Document of
The World Bank

Report No: ICR2157

IMPLEMENTATION COMPLETION AND RESULTS REPORT
(IDA-48290)

ON A

CREDIT

IN THE AMOUNT OF SDR 49.6 MILLION
(US$ 74.7 MILLION EQUIVALENT)

TO THE

REPUBLIC OF HONDURAS

FOR A

FISCAL EMERGENCY RECOVERY
DEVELOPMENT POLICY CREDIT

May 9, 2012

Poverty Reduction and Economic Management
Central America Country Management Unit
Latin America and the Caribbean Region

**Honduras - Government Fiscal Year**
January 1 – December 31

**Currency Equivalents**
(Exchange rate effective as of May 9, 2012)
Currency unit = Lempiras (L)
19.06 L. = US$1

**Weights and Measures**
Metric System

## ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| CABEI | Central American Bank for Economic Integration |
| CCT | Conditional Cash transfer |
| CPI | Consumer Price Inflation |
| CPS | Country Partnership Strategy |
| DPC | Development Policy Credit |
| ENEE | National Electricity Company (*Empresa Nacional de Energía Eléctrica)* |
| GDP | Gross Domestic Product |
| IDA | International Development Association |
| IDB | Inter-American Development Bank |
| IGR | Institutional Governance Review |
| IMAE | Monthly economic activity index |
| IMF | International Monetary Fund |
| ISN | Interim Strategy Note |
| ISV | Value-Added Tax (*Impuesto Sobre Ventas*) |
| OAS | Organization of American States |
| PDO | Project Development Objective |
| PER | Public Expenditure Review |
| PETS | Public Expenditure Tracking Survey |
| PRSC | Poverty Reduction Support Credit |
| SBA | Stand-by arrangement |
| SEE | Ministry of Education (*Secretaría de Educación*) |
| SEFIN | Ministry of Finance (*Secretaría de Finanzas*) |
| SEPLAN | Ministry of Planning (*Secretaría de Planificación*) |
| SIAFI | Integrated Financial Management System |
| SIARH | Integrated Human Resources Management System |

| | |
|---|---|
| Vice President: | Hasan A. Tuluy |
| Country Director: | C. Felipe Jaramillo |
| Sector Director: | Rodrigo A. Chaves |
| Sector Manager: | Auguste Tano Kouame |
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**REPUBLIC OF HONDURAS**

**Implementation Completion and Results Report for the Fiscal Emergency Recovery Development Policy Credit**

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| A. Basic Information | | | |
|---|---|---|---|
| Country: | Honduras | Program Name: | Fiscal Emergency Recovery Development Policy Credit |
| Program ID: | P121220 | L/C/TF Number(s): | IDA-48290 |
| ICR Date: | 04/05/2012 | ICR Type: | Core ICR |
| Lending Instrument: | DPC | Borrower: | REPUBLIC OF HONDURAS |
| Original Total Commitment: | SDR 49.60M | Disbursed Amount: | SDR 49.60M |
| Revised Amount: | SDR 49.60M | | |
| **Implementing Agencies:** Ministry of Finance | | | |
| **Cofinanciers and Other External Partners:** | | | |

| B. Key Dates | | | | |
|---|---|---|---|---|
| **Process** | **Date** | **Process** | **Original Date** | **Revised / Actual Date(s)** |
| Concept Review: | 07/27/2010 | Effectiveness: | 12/10/2010 | 12/09/2010 |
| Appraisal: | 09/21/2010 | Restructuring(s): | | |
| Approval: | 11/09/2010 | Mid-term Review: | 03/07/2011 | 04/04/2011 |
| | | Closing: | 11/15/2011 | 11/15/2011 |

| C. Ratings Summary | |
|---|---|
| **C.1 Performance Rating by ICR** | |
| Outcomes: | Satisfactory |
| Risk to Development Outcome: | Moderate |
| Bank Performance: | Satisfactory |
| Borrower Performance: | Satisfactory |

| C.2 Detailed Ratings of Bank and Borrower Performance (by ICR) | | | |
|---|---|---|---|
| **Bank** | **Ratings** | **Borrower** | **Ratings** |
| Quality at Entry: | Satisfactory | Government: | Satisfactory |
| Quality of Supervision: | Satisfactory | Implementing Agency/Agencies: | Satisfactory |
| **Overall Bank Performance:** | Satisfactory | **Overall Borrower Performance:** | Satisfactory |

| C.3 Quality at Entry and Implementation Performance Indicators | | | |
|---|---|---|---|
| **Implementation Performance** | **Indicators** | **QAG Assessments (if any)** | **Rating:** |
| Potential Problem Program at any time (Yes/No): | No | Quality at Entry (QEA): | None |

| | | | |
|---|---|---|---|
| Problem Program at any time (Yes/No): | No | Quality of Supervision (QSA): | None |
| DO rating before Closing/Inactive status: | Satisfactory | | |

| **D. Sector and Theme Codes** | | |
|---|---|---|
| | **Original** | **Actual** |
| **Sector Code (as % of total Bank financing)** | | |
| Central government administration | 70 | 60 |
| General education sector | 10 | 10 |
| Power | 20 | 30 |
| | | |
| **Theme Code (as % of total Bank financing)** | | |
| Public expenditure, financial management and procurement | 60 | 60 |
| Tax policy and administration | 40 | 40 |

| **E. Bank Staff** | | |
|---|---|---|
| **Positions** | **At ICR** | **At Approval** |
| Vice President: | Hasan A. Tuluy | Pamela Cox |
| Country Director: | Carlos Felipe Jaramillo | Laura Frigenti |
| Sector Manager: | Auguste Tano Kouame | Rodrigo A. Chaves |
| Program Team Leader: | Denis Medvedev | Christian Y. González & Jasmin Chakeri |
| ICR Team Leader: | Denis Medvedev | |
| ICR Primary Author: | Ana Lucia Armijos | |

## F. Results Framework Analysis

**Program Development Objectives (from Project Appraisal Document)**

The operation's Development Objective is to assist the Government in bringing public finances back to a sustainable path. The DPC operation supports progress towards the Interim Strategy Note objective of macroeconomic stability and growth.

**Revised Program Development Objectives (if any, as approved by original approving authority)**

**(a) PDO Indicator(s)**

| Indicator | Baseline Value | Original Target Values (from approval documents) | Formally Revised Target Values | Actual Value Achieved at Completion or Target Years |
|---|---|---|---|---|
| **Indicator 1 :** | Central Government tax revenue as share of GDP increases to 16.1 percent in 2011 | | | |
| Value | The tax system had | 16.1 percent of GDP | | Central Government |

| | | | | |
|---|---|---|---|---|
| (quantitative or Qualitative) | important loopholes that reduced the Government's ability to mobilize revenues.<br><br>14.4 percent of GDP | | | tax revenue as share of GDP reached 15.1 percent of GDP |
| Date achieved | 12/31/2009 | 09/30/2011 | | 12/30/2011 |
| Comments (incl. % achievement) | **Partially achieved.** Tax revenue fell short of the target due to delays in implementing tax reform, which meant that the impacts were observed over a period of less than 12 months. Furthermore, economic growth was slower than expected due to high international oil prices and slow recovery in the U.S., Honduras's main trading partner and investor. | | | |
| **Indicator 2 :** | The number of taxpayers statements using the electronic payment system will increase by at least 10 percent in 2010 | | | |
| Value (quantitative or Qualitative) | The lack of enforcement and control has led to weak taxpayer compliance.<br><br>163,198 taxpayers in 2009 | 179,518 taxpayers (1.10*163,198) in 2010 | | The number of tax statements submitted through the electronic payment system increased to 177,363 in 2010 and 238,340 in 2011. |
| Date achieved | 12/31/2009 | 12/31/2010 | | 12/30/2011 |
| Comments (incl. % achievement) | **Partially achieved.** | | | |
| **Indicator 3 :** | The wage bill, as a share of GDP, falls by at least 0.5 percent of GDP | | | |
| Value (quantitative or Qualitative) | Salary increases for public sector employees had skyrocketed in recent years(11.1 percent of GDP in 2009). | 10.6 percent of GDP | | In 2011, the wage bill in the Central Administration accounted for 9.8 per cent of GDP. |
| Date achieved | 12/31/2009 | 09/30/2011 | | 12/30/2011 |
| Comments (incl. % achievement) | **Achieved.** | | | |
| **Indicator 4 :** | The increases in electricity tariffs raise the monthly revenues of the Electricity Company (ENEE) by US$6 million | | | |
| Value (quantitative or Qualitative) | US$65 million / month | US$71 million / month | | The cumulative adjustment of electricity tariffs in 2010-11 created US$123.6 million of additional revenue, equivalent to US$6.2 million per month (April 2010 – January 2011) |
| Date achieved | 04/30/2010 | 09/30/2011 | | 12/30/2011 |

| | | | | |
|---|---|---|---|---|
| Comments (incl. % achievement) | **Achieved.** | | | |
| **Indicator 5 :** | The restructuring of direct subsidies has generated annual savings for the Government of US$23 million. | | | |
| Value (quantitative or Qualitative) | The direct subsidy in 2009 was estimated at US$63 million. | US$40 million | | Despite the restructuring of subsidies, the cost of subsidies reached US$47.1 million in 2011 due to higher international bunker prices |
| Date achieved | 12/31/2009 | 12/31/2010 | | 12/30/2011 |
| Comments (incl. % achievement) | **Partially achieved.** Although policy actions were taken to reduce the number of beneficiaries through better targeting, the total cost of the subsidy exceeded the target because the price of bunker in the international market was higher than the price originally estimated in the 2011 budget. | | | |
| **Indicator 6 :** | The Electricity Company (ENEE) has eliminated its arrears with private sector power generators | | | |
| Value (quantitative or Qualitative) | The estimated amount of arrears as of April 2010 = L.1 billion | No arrears | | The ENEE does not have any delays in the payment of invoices (arrears) with private sector power generators |
| Date achieved | 10/04/2010 | | | 12/30/2011 |
| Comments (incl. % achievement) | **Achieved.** | | | |
| **Indicator 7 :** | About 0.3 percent of GDP worth of previously unaccounted and unpaid transactions has been audited and resolved. | | | |
| Value (quantitative or Qualitative) | Disputed public sector arrears were estimated at L.3 billion (1.1 percent of GDP) | | | A forensic audit of the disputed payment arrears took place as of September 2011. The disputed public sector arrears have been audited. The Superior Court of Auditors will take the corresponding actions towards resolving them. |
| Date achieved | 10/04/2010 | | | 12/30/2011 |
| Comments (incl. % achievement) | **Partially achieved.** | | | |

**(b) Intermediate Outcome Indicator(s)**

| Indicator | Baseline Value | Original Target Values (from approval documents) | Formally Revised Target Values | Actual Value Achieved at Completion or Target Years |
|---|---|---|---|---|

## G. Ratings of Program Performance in ISRs

| No. | Date ISR Archived | DO | IP | Actual Disbursements (USD millions) |
|---|---|---|---|---|
| 1 | 02/26/2011 | Satisfactory | Satisfactory | 76.34 |
| 2 | 08/22/2011 | Satisfactory | Satisfactory | 76.34 |

## H. Restructuring (if any)

Not Applicable

# Implementation Completion and Results Report for the Fiscal Emergency Recovery Development Policy Credit to the Republic of Honduras

## 1. Program Context, Development Objectives and Design

**This Implementation Completion and Results Report (ICR) describes the results of the Fiscal Emergency Recovery Development Policy Credit (DPC) to Honduras**. The single tranche loan of SDR 49.6 million (US$74.7 million equivalent) was approved by the World Bank Board of Executive Directors on November 9, 2010 and disbursed upon loan effectiveness on December 9, 2010. This operation, prepared under regular budget support procedures, was intended to support the Government's efforts to stabilize the economy and reestablish the groundwork for growth. Specifically, the operation supported four areas that are central to the Government's reform program: (i) tax reform, including closing tax loopholes, widening the tax base, and improving tax administration; (ii) civil service reform, focused on human resource management in the education sector and a rationalization of the public wage bill; (iii) reform of power sector tariffs to support the financial sustainability of the state-owned electricity company (National Electricity Company-ENEE); and (iv) strengthening public financial management and transparency by resolving outstanding public sector arrears and investigating the shortcomings of the Integrated Financial Management System (SIAFI).

### 1.1 Country context at appraisal

#### *Political Context*

**On June 28, 2009 Honduras experienced a governance crisis when the Supreme Court ordered the removal of President Zelaya.** Following these political developments, Honduras was suspended from the Organization of American States (OAS) and much of the international community put aid programs on hold. However, a number of donors continued implementation of projects, particularly those focused on the poor. The Bank conducted an assessment of the prevailing situation and temporarily halted the implementation of the existing portfolio during the political crisis. In addition, no new lending was approved during this period.

**In November 2009, Porfirio Lobo from the National Party was elected President and set a series of actions aimed at easing political tensions.** Some of the most important steps were naming a government of national reconciliation which included some political rivals; establishment of a Truth and Reconciliation Commission which became operational on May 4, 2010; working with Congress on important Constitutional reforms; restoring diplomatic relations with partner countries; and prompting re-engagement with the international community and development partners. In December 2009, the Bank resumed disbursements to Honduras, once it was clear that the conditions of the Operational Policy were fulfilled. In June 2011, Honduras' membership in the Organization of American States was restored, marking a milestone in the country's efforts to normalize international relations.

#### *Economic Context*

**Honduras is a lower middle income country with deeply rooted growth and development challenges.** The country remains one of the poorest and most unequal countries in Latin America. It is Central America's second most populated country, with 7.5 million people, and the second largest in size. About half of the population is rural, 80 percent of which live in hillside areas, practicing subsistence agriculture. Poverty is very high at around 60 percent of the population in 2010, but has been on a gradual declining trend since 2005. Human development challenges persist, particularly with regards to educational attainment and gender gap. Honduras is also one of the most at-risk countries to natural hazards, with the national infrastructure subject to substantial damages from the 1998 Hurricane Mitch and subsequent storms. The security situation is precarious as Honduras has the highest homicide rate in the world (UNODC, 2011).

**The global crisis, the internal political crisis, and pre-existing structural problems combined to present a significant fiscal challenge for the Government of Honduras.** After growing by 4.0 percent in 2008, real GDP contracted by 2.1 percent in 2009 due to lower exports (which fell by 18.7 percent), lower international remittances (which declined from 19.4 to 16.8 percent of GDP), and lower foreign direct investment (which fell by 3.6 percent of GDP). These developments adversely affected tax collection and as a result, as in many other countries, the fiscal situation deteriorated dramatically. The situation was further exacerbated by weak expenditure controls and a substantial increase in the public sector wage bill. The deficit of the combined public sector rose to 4.6 percent of GDP (up from 1.7 percent of GDP in 2008), while the deficit of the Central Government increased to 6.2 percent of GDP (up from 2.4 percent of GDP). The widening of the deficit was financed largely by costly short term bonds, while the position of the largest public sector enterprises and the pension funds worsened (See Table 1).

**The Lobo administration took a series of corrective measures aimed at stabilizing the fiscal situation**. The Government's strategy comprised tax reforms and spending cuts, including measures to control public sector wages and especially teacher salaries. The international community supported the country's fiscal consolidation efforts through World Bank Fiscal Emergency Recovery Development Policy Credit, the IMF SBA and SCF programs, and budget support operations from the IDB, European Union, and the Central American Bank for Economic Integration. As a result of the Government's consolidation efforts, the combined public sector deficit reached 2.9 percent of GDP in 2010, down from 4.6 percent in 2009 and well below the target of 3.7 percent under the IMF program. A large part of the adjustment came from a 0.9 percent of GDP decline in investment spending (relative to 2009), returning public investment to the levels observed in 2006-07. However, there was also a 0.8 percent of GDP reduction in central government recurrent expenditure, and the surplus in the rest of the public sector improved by 0.3 percent of GDP.

**The economic recovery in 2010 was accompanied by deterioration in the external balance and an increase in inflation**. The Honduran economy showed a moderate recovery in 2010. GDP grew 2.8 percent, reversing the decline of 2.1 percent in 2009. Growth was supported by expansion in exports (17.1 percent), public investment (5.6 percent), and increases in remittances from the US. The current account deficit increased from 3.7 percent of GDP in 2009 to 6.2 percent in 2010, reflecting a jump in the merchandise trade deficit due to higher oil prices. Inflation reached 6.5 percent in 2010, up from 3 percent in 2009. The increase in the current account deficit was financed primarily by FDI and long term public sector borrowing.

### 1.2 Country context during Implementation

**The Government continued to demonstrate its commitment to fiscal consolidation efforts and reducing public sector vulnerabilities in 2011.** In June 2011, Congress approved the

Efficiency of Revenues and Expenditures Law, which eliminated some tax exemptions and enforced new measures against tax evasion; and the Reforms of the Population Security Law, which creates temporary taxes to finance security and social prevention. The Government was also successful in further reducing the wage bill to 9.8 percent of GDP from 11 percent in 2010. Although tax revenues increased from 14.8 to 15.1 percent of GDP between 2010 and 2011, they fell short of the 16.1 percent DPC target. Nonetheless, the reduction in current expenditure was sufficient to reduce the combined public sector deficit to 2.8 percent of GDP in 2011 (from 2.9 percent in 2010) and the central government deficit to 4.6 percent of GDP (from 4.8 percent of GDP in 2010).

**Table 1: Honduras - Selected Economic Indicators**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Output and Inflation (annual percentage change)** | | | | | | | |
| | **2006** | **2007** | **2008** | **2009** | **2010** | **2011 [a/]** | **2012 [b/]** |
| Real GDP Growth | 6.6 | 6.3 | 4.0 | -2.1 | 2.8 | 3.6 | 3.6 |
| Consumer Prices | 5.3 | 8.9 | 10.8 | 3.0 | 6.5 | 5.6 | 6.2 |
| **Public Sector (percentage of GDP )** | | | | | | | |
| **Central Government Total Revenues** | 18.2 | 19.2 | 19.9 | 17.4 | 17.4 | 17.4 | 17.5 |
| Current Revenues | 16.6 | 17.6 | 17.8 | 15.5 | 16.0 | 16.2 | 16.7 |
| Tax Revenues | 15.3 | 16.4 | 16.1 | 14.4 | 14.8 | 15.1 | 15.3 |
| Non Tax Revenues | 1.4 | 1.2 | 1.7 | 1.1 | 1.2 | 1.1 | 1.4 |
| Other | 1.5 | 1.6 | 2.1 | 1.9 | 1.4 | 1.2 | 0.8 |
| **Central Government Total Expenditures** | 19.3 | 22.1 | 22.4 | 23.8 | 22.2 | 22.0 | 20.6 |
| Current Expenditures | 16.1 | 16.8 | 17.5 | 19.2 | 18.4 | 17.3 | 16.7 |
| Wages and Salaries | 8.3 | 9.2 | 9.3 | 11.2 | 11.0 | 9.8 | 9.7 |
| Capital Expenditures | 3.4 | 4.1 | 4.8 | 4.6 | 3.7 | 4.7 | 3.9 |
| Other | 1.1 | 1.4 | 2.4 | 1.8 | 2.0 | 1.6 | 1.8 |
| **Central Government Balance** | (1.1) | (2.9) | (2.4) | (6.2) | (4.8) | (4.6) | (3.1) |
| **Combined Public Sector Balance** | (1.3) | (1.6) | (1.7) | (4.6) | (2.9) | (2.8) | (2.5) |
| **Total Public Sector Debt** | 31.7 | 19.7 | 19.8 | 23.9 | 26.3 | 27.6 | 27.5 |
| Public sector external debt | 27.9 | 16.4 | 16.3 | 17.4 | 18.4 | 18.3 | 19.2 |
| **External Sector** | | | | | | | |
| Current account balance (% of GDP) | (3.7) | (9.0) | (12.9) | (3.7) | (6.2) | (6.4) | (6.2) |
| (excluding official transfers) | (5.5) | (10.3) | (14.1) | (4.5) | (7.0) | (6.9) | (6.6) |
| Exports (annual percentage change) | 4.5 | 9.6 | 8.3 | (18.7) | 17.1 | 20.0 | 7.2 |
| Imports (annual percentage change) | 11.6 | 21.7 | 17.4 | (28.1) | 17.6 | 15.2 | 6.7 |
| Gross international reserves (US$ million) | 2,824 | 2.733 | 2,691 | 2,331 | 2,931 | 3,280 | 3,460 |
| In months of imports | 4.4 | 3.5 | 4.7 | 3.5 | 3.8 | 3.2 | 3.1 |

Sources: IMF Art. IV, WB DPC and CPS 2011, and Central Bank of Honduras
a/ Preliminary b/ Projected

**Growth picked up to 3.6 percent in 2011, an improvement from 2009-2010 but still low compared with the average growth of 5.7 percent during 2005-2008.** The improvement in growth is explained by renewed investment spending and a growing demand for the country's exports. While commodity prices remained high, the value of agriculture exports such as coffee and bananas increased. However, rising international prices of food and fuel created inflationary pressures and widened the current account deficit. Inflation reached 5.6 percent and the current account deficit increased somewhat from 6.2 percent of GDP in 2010 to 6.4 percent in 2011. The slight increase in the current account deficit was financed primarily by an increase in FDI that rose from 5.2 percent of GDP in 2010 to 5.5 percent of GDP in 2011.

**Despite high vulnerability to external shocks, the growth and debt outlook for Honduras remain positive and the exchange rate will continue to serve as the main anchor for inflation expectations.** Honduras is one of the most vulnerable countries in the region with exports and remittances being the main channels of transmission of external shocks to the Honduran economy. The fiscal space to counteract external shocks through expansionary fiscal policy is very limited, and the authorities' ability to use monetary policy stimulus is also restricted by the narrow foreign exchange band. Although social protection systems—including the recently launched conditional cash transfer program Bono 10,000—are in place, there is limited scope for expansion due to fiscal constraints. Nonetheless, under a baseline scenario of no further deterioration in the global economy, Honduras is expected to grow by 3.6 percent in 2012. The Central Bank will continue to absorb excess liquidity through the placement of its own securities in order to meet the inflation targets. The latest debt sustainability analysis suggests that Honduras' public-debt-to-GDP is expected to increase from 26.3 percent of GDP in 2010 to around 27.5 percent in 2011-12 and gradually decline afterwards.

### 1.3 Original Program Development Objectives (PDO) and Key Indicators (as approved)

**The Program Development Objective was to assist the Government in bringing public finances back to a sustainable path.** In this regard, the DPC operation supported progress towards the Interim Strategy Note objective of macroeconomic stability and growth.

**The Key Outcome Indicators, expected to be achieved by September 2011, were as follows:**

I. Expanding the tax base and improving tax administration by:
- Increasing the Central Government tax revenues as a share of GDP to 16.1 percent in 2011 from a baseline of 14.4 percent in 2009;
- Increasing the number of taxpayers using the electronic payment system by at least 10 percent in 2010 from a baseline of 163,198 taxpayers in 2009;

II. Improving public sector human resource management through:
- Decreasing the wage bill as a share of GDP by at least 0.5 percent of GDP from a baseline of 11.1 percent of GDP in 2009;

III. Reforming the power sector tariffs to contribute to the financial sustainability of ENEE through :
- Increases in electricity tariffs to raise ENEE's monthly revenues by US$6 million from a baseline of US$65 million as of April 2010;
- Restructuring of the direct electricity subsidy to generate savings for the Government of up to US$23 million yearly;
- Eliminating ENEE's arrears with private sector power generators, which as of April 2010 were L.1 billion.

IV. Strengthening public financial management and transparency by:

- Auditing and resolving about 0.3 percent of GDP worth of previously unaccounted and unpaid transactions.

### 1.4 Revised PDO (as approved by original approving authority) and Key Indicators, and Reasons/Justification

Neither the program development objectives not the core indicators were formally revised.

### 1.5 Original Policy Areas Supported by the Program (as approved)

**The Government devised a strategy to bring public finances back under control after the 2009-2010 fiscal crisis**. The administration was committed to tackle the fiscal challenges in order to support the recovery and contribute to sustainable growth in the medium to long term. To that end the Government secured the approval in Congress of the Fiscal Emergency Law and the Law on the Strengthening of Revenues, Social Equity and Rationalization of Public Spending which formed the core of its fiscal reform package. The strategy also included additional fiscal measures, especially on the expenditure side. The Fiscal Emergency Recovery DPC was a regular budget support operation, prepared in a state of fiscal emergency, to aid Government efforts in launching structural reforms to tackle the difficult fiscal situation and reestablish the foundations for growth. In particular, the DPC supported key reforms and policy actions in four areas of (i) tax reform, (ii) civil service reform, (iii) reform of power sector tariffs, and (iv) public financial management and transparency.

**Policy Area I: Tax Reform**

**This component supported the Government efforts to close tax loopholes, widen the tax base, and improve tax administration.** Tax collections increased steadily between 2002 and 2008, but fell in 2009 as a result of the economic and political crisis. In April 2010 Congress approved Law 17/2010 on the Strengthening of Revenues, Social Equity and Rationalization of Public Spending, which introduced a number of tax policy changes that were estimated to raise revenues by 1 - 1.5 percent of GDP on an annual basis over three years. In addition, a new electronic tax payment system was expected to increase the number of electronic filings and reduce transaction costs for taxpayers and the Revenue Administration Agency (DEI).

**Policy Area II: Civil Service Reform**

**This component of the operation was aimed at improving public sector human resource management and rationalizing the wage bill, particularly in the education sector**. While current expenditures increased from 16.1 percent of GDP in 2006 to 19.0 percent of GDP in 2009, the wage bill rose from 8.3 percent of GDP to 11.2 percent of GDP in the same period. The public sector wage bill consumed 75 percent of total tax collections and, although teachers accounted for more than 60 percent of the total wage bill, education results lagged behind the regional average. A mid-2010 survey had confirmed the existence of a large number of redundant teacher positions throughout the country. In order to control the wage bill in the education sector, the Government, through the Ministry of Finance (SEFIN), signed an inter-institutional agreement with the Ministry of Planning (SEPLAN) and the Ministry of Education (SEE) to make publicly available a list of teachers on the payroll and eliminate redundant teacher positions.

**Policy Area III: Reform of the Power Sector Tariffs**

**This component was aimed at reforming the power sector tariff structure to improve to the financial sustainability of the state owned electricity company (ENEE).** Honduras has subsidized electricity for a long time. Direct and indirect subsidies include: (i) prices that do not reflect the full cost of service, including the effect of a tax-exemption on fuels for generation; (ii) a direct subsidy of the state to residential consumers; (iii) a value-added tax exemption for electricity; and (iv) free electricity for irregular users. The total cost of subsidies in 2009 was estimated at US$377 million (2.4 percent of GDP). These large subsidies, combined with ENEE's inability to raise tariffs due to political interference, have created a major challenge for ENEE which provides 98 percent of electricity service in the country. Furthermore, due to significant technical and non-technical losses, customer payment arrears (including public and private sector clients) and low tariff collections, ENEE had accumulated significant arrears with private sector fuel electricity generators. The implementation of reform in this area was expected to improve ENEE's monthly revenues by US$6 million, save Government $23 million per year in subsidy costs, and eliminate ENEE's arrears.

**Policy Area IV: Strengthening Public Financial Management and Transparency**

**This component of the operation supported the Government's efforts to resolve outstanding public sector arrears and investigate shortcomings of the integrated financial management system (SIAFI).** Public sector financial management and transparency remain a key weakness notwithstanding the fact that since 2004 the Government embarked on a Public Financial Management (PFM) reform program to address them. Gaps in the coverage of the SIAFI have been particularly problematic and have led to the accumulation of public sector arrears. As of 2010 total public sector arrears were estimated at L. 12 billion (4.1 percent of GDP), with the bulk representing intra-public sector arrears, delayed payments to civil servants or contingent liabilities. For those claims that were documented, the Government devised an adequate payment plan (through inclusion as expenditure in the 2010 budget, bond issuance, etc.). However, approximately L. 3 billion in undocumented claims remained, which may or may not have represented legitimate claims on public resources. Thus, the Government required an audit in order to determine the legitimacy of these claims and resolve them.

### 1.6 Revised Policy Areas (if applicable)

N/A

### 1.7 Other significant changes

N/A

## 2. Key Factors Affecting Implementation and Outcomes

### 2.1 Program Performance

**Upon the completion of all prior actions, the Fiscal Emergency Recovery DPC was approved by the Board on November 9, 2010.** The single tranche operation became effective on December 9, 2010 and was disbursed on December 15, 2010. The quick disbursement fulfilled a critical role in helping to fill the 2010 financing gap of the Government, and the loan closed on November 15, 2011. The DPC was the single lending operation envisaged in the Interim Strategy Note (ISN), which was presented to the Board simultaneously with this DPC and was intended to specifically contribute to the ISN objective of macro stability and growth.

**Table 2 Objectives, Prior Actions and Status**

<table>
<tr><th>Objectives</th><th>Prior Actions</th><th>Status</th></tr>
<tr><td colspan="3" align="center">I. Tax Reform</td></tr>
<tr><td>Close tax loopholes and widen the tax base</td><td>In order to widen the tax base and reduce exemptions, the Government passed Law No. 17-2010 which:<br>• Eliminated, under the value-added tax (ISV) regime, the tax credit in favor of producers of tax-exempt goods which inputs are associated directly with the manufacture of the same;<br>• Eliminated ISV exemptions for: (i) freight and insurance charges, and (ii) residential customers which electricity consumption exceeds 750 kWh per month; and<br>• Introduced a flat 10 percent income tax rate on dividends and capital gains on: (i) individuals who reside, or have a domicile, in the country, and (ii) individuals and legal entities which do not reside, or do not have a domicile, in the Recipient’s territory.</td><td>Completed</td></tr>
<tr><td>Improve tax administration</td><td>In order to help the Revenue Administration Agency (DEI) improve taxpayer compliance, the Government has:<br>• Submitted to Congress the Law on Strengthening and Updating the Tax and Customs System, which reforms the tax procedure code.<br><br>In order to reduce transaction costs, the Government, through the DEI, has :<br>• Established a fully operational electronic tax payment system in five private banking institutions for purposes of enabling taxpayers to make payments of their tax obligations through the system.</td><td>Completed</td></tr>
<tr><td colspan="3" align="center">II. Civil Service Reform</td></tr>
<tr><td>Improve public sector human resource management and rationalize the wage bill to create fiscal space</td><td>In order to control the wage bill in the education sector, the Government, through SEFIN, has signed an inter-institutional agreement, with the Ministry of Education and Ministry of Planning, whereby it was agreed to:<br>• Prepare, and make publicly available after 3 months of the date of the agreement, a list of the teachers enrolled on the payroll of the Ministry of Education (Anexo Desglosado de Plazas Docentes), classified by department, municipality, and education level (including the corresponding salary information);<br>• Eliminate all teachers’ positions deemed to be redundant based on the results of the Supreme Audit Court’s audits (Censo de Auditoria de Puestos); and<br>• Fulfill the demand of new teachers’ positions using teachers already enrolled on the payroll of the Ministry of Education and available based on the results of the Supreme Audit Court’s audits (Censo de Auditoria de Puestos).</td><td>Completed</td></tr>
</table>

| III. Reform of Power Sector Tariffs | | |
|---|---|---|
| ***Design a power sector tariff structure that contributes to the financial sustainability of ENEE*** | In order to contribute to the financial sustainability of ENEE, the Government:<br>• Passed Law 17-2010 and implemented it to eliminate the direct electricity subsidies for residential customers consuming more than 150 kwh per month<br>• Raised electricity tariffs by a total of 9% in accordance with the automatic adjustment formula for electricity tariffs published in the Official Gazette (La Gaceta No. 31826) of January 31, 2009.<br>• Paid all identified arrears on electricity bills and subsidies owed to ENEE (L.1742 million), as of December 31, 2009. | Completed |
| **IV. Resolution of Public Sector Arrears** | | |
| ***Resolve the issue of outstanding public sector arrears and investigate shortcomings of the SIAFI*** | In order to ascertain the correct amount of public sector arrears with the private sector, the Government has:<br>• Drafted the Terms of Reference for an international audit firm to conduct an audit of disputed public sector arrears, estimated at L.3 billion<br>• Invited firms to submit proposals. | Completed |

## 2.2 Major Factors Affecting Implementation:

The implementation of the program was somewhat affected by the following factors:

- **Impacts of the global financial crisis.** The slower-than-expected recovery from the global crisis prevented tax revenues from reaching the DPC outcome indicator target of 16.1 percent due to difficulties in central government finances (higher than expected use of income tax credits) and unresolved weaknesses in tax administration. Furthermore, higher-than-anticipated international prices of bunker fuel—which is used to generate 70 percent of electricity in the country—increased subsidy costs despite the reduction in the number of subsidy recipients.

- **Impact of crime and violence**. Crime and violence is one of the most important development challenges in Honduras, which has the highest homicide rate in the world (82.4 homicides per 100,000 inhabitants). To protect the citizens from the rise in crime and violence, the Government scaled up security and defense expenditure by 0.3 per cent of GDP.

Nevertheless, ***program implementation has been satisfactory*** mainly due to the following:

- **Consultation and consensus building:** The Government gathered strong political support for its reform program. The Fiscal Emergency Law and the Law on the Strengthening of Revenues, Social Equity and Rationalization of Public Spending were approved by Congress in record time, providing a strong foundation for fiscal reforms. Although there has been some discontent, fed by a widespread perception of lack of transparency in public financial management, in general there was awareness that the global economic crisis, combined with the domestic political crisis of 2009, had exacerbated structural challenges in the country, increasing the need for reform.

- **Collaboration with other donors:** The DPC was prepared in coordination with a number of donors, including the International Monetary Fund (IMF), the Inter-American

Development Bank (IDB), the European Union (EU), and the Central American Bank for Economic Integration (CABEI). In this regard, on October 1, 2010 the IMF Board approved blended 18-month arrangements under the Stand-by Credit Facility and the Stand-By Arrangement with a total access of 100 percent of quota (about US$202 million).

- **Coordination with other World Bank operations:** The stand-alone DPC complemented the Social Protection Project (US$40 million) approved in September 2010, which supported the Bono 10,000 CCT program launched by the Lobo administration to mitigate the impact of the economic crisis on the poor. The Fiscal Emergency Recovery DPC helped to fill the financing gap created by the crisis and allowed the Government to continue implementing the CCT program that would provide a transfer of approximately US$45 per family to a large share of the extreme poor conditional on investments in human capital through regular use of health and/or education services.
- **The design of the DPC was based on solid analytical work conducted by the Bank, the IDB and the IMF:** Most notably, the overall design of the operation was based on analytical work such as: Fiscal Emergency Non-Lending Technical Assistance (WB 2010); Public Expenditure Tracking and Service Delivery Survey- Education and Health in Honduras (WB 2010); Honduras Public Expenditure Review (WB 2007); and Power Sector Efficiency Enhancement Project (WB 2010). The DPC also drew on analytical work carried out by the IDB and the Government on the main weaknesses, challenges, and future opportunities for tax policy and tax administration: Desafíos de la Política Tributaria en Honduras (IDB 2010) and Honduras: Hacia un Sistema Tributario Más Transparente y Diversificado (IDB 2005).

**2.3 Monitoring and Evaluation (M&E) Design, Implementation and Utilization:**

***Design:*** Outcome indicators, baseline values, and targets were assigned to each of the four policy areas defined under the DPC program. The design focused on outcome and output indicators that were easy to calculate with existing information and that were expected to be achieved by the closing date of the operation (September 2011). The M&E sought to align output indicators to indicators and targets frequently monitored by the Government, such as tax revenues to GDP, number of taxpayers using the electronic payment system and number of households receiving the electricity subsidy. The M&E arrangements also placed clear responsibilities for data collection within the Government. Thus, SEFIN and the National Institute of Statistics (INE), together with the Central Bank of Honduras and the Ministries of Education and Planning, had to collect the necessary data for the identified monitoring indicators. The adequacy of the indicators is satisfactory and the existing data has been used for decision making.

***Implementation:*** The Ministry of Finance (SEFIN) is the agency responsible for the implementation of the operation as well as for coordinating the actions among the concerned agencies including the Central Bank of Honduras, the Ministry of Education, and the Ministry of Planning. The SEFIN and the Bank had agreed to monitor the progress in the program supported by the DPC and had joint responsibilities in the preparation of periodic reports. These reports included specific milestones to assist in monitoring adequate and timely implementation of the program. A mid-year review of progress towards achieving the DPC outcomes took place in March 2011 in preparation of the new Country Partnership Strategy (CPS) with the Government.

Overall, data collection was appropriate and indicators were reported most of the time on a timely basis.

***Utilization:*** The Bank leveraged its M&E engagement with the Government of Honduras in the design of new investment lending and a new series of programmatic development policy credits. In the First Programmatic Reducing Vulnerabilities for Growth DPC (November 2011), outcome indicators such as Indicator 1 (raise Tax to GDP), Indicator 2 (improve tax administration) and Indicator 3 (bringing the public wage bill under control in key sectors, with a focus on education) were used to monitor further progress in the key reform areas.

### 2.4 Expected Next Phase/Follow-up Operation (if any):

**The Government demonstrated its interest in continued financial and technical support from the Bank in the context of a series of DPCs**. The Bank continued providing assistance in the policy areas supported under the Fiscal Emergency Recovery DPC through the Programmatic Reducing Vulnerabilities for Growth DPC series (first operation of US$ 86 million approved on December 6, 2011). In parallel, the Bank prepared the Improving Public Sector Performance Technical Assistance Loan to address, *inter alia*, human resource management issues (US$18 million, approved on December 6, 2011)

**The First Programmatic Reducing Vulnerabilities for Growth DPC builds on the progress achieved under the Fiscal Emergency Recovery DPC**. It reflects the Government's priority of achieving fiscally and economically sustainable growth and is designed to assist the Government in strengthening fiscal management and in designing an integrated citizen security policy. Specifically, the operation supports four areas that are central to the reform program: (i) tax administration; (ii) civil service reform; (iii) pension reform, and (iv) citizen security reform. The DPC series is envisaged in the new Country Partnership Strategy for FY2012-2014.

**The DPC objectives are closely aligned with other Bank operations**. The recently approved Improving Public Sector Performance Technical Assistance Loan supports the Government in strengthening public sector human resource management through: (i) upgrading the public financial management system; (ii) upgrading the e-procurement platform; (iii) enhancing the internal control systems over personnel expenditures; and (iv) building capacity of the Central Administration.

## 3. Assessment of Outcomes

### 3.1 Relevance of Objectives, Design and Implementation

**The operation's Program Development Objectives (PDOs) continue to be relevant.** The Government is committed to fiscal consolidation and reducing public sector vulnerabilities. In June 2011, Congress approved the Efficiency of Revenues and Expenditures Law, which eliminates some tax exemptions and enforces new measures against tax evasion. The fiscal consolidation will come from reducing the wage bill, increasing tax revenues through tax administration measures, and addressing contingent liabilities in the electricity sector. The Government's National Development Plan 2010-2022 consolidated the provision of social services while recognizing the importance of a sustainable macroeconomic environment and a modern, transparent, efficient and competitive state, two of the four pillars of the 2010-2014 Country Partnership Strategy (CPS).[1]

**While growth rebounded in 2010-11, the uncertainty due to the Euro zone crisis continues to represent a threat**. In the event of a new global crisis, the Honduran economy may experience a contraction similar to the one in 2009 (-2.1 percent).[2] However, the fiscal impact may be less severe thanks to the structural reforms which helped create fiscal space by improving public sector human resource management and rationalizing the wage bill.

**Structural reforms in the electricity and education sectors continue to be at the forefront of the national policy debate**. The program initiated the policy dialogue on targeting electricity subsidies and tariffs based on income surveys, contributing to the financial sustainability of the Electricity Company. The policy actions and measures taken were also relevant for supporting good governance and transparency in the use of public resources in the education sector. Finally, the actions taken to resolve outstanding public sector arrears and investigate shortcomings of the SIAFI helped to strengthen public financial management and transparency.

### 3.2 Achievement of Program Development Objectives

**Overall, the program was successful in achieving the proposed objectives**. The PDO was to assist the Government in bringing public finances back to a sustainable path. Annex 1 of this report details the status of the outcomes as of the closing of the operation, and also lays out the actions the Government is implementing as part of its medium term reform program. The outcomes and current status of policy areas under each objective are discussed below.

#### Objective 1: Closing tax loopholes and widening the tax base

**Policy Area I (a): Increase Central Government tax revenue. *Partially achieved***. Central Government tax revenue as share of GDP reached 15.1 percent in 2011, up from 14.4 and 14.8 percent of GDP in 2009 and 2010, respectively, but below the 16.1 percent target. The reasons for this outturn include some delays in implementing the tax reform—which meant that the impacts were observed over a period of less than 12 months—and the fact that economic growth was slower than expected due to high international oil prices and slow recovery in the U.S., Honduras's main trading partner and investor. However, it should be noted that reaching 15.1 percent tax/GDP ratio is no small achievement compared to other countries in the region: Guatemala (11 percent), Panama (12.3 percent), Costa Rica (13.4 percent), and El Salvador (13.8 percent).

#### Objective 2 - Improve tax administration

**Policy Area I (b): Increase the number of taxpayers using the electronic payment system. *Partially achieved***. The number of taxpayers using the electronic payment system was expected

[1] An Interim Strategy Note (ISN) for Honduras covered a 12-month period up to October 2011. The ISN was completed successfully, setting the stage for moving to a full Country Partnership Strategy (CPS) for the period 2012-2014 that responds to the Honduras Country Vision and National Plan, supported by the Lobo Administration.

[2] In the event of a new global contraction, *maquila* exports and remittances—two major sources of income and foreign exchange—are likely to decline significantly.

to increase by 10 percent from 163,198 in 2009 to about 180,000 in 2010. Although the information on the number of taxpayers is not available, the number of tax return statements submitted through the electronic payment system rose to 177,363 in 2010. Additional progress took place in 2011, with the number of returns increasing by 35 percent to 238,340. In the medium term the Government is committed to further strengthening the tax administration through a number of measures aimed at making customs and tax administration more effective. This includes the adoption of legislation on transfer pricing and tax evasion, the creation of the office of control of tax exemptions and the application of rules of origin in customs. In this regard, the transfer pricing law has been approved and published in December 2011 and the General Directorate of Control of Customs Franchises was created in the Ministry of Finance (SEFIN) on March 2011. The Directorate is responsible for acknowledging and registering matters related to tax exemptions in accordance with Conventions and International Treaties.

**Objective 3 - Improving human resource management in the education sector and rationalizing the public sector wage bill**

**Policy Area II: Reduction of the wage bill.** ***Achieved***. The wage bill of the central government declined to 9.8 percent of GDP in 2011, nearly a full percentage point of GDP better than the 10.7 percent target and an extraordinary achievement on the part of the Government. The reasons for better-than-expected performance included a teachers' payroll audit which allowed the Government to eliminate ghost workers and stop paying incorrect allowances, freezing of teachers pay through October 2011, permanently delinking teachers' salary adjustments from the private sector minimum wage, and filling new teachers' demands with existing teachers once the list of teachers had been made public. Furthermore, the Government has committed to using the previous year's inflation rate, as determined by the Central Bank, as the basis for pay negotiation for all public servants.

**Objective 4 - Reforming the Power Sector Structure to contribute to the financial sustainability of the state-owned Electricity Company**

**Policy Area III (a): Increase electricity tariffs and revenues of the Electricity Company.** ***Achieved***. A series of adjustments to ENEE electricity tariffs generated additional average monthly revenue of US$6.2 million between April 2010 and December 2011, exceeding the program target of US$6 million. Electricity tariffs were adjusted by 6 percent in June 2010 and an additional 3 percent towards the end of the year. In 2011, the Government continued to apply the automatic adjustment formula to achieve a cumulative tariff increase of 32 percent for the entire year. These adjustments generated additional revenues of US$123.6 million by December 2011, which averages to a monthly increase of US$6.18 million. However, the sharp increase in international prices of bunker fuel—which rose from to US$101.31 per barrel in December 2011 from US$74.99 in January 2011—prevented further gains in revenue.

**Policy Area III (b): Increase the Government's savings by restructuring direct subsidies.** ***Partially Achieved***. Direct subsidy costs declined by US$16 million in 2011, short of the US$23 million target. In 2009, the direct subsidy costs were estimated at US$63 million, the baseline value for this outcome indicator. In 2010, following the revision of the subsidy thresholds, the total subsidy costs declined to US$45.2 million. However, due to a significant increase in bunker fuel prices in 2011—and despite the reduction in the number of households receiving subsidies to 535,000 from 900,000 in 2009—the cost of subsidies rose to US$47.1 million, exceeding the target by US$7 million.

**Policy Area III (c): Elimination of ENEE's arrears with private sector power generators.** ***Achieved***. By end-2011, ENEE paid all the arrears to private sector generators—ELCOSA, LUFUSSA, ENERSA-EMCE and RENOVABLES--using the resources provided by the Ministry of Finance last September. Currently, ENEE does not register any delays in payments.

**Objective 5 - Resolving outstanding public sector arrears and investigating the shortcomings of the Financial Management System**

**Policy Area IV: Auditing and resolving unaccounted and unpaid transactions.** ***Partially Achieved***. As of September 2011, results of a forensic audit of the disputed payment arrears have been delivered to the Superior Court of Auditors, which will take the appropriate actions. The resolution of the disputed payments based on this audit will allow unfounded claims to be eliminated from the books. Moreover, as a first step in improving the effectiveness of the SIAFI, the Government plans to link procurement, investment and human resources management modules to the SIAFI to ensure broader coverage. With regard to procurement, every Government institution is now required to prepare and publish its annual procurement plan linked to its operating annual plan, to the budget, and the SIAFI.

### 3.3 Justification of Overall Outcome Rating

**Rating: Satisfactory**

The overall rating is *Satisfactory*. The DPC achieved the proposed Program Development Objectives. The supported program helped bring public finances back on a sustainable path and aided in the progress towards macroeconomic stability despite the unfavorable external environment. The operation supported tax policy and administration reforms and a substantial reduction in the public wage bill. It also help reduce inefficient and poorly targeted subsidies in the electricity sector and supported the Government's public financial management strategy, allowing the repayment of significant public sector arrears. Overall, the Government was able to fully achieve three of the seven outcome indicators and partially achieve the rest.

### 3.4 Overarching Themes, Other Outcomes and Impacts

#### (a) Poverty Impacts, Gender Aspects, and Social Development

The DPC implementation was expected to have an overall positive impact on poverty and social development, especially when taking into account the effects of the Bono 10,000 CCT program. The tax and civil service reforms were estimated to have a progressive impact, affecting higher income groups more than the poor. Similarly, the analysis in the DPC program document demonstrated that electricity tariffs were highly regressive and their reduction would have a positive distributional effect. The implications in poverty and social development are less clear for the elimination of redundant teachers' positions and from fulfilling the demand of new teachers using those already registered on the payroll of the Ministry of Education, but this is expected to lead to improved human resource management and important savings in the wage bill. Finally, the program supported by the DPC has no identifiable impact on gender.

**(b) Institutional Change/Strengthening** *(particularly with reference to impacts on longer-term capacity and institutional development)*

The DPC helped promoting institutional changes by supporting actions to strengthen tax administration; to optimize the management of human resources in the Ministry of Education; to contribute to the financial sustainability of ENEE; and, further strengthen the public financial management and fiscal transparency.

**(c) Other Unintended Outcomes and Impacts (positive or negative, if any)**

Not applicable.

### 3.5 Summary of Findings of Beneficiary Survey and/or Stakeholder Workshops

Not applicable.

## 4. Assessment of Risk to Development Outcome

**Rating: Moderate**

The operation identified that achievement of the development objectives of this operation would be subject to four main sources of risk:

***Political risks:*** The highly polarized society following the political crisis of 2009 continued to be a political obstacle for the approval and implementation of the planned fiscal reform package, which proved to be more difficult than anticipated and therefore jeopardized the needed increase in revenues. In order to reduce this risk, the Government has been building consensus to implement the needed reforms to bring the country's finances back to a sustainable path. For example, the Government garnered initial political support for its reform program. The Fiscal Emergency Law and the Law on the Strengthening of Revenues, Social Equity and Rationalization of Public Spending were approved by Congress in record time, providing a strong foundation for the fiscal reforms. The Honduran public was made aware of the urgent need for fiscal reform through news coverage and public debates among political figures.

***Macroeconomic risks:*** On the economic front, the main risk comes from high external vulnerabilities and the still fragile recovery from the global crisis. Although growth has rebounded since the 2009 contraction, Honduras remains one of the most vulnerable countries in the region to any potential global slowdown. Its strongest linkages are with the US, which purchases 41 percent of Honduran exports and is the source of 89 percent of all remittances coming into Honduras. Although vulnerabilities in the financial sector are likely to be limited due to the sector's relatively good health and its relatively low external exposure, export and remittances vulnerabilities are high. In the event of a global slowdown, the scope to counteract through fiscal or monetary policy would be very limited given the scarce fiscal space and the narrow foreign exchange. To mitigate the risk, the Bank and the IMF are maintaining on-going dialogue with the authorities on macroeconomic policy issues.

***Institutional risk:*** On the institutional side, the main risk is related to a weak capacity of Government institutions to implement the program. In order to reduce this risk, the Bank has been working with other donors to support the Government's fiscal consolidation efforts, including through technical assistance.

***Environmental risks:*** On the environmental side, the main risk is the country's high exposure to multiple natural disasters. Honduras has been hit by multiple hurricanes in recent years which resulted in significant damage. The country's past experience has highlighted the value of investing on early warning systems, institutional strengthening and mitigation efforts. Building on the progress made to date in this area, the Bank is providing support to strengthen the country's natural disaster mitigation systems.

## 5. Assessment of Bank and Borrower Performance

### 5.1 Bank Performance

**(a) Bank Performance in Ensuring Quality at Entry**
**Rating: Satisfactory**

The design of the DPC was appropriate, timely, and relevant for addressing the challenges faced by the country given external and internal developments, including higher fuel and commodity prices. The Fiscal Emergency Recovery DPC was designed in close collaboration with the Government to ensure the actions supported by the operation were fully consistent with the country’s long term development goals included in the Interim Strategy Note (ISN), which was designed to bridge the gap until a full Country Program Strategy (CPS) was prepared. The consultation and consensus building activities during preparation were also essential to the approval and sustainability of the operation, mitigating the political risks associated with the high social polarization that followed the political crisis of 2009.

**(b) Quality of Supervision** *(including M&E arrangements)*
**Rating: Satisfactory**

Supervision was carried formally through two supervision missions that followed the Ministry of Finance (SEFIN) and the Bank agreement during project preparation. These reviews are summarized in two Implementation Status and Results (ISR) of January 2011 and April 2011, and in more detail in the Aide-Memoire of April 6, 2011. The Program Performance was considered satisfactory by the two ISR reports. In parallel, informal supervision took place when team members visited the country in the context of the CPS preparation and new DPOs. Supervision was also successful given the clear assignment of responsibilities whereby SEFIN was responsible for the implementation of the operation as well as for coordinating the actions among the concerned agencies, including the Central Bank of Honduras, the Ministry of Education and the Ministry of Planning.

**(c) Justification of Rating for Overall Bank Performance**
**Rating: Satisfactory**

Overall, Bank performance is rated Satisfactory. The operation supported relevant development objectives, and built consensus around critically important issues. The operation also assessed several risks for the program sustainability and helped mitigate them. Finally the monitoring and evaluation system in place allowed both the Government and the Bank to periodically track progress toward the target outcomes. The SEFIN and the Bank have agreed to monitor the progress in the program supported by the DPC and its evaluation also served for the preparation of the new Country Partnership Strategy for the period FY2012-2014 that was finalized in November 2011.

### 5.2 Borrower Performance

**(a) Government Performance**
**Rating: Satisfactory**

Throughout the preparation and supervision process of the operation, the Ministry of Finance (SEFIN) successfully coordinated with the different ministries (Education and Planning) and other institutions involved in the operation including, the Central Bank of Honduras (BCH), the National Institute of Statistics (INE) and the national Electricity Company (ENEE). The coordination was instrumental in shaping the actions of each institution and ensuring the timely implementation of the prior actions under program.

**(b) Implementing Agency or Agencies Performance**
**Rating: Satisfactory**

SEFIN was the principal executing agency, responsible for the overall coordination of the operation as set out in the Letter of Development Policy. Similarly, SEFIN was in charge of reporting progress and coordinating actions among other concerned entities, including the SEE, SEPLAN, INE and ENEE. Although delays were encountered in the implementation of the Government's program supported by the DPC, the staff in SEFIN continued monitoring and coordinating the program with the support of Bank Staff. They provided leadership to address bottlenecks or pending problems, and ensured attention to the every issue.

**(c) Justification of Rating for Overall Borrower Performance**
**Rating: Satisfactory**

Overall the Borrower's performance is rated as Satisfactory given its high level of engagement during the preparation, implementation and supervision. As described above, substantial progress was made in implementation of the program despite the obstacles that prevented the achievement of one of the outcome indicators, and partially meeting three others. The borrower participation was crucial in the coordination among the different ministries and institutions involved in the Program. The fragile social and security situation following the political crisis of 2009 also played a role in the performance shortcomings.

## 6. Lessons Learned

The Fiscal Emergency Recovery DPC responded to a specific request from the Government of Honduras to rapidly address a difficult fiscal situation—which arose due to the combined effects of an internal political crisis and the global financial crisis—while launching several important structural reforms. The main lessons from the implementation of this operation include:

**Lingering impacts of the crisis and external shocks can have a significant impact on the achievement of outcomes.** The performance on a few outcome indicators was worse than anticipated during the operation design due to stronger-than-expected effects of the global crisis and the shocks to bunker fuel prices. While it is not possible to predict the impacts of external shocks with any degree of certainty, in the future care should be exercised in establishing the outcome indicators which are, to a large extent, outside of the sphere of control of the authorities. While continued policy dialogue and technical assistance to the authorities—in this case through the Programmatic Reducing Vulnerabilities for Growth DPC series and the Improving Public

Sector Performance technical assistance loan—can help mitigate these risks, they cannot eliminate them completely.

**Strong analytical underpinnings are a necessary component of a rapid response.** The design of the operation was backed by solid analytical work which enabled the Bank team to respond to the Government request within the window of opportunity generated by the social and political context. Analytical work prepared before the operation, such as the Fiscal Emergency Non-Lending Technical Assistance; the Public Expenditure Tracking and Service Delivery Survey-Education and Health; the Honduras Public Expenditure Review; and the Power Sector Efficiency Enhancement Project allowed the Government and the team to identify priority policy areas, build consensus around critical issues, and prepare the groundwork for future engagement in the strategic objective areas under the new Country Program Strategy.

**Ownership of reforms and a well-defined reform strategy are critical for a successful outcome.** Bank involvement in promoting consultation and consensus-building activities as well as continued policy dialogue with the authorities was essential for the successful implementation of the DPC program in a socially and politically polarized environment. Early re-engagement by the donors and close collaboration within the donor community was also a key factor for the success of this operation. However, the satisfactory outcome of the operation is to a large extent a consequence of the Government's commitment to address long-standing problems and the development of a clear reform plan to achieve these objectives.

## 7. Comments on Issues Raised by Borrower/Implementing Agencies/Partners

**(a) Borrower/Implementing agencies**
Not applicable

**(b) Cofinanciers**
Not applicable

**(c) Other partners and stakeholders**
Not applicable

## Annex 1. Fiscal Emergency Recovery Development Policy Credit – Policy Matrix

| Objective | Prior Actions | Outcome Indicator expected by September 2011 | Status of reforms by end September 2011 | Government's medium-term reform program | Status of medium-term reforms |
|---|---|---|---|---|---|
| | | | **I. Tax Reform** | | |
| 1. Close tax loopholes and widen tax base | In order to widen the tax base and reduce exemptions, the Government has passed Law No. 17-2010 which:<br><br>(a) eliminated, under the value-added tax (ISV) regime, the tax credit in favor of producers of tax-exempt goods which inputs are associated directly with the manufacture of the same;<br><br>(b) eliminated ISV exemptions for: - freight and insurance charges, and - residential customers which electricity consumption exceeds 50 kWh per month; and<br><br>(c) introduced a flat 10 percent income tax rate on dividends and capital gains on:<br>- individuals who reside, or have a domicile, in the country, and<br>- individuals & legal entities which do not reside or do not have a domicile in the recipient's Territory.<br><br>*Status: Completed.* | Central Government tax revenue as share of GDP increases to 16.1 percent in 2011 (baseline: 2009 = 14.4). | **Partially achieved**<br><br>Central Government tax revenue as share of GDP reached 15.1 percent in 2011. However, delays in reform implementation meant that the impacts were observed over a period of less than 12 months (as originally anticipated). Moreover, the pace of economic growth was slower than expected due to high international oil prices and slow recovery in the U.S., Honduras's main trading partner and investor. | Implementation of Law No. 17-2010 | Some articles of the Law became effective immediately, while others awaited the approval of the corresponding regulations. |

| Objective | Prior Actions | Outcome Indicator expected by September 2011 | Status of reforms by end September 2011 | Government's medium-term reform program | Status of medium-term reforms |
|---|---|---|---|---|---|
| 2. Improve tax administration | In order to help the Revenue Administration Agency (DEI) improve taxpayer compliance, the Government has submitted to Congress the Law on Strengthening and Updating the Tax and Customs System (*Ley de Fortalecimiento y Actualizacion del Sistema Tributario, Aduanero y Medidas Antievasión*), which reforms the tax procedure code.<br>In order to reduce transaction costs, the Government, through the DEI, has established a fully operational electronic tax payment system in five private banking institutions for purposes of enabling taxpayers to make payments of their tax obligations through the system.<br><br>*Status: Completed.* | The number of taxpayers using the electronic payment system will increase by at least 10 percent in 2010<br>(baseline: 2009 = 163,198) | **Partially achieved**<br><br>The number of tax statements submitted through the electronic payment system reached 177,363 by end-2010. The number further increased by 35% in 2011 compared to 2010. (2010 = 177,363 and 2011= 238.340) | Implementation of the institutional reform strategy for DEI.<br><br>Adoption of legislation on transfer pricing and tax evasion.<br>Application of rules of origin in customs.<br><br>Creation of an office that controls tax exemptions. | The transfer pricing law was approved December 8, 2011 by Decree No. 232, and was published in the Official Gazette No.32, 691 of December 10, 2011<br><br>The General Directorate of Control of Customs Franchises was created in the Ministry of Finance (SEFIN) by Executive Decree No. PCM-017-2011 of March 22, 2011, published in the Official Gazette No. 32,489, of April 9, 2011.<br><br>The Directorate is responsible for acknowledging and registering matters related to all exemptions and tax exemptions to be granted in accordance with Conventions and International Treaties and the laws in-force without prejudice to the powers that by law it is up to each State Secretariat. |
| **II. Civil Service Reform** | | | | | |
| 3. Improve public sector human resource management and rationalize the wage bill to create fiscal space | In order to control the wage bill in the education sector, the Government, through SEFIN, has signed an inter-institutional agreement with the Ministry of Education and Ministry of Planning, whereby it was agreed to:<br>• Prepare, and make publicly | As a share of GDP, the wage bill falls by at least 0.5 percent of GDP<br>(baseline: 2009 = 11.1 percent) | **Achieved**<br><br>For 2011, the wage bill in the central Administration accounted for 9.8 per cent of GDP. | Design of a human resources management system for the education sector, and its integration with the SIAFI. | The system for human resources administration in the education sector (SAD) has been designed and integrated into the SIAFI. The system is intended to support optimization and autonomy in the management of human resources in the Ministry of Education and in the Control Unit in the Ministry of Finance, which does the follow-up of payrolls. |

| Objective | Prior Actions | Outcome Indicator expected by September 2011 | Status of reforms by end September 2011 | Government's medium-term reform program | Status of medium-term reforms |
|---|---|---|---|---|---|
| | available after 3 months of the date of the agreement, a list of the teachers enrolled on the payroll of the Ministry of Education (*Anexo Desglosado de Plazas Docentes*), classified by department, municipality, and education level (including the corresponding salary information);<br>• Eliminate all teachers' positions deemed to be redundant based on the results of the Supreme Audit Court's audits (*Censo de Auditoria de Puestos*); and<br>• Fulfill the demand of new teachers' positions using teachers already enrolled on the payroll of the Ministry of Education and available based on the results of the Supreme Audit Court's audits (*Censo de Auditoria de Puestos*).<br>*Status: Completed.* | | | Reform of the Civil Service Law. | Additionally, the regulations and procedures for adding new teachers and time burden have been unified.<br><br>A disaggregated annex of teachers enrolled on the payroll of the Ministry of Education was published on the website of SEFIN. With the SAD in place it is now possible to link the budget with the financial availability. In addition, communities now have an instrument to learn of the availability of educational resources in the schools in their areas. |
| **III. Reform of Power Sector Tariffs** | | | | | |
| 4. Design a power sector tariff structure that contributes to the financial sustainability of ENEE | In order to contribute to the financial sustainability of ENEE, the Government:<br>• Passed Law 17-2010 and implemented it to eliminate the direct electricity subsidies for residential customers consuming more than 150 kWh per month; | The increases in electricity tariffs raise ENEE's monthly revenues by US$6 million<br>(baseline: April 2010 = US$ 65 million) | **Achieved**<br>The financial situation of the ENEE continued to be strengthened. The cumulative 2010-11adjustment in electricity tariffs of tariffs increased ENEE average ENEE monthly revenue by US$6.2 million. | ENEE will further reform electricity subsidies and tariffs:<br>• Adjustment of number of households receiving subsidy based on income survey (starting | In 2012, geographic targeting will be used to further reduce the number of subsidized users.<br><br>. |

| Objective | Prior Actions | Outcome Indicator expected by September 2011 | Status of reforms by end September 2011 | Government's medium-term reform program | Status of medium-term reforms |
|---|---|---|---|---|---|
| | and<br>• Raised electricity tariffs by a total of 9 percent in accordance with the automatic adjustment formula for electricity tariffs published in the Official Gazette (La Gaceta No 31,826) on January 31, 2009.<br><br>The Government has paid all identified arrears in respect of unpaid electricity bills and subsidies owed to ENEE<br><br>*Status: Completed.* | The restructuring of direct subsidies has generated savings for the Government of US$23 million yearly.<br><br>ENEE has eliminated its arrears with private sector power generators (baseline: April 2010 = L.1 billion). | **Partially achieved**<br>The restructuring of direct subsidies took place (535.000 households in 2011 from 900.000 in 2009 consuming up to 150kWh/month). However, the subsidy increased because the price of bunker in the international market was higher than the estimated in the budget 2011<br><br>**Achieved**<br>The ENEE does not register any delay in the payment of invoices (arrears) with private sector power generators as of December. 2011. Arrears were paid in full in the amount of LS 1.2 billion | October 2010)<br>• Lowering of subsidy threshold from 150kWh to 100kWh (January 2011)<br>• Implementation of another raise in electricity tariffs to bring them in line with current fuel prices (October 2010)<br>• Application of automatic monthly adjustment of tariffs using formula linking it to fuel prices | |
| | | | **IV. Strengthening Public Financial Management and Transparency** | | |
| 5. Resolve outstanding public sector arrears and investigate shortcomings of the SIAFI | In order to ascertain the correct amount of public sector arrears with the private sector, the Government has<br>• drafted the TOR for an international audit firm to conduct an audit of disputed public sector arrears, estimated at L.3 billion; and<br>• invited firms to submit proposals. *Status: Completed* | About 0.3 percent of GDP worth of previously unaccounted and unpaid transactions has been audited and resolved. | **Partially achieved**<br><br>A forensic audit of the disputed payment arrears has taken place. The results were delivered to the Superior Court of Auditors that will take the corresponding actions. Finally, unfounded claims would be eliminated from the books. | Procurement, investment and human resources management modules will be linked to the SIAFI to ensure broader coverage.<br><br>Human and technical resources to manage the SIAFI will be strengthened. | The human resources module is linked to the SIAFI. With regard to procurement, by 2012 every government institution is required to prepare & publish the annual procurement plan linked to the operating annual plan, to the budget and to SIAFI.<br><br>A program aimed at strengthening the SIAFI in terms of human resources and technological platform is in process. |

## Annex 2. Bank Lending and Implementation Support/Supervision Processes

### (a) Task Team members

| Names | Title | Unit | Responsibility/ Specialty |
|---|---|---|---|
| Rodrigo A. Chaves | Sector Manager | LCSPE | Sector Manager |
| J. Humberto Lopez | Lead Economist and Sector Leader | LCSPE | Lead Economist and Sector Leader |
| Jasmin Chakeri | Senior Economist | LCSPR | Task Team Leader |
| Christian Y. Gonzalez | Senior Economist | LCCHT | Task Team Leader |
| Andrea Kucey | Senior Country Officer | LCC2C | Team Support |
| Cristian Aedo Inostroza | Senior Education Economist | LCSHE | Education |
| Enrique Fanta | Senior Public Sector Specialist | LCSPS | Public Sector Reform |
| Antonio Leonardo Blasco | Senior Financial Management Specialist | LCSFM | Financial Management |
| Jimena Garrote | Counsel | LEGLA | Legal |
| Patricia De la Fuente Hoyes | Senior Finance Officer | CTRLN | Finance |
| Patricia Chacon Holt | Program Assistant | LCSPE | Team Support |

### (b) Staff Time and Cost

| Stage | Staff Time and Cost (Bank Budget Only) | |
|---|---|---|
| | **No. of staff weeks** | **USD Thousands (including travel and consultant costs)** |
| **Lending** | 48.34 | 155,261.55 |
| **Supervision/ICR** | 3.58 | 13,498,05 |
| **Total:** | | 168,759.60 |

## Annex 3. Summary of Borrower's ICR and/or Comments on Draft ICR

On behalf of the Government of Honduras, the Vice Minister of Finance expressed its agreement with the content of the ICR in a letter to the ICR Task Team Leader dated May 7, 2012.

The Government of Honduras proposed only minor editorial changes and also took the opportunity to reiterate its interest in continued collaboration with the Bank in 2012 and 2013 through development policy operations supported by joint World Bank – Government of Honduras analytical work.

SEFIN | SECRETARIA DE FINANZAS

Tegucigalpa, 07 de mayo de 2012

**No. UNAGE-008-2012**

Señor
**DENIS MEDVEDEV**
Banco Mundial
Washington, DC, EUA

Estimado Señor Medvedev:

En atención al Reporte No.: ICR00002157 del 18 de abril sobre Implementation Completion and Results Report (IDA-48290) respecto al crédito para la política de desarrollo para la emergencia fiscal de recuperación, me permito manifestarle que esta Secretaría, a nombre del Gobierno de Honduras, está de acuerdo con el contenido del mismo. Algunos errores tipográficos se mencionan en el anexo.

Asimismo, deseo aprovechar la oportunidad para reiterar el interés del gobierno de continuar por este tipo de operaciones para 2012 y 2013 apoyados por el trabajo analítico que realiza el Banco conjuntamente con nuestras instituciones.

Atentamente,

SECRETARIA DE FINANZAS
SUB-SECRETARIA DE CREDITO E INVERSION PUBLICA
REPUBLICA DE HONDURAS

**EVELYN LIZETH BAUTISTA GUEVARA**
**Subsecretaría de Inversiones y Crédito Público**

Cc_ archivo

**JN/gsr**

SEFIN | SECRETARIA DE FINANZAS

**ANEXO**

En diferentes partes del documento se hace referencia a la moneda nacional lempira. El símbolo oficial es L y no Ls.

En la segunda página en la lista de abreviaciones en referencia a SEPLAN debe decir Planificación.

En la página 5 en el párrafo referente a *Tax Reform* se dice “the political and economic crisis” y se debe decir “the economic and political crisis”.

En la página 6 en el párrafo referente a Reform of the Power Sector Tariffs se dice “private sector electricity generators” y se debe decir “private sector fuel electricity generators”.

En la página 7 en la matriz cuando se refiere a la DEI se debe decir Revenue Administration *Agency.*

## Annex 4. List of Supporting Documents

Fiscal Emergency Recovery Development Policy Credit Emergency in the amount of SDR 49.6 million to the Republic of Honduras. Report No. 55656-HN, October 4, 2010.

First Programmatic Reducing Vulnerabilities for Growth Development Policy Credit in the amount of SDR 55.1 million to the Republic of Honduras. Report No. 55656-HN, November 3, 2011.

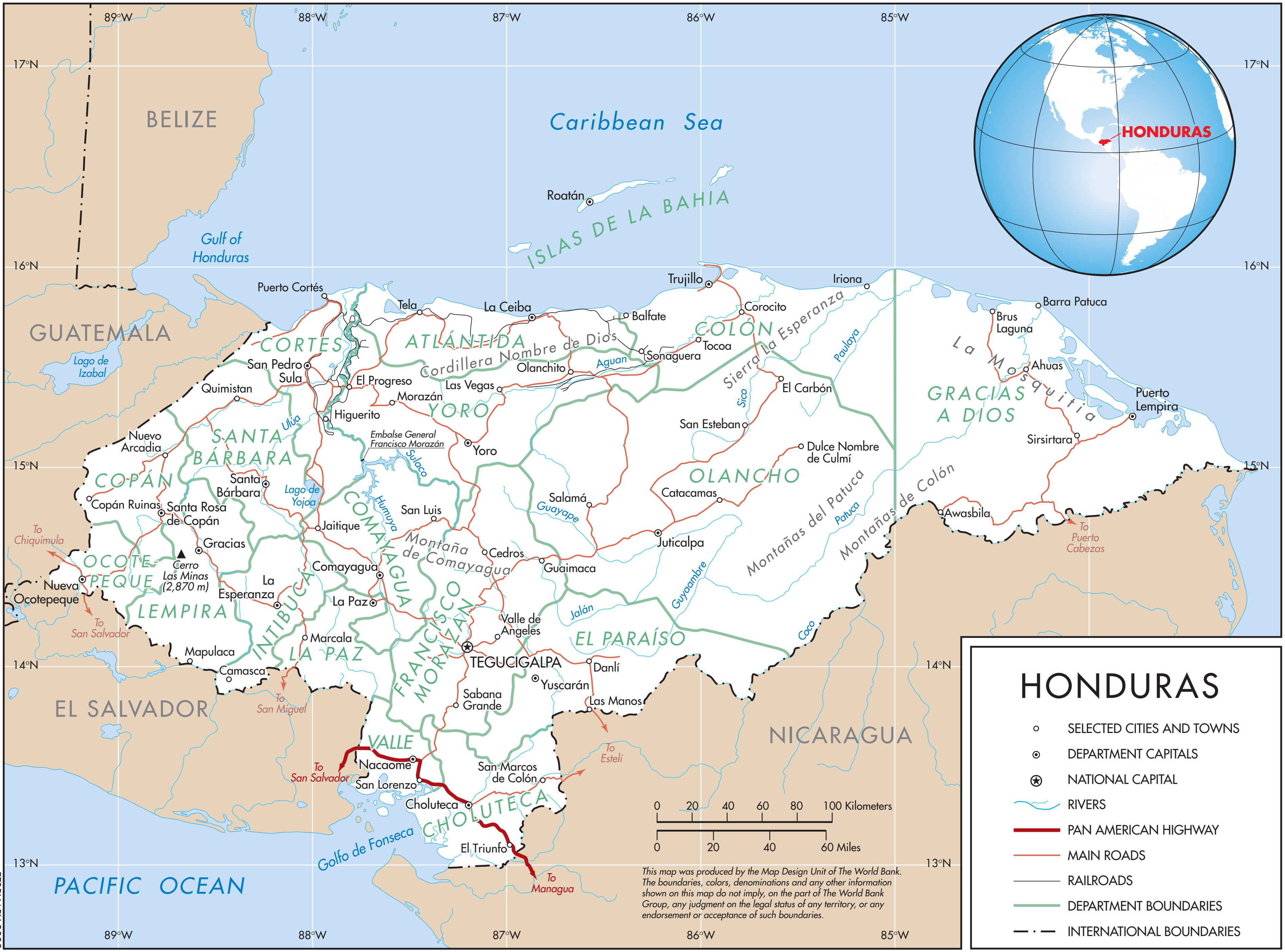
Country Assistance Strategy for the Republic of Honduras for the period FY12-FY2014 November 1, 2011

Emergency DPC Aide Memoire April 6, 2011

IMF Honduras Second Review Under the Stand-By Arrangement and Under the Stand-By Credit Facility and Request for a Modification and Waivers of Applicability of Performance Criteria. Julio 15, 2011

Implementation Status & Results for Honduras Fiscal Emergency Development Policy Credit, January 31, 2011

Implementation Status & Results for Honduras Fiscal Emergency Development Policy Credit, July 15, 2011

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