PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: AB5917

Operation Name	Emergency Recovery Development Policy Credit
Region	LATIN AMERICA AND CARIBBEAN
Sector	Central government administration (100%)
Project ID	P121220
Borrower(s)	GOVERNMENT OF HONDURAS
Implementing Agency	OVERNMENT OF HONDURAS
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1. Key development issues and rationale for Bank involvement

The Honduran government is facing serious fiscal challenges that are the direct result of historical fiscal structural problems, compounded by the global economic shock and the recent political standoff. Prior to 2009, Honduras had maintained an overall fiscal deficit not exceeding 2 percent of GDP per year, financed by a combination of external and domestic sources. Although the deficits were relatively small, the budget had become very rigid, especially due to large increases in the public wage bill. By 2009, external budget financing dried up as a result of a lack of progress on key structural reforms. This, combined with dwindling tax revenues as a result of the economic contraction, the temporary suspension of aid and credits following the political fallout, and the lack of spending discipline resulted in the build-up of substantial arrears by the end of 2009, estimated around 5 percent of GDP. Moreover, the political decision to withdraw ALBA in January 2010 curtailed an important source of projected financing originating from Venezuela.

In order to avoid a full-blown fiscal crisis, the Lobo administration took a series of decisive corrective measures to help stabilize the fiscal situation in the short term and lay the foundation for structural reforms in the medium term. Fiscal sustainability is expected to improve in 2010 as tax revenues recover and public spending is contained as a result of the fiscal reform package adopted by the Government in April, including tax reforms and spending cuts. The fiscal situation will also benefit from the recovery of the Honduran economy in 2010-11, which will help boost tax revenues back to previous levels. In the medium to long run, the structural measures will pay off in terms of higher tax revenues and lower spending on public sector wages, especially teacher salaries.

The coordinated financial and technical support of Honduras' development partners will be important to ensure the success of these reforms. The proposed operation is being prepared in close coordination with the Inter-American Development Bank (IDB), the European Union (EU), the Central American Bank for Economic Integration (BCIE) and the International Monetary Fund (IMF). Technical assistance from the Bank and the IDB has helped in the formulation of the reforms and will support the implementation of the measures. In addition to the proposed DPC, budget support will be provided by the IDB, the EU, and the BCIE. Finally, the IMF is expected to begin negotiations for a new Stand-By Agreement (SBA) in early August.

The Government's fiscal reforms are complemented by the introduction of targeted social programs to mitigate the impact of the economic crisis and the fiscal austerity measures on the poor. The Government is preparing a new Conditional Cash Transfer Program (*Bono 10,000*) with the aim of encouraging families to increase investments in education and child health and nutrition. The Program is expected to cover about 600,000 families living in extreme poverty and provide more adequate benefits (US$44 per month per family) conditional on their making efforts to improve children's school attendance and the family's use of preventive health services. The Bank is supporting the *Bono 10,000* through the recently approved Social Protection Project.

2. Proposed objective(s)

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

3. Preliminary description

The operation would support the Government's efforts to stabilize the economy and reestablish the groundwork for growth. In particular, it seeks to support the Government's program to tackle its difficult fiscal situation, which resulted from the combined political and economic crisis of 2009. Four complementary areas are supported: (i) tax reform; (ii) civil service reform; (iii) reform of public service tariffs; and (iv) resolution of public sector arrears.

4. Environment Aspects

While the electricity tariff reforms may have a beneficial impact, the overall reform program supported by the proposed operation is not expected to produce significant impacts on the environment, forests or other natural resources. Electricity tariffs in Honduras are below the cost recovery level and do not reflect the economic costs of supply. The low electricity prices seem to have induced higher electricity consumption per household compared to other countries in the region. A reduction in subsidies would translate into reduced electricity consumption and reduced green-house gas emissions, considering more than 60 per cent of total generation in Honduras is based on hydrocarbons.

5. Tentative financing

Source:	($m.)
BORROWER/RECIPIENT	0
International Development Association (IDA)	80
Total	80

6. Contact point

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