to the strategic objectives agreed upon with the government.</p> <p>In the case of Honduras, the Bank has prioritized effectiveness and the targeting of the social protection network, health and education services delivery, energy sector efficiency, and fiscal sustainability. It has also provided technical and financial support beyond the country strategy cycle. Based on dialogue with Honduras, the new country strategy will build on and continue the objectives agreed upon in these sectors, deepening actions that result in services of better quality, as well as greater coverage, efficiency, and sustainability.</p> <p>According to the above-mentioned country strategy guidelines, however, identifying the portfolio's contribution to the priority areas agreed upon with the government "does not mean that all of the issues [...] already supported through the active portfolio must necessarily be addressed in the country strategy, since it is the outcome of a mutual agreement with the beneficiary country." Consequently, not including an operation or group of portfolio interventions in priority areas does not mean that the Bank is reducing its efforts to ensure appropriate implementation. With specific regard to Honduras, portfolio performance is a factor that influences the allocation of concessional resources.</p>