

INTERNATIONAL MONETARY FUND AND
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

HONDURAS

**Poverty Reduction Strategy Paper
Joint Staff Assessment**

Prepared by the Staffs of the International Monetary Fund
and International Development Association

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I. OVERVIEW

1. The Poverty Reduction Strategy Paper (PRSP) prepared by the Honduran authorities builds on past efforts at poverty reduction, including the Master Plan for Reconstruction and Transformation (MPRT), which presented the government's strategy to rebuild the country after Hurricane Mitch, and the Interim PRSP (I-PRSP), which was presented to the Boards of the Fund and IDA in June and July 2000, respectively.
2. **The preparation of the PRSP represents an important effort by the government to define, with broad participation of civil society and other stakeholders, the causes of poverty and a strategy to reduce it.** The main strengths of the PRSP include: (i) a broad participatory process; (ii) a comprehensive diagnosis of poverty, which explores poverty in its many dimensions and the impact of past policies; (iii) a clear commitment to a sound macroeconomic framework and the implementation of structural reforms; (iv) the identification of medium- and longer-term outcomes in line with the International Development Goals (IDGs); and (v) proposed mechanisms and institutional structures to monitor progress toward those targets. The PRSP also presents a costing exercise of the strategy, an analysis of the financing possibilities, and a discussion of the risks of the strategy.
3. **In the staffs' view, the PRSP presents an appropriate strategy to reduce poverty in Honduras, but additional areas will need to be addressed or strengthened during implementation and in subsequent updates of the strategy.** It will be especially important to: (i) continue efforts to strengthen participatory mechanisms and ownership, focusing on implementation and monitoring of the strategy; (ii) develop alternative financing scenarios and clearer priorities that would be pursued in the event that external financing projections do not materialize; (iii) strengthen the proposed set of indicators by adding regional indicators and better defining intermediate and input indicators; and (iv) fully implement the agreed action plan to upgrade poverty-reducing

expenditure-tracking capabilities. It is also the staffs' view that subsequent updates of the strategy could further emphasize the need for improvements in the efficiency and targeting of the resources devoted to social expenses by the public sector. In this regard, improving the quality and coverage of public services for the poor will likely depend less on reallocations and more on improving the quality and efficiency of the entire systems of education, health, water, and sanitation, etc.

II. THE PARTICIPATORY PROCESS

4. **The government has made a considerable effort and substantial progress in developing a participatory process to guide preparation of the PRSP.** The PRSP adequately describes the broad consultative process that took place, including the modalities and operative aspects of the consultations and the results achieved. A more detailed description can be found in the document "Evidence on the PRSP Participatory Process" prepared by the government in parallel to the PRSP. That document, other relevant material and the PRSP, are posted in the Ministry of the Presidency web site: <http://www.sdp.gob.hn/>.

5. **The government followed a three-pronged approach for the PRSP consultations.** First, it hosted 19 regional consultations aimed at reaching the general population and local civil society organizations all over the country. Second, it has maintained an open line of dialogue with organizations and NGOs operating at the national level. Third, it held meetings and solicited views from congress and the presidential candidates running in the November 2001 elections. The involvement of civil society is expected to continue in the monitoring and implementation phases of the strategy, as discussed in the document. Also, without crowding out participation by domestic stakeholders, external development partners were also included in the consultations through various forums.

6. **The regional consultations were broadly based.** They benefited from broad participation by various sectors of civil society, including local NGOs, religious groups, cooperatives, campesino movements, indigenous groups, trade unions, and local politicians. These consultations had the purpose of better understanding and integrating into the strategy the priorities and demands of the general population and the poor. Issues raised included the high priority placed on improving education, rural development and access to land, anti-corruption mechanisms, and decentralization. There was also a high level of skepticism from the population in some regions regarding the PRSP process.

7. **The consultation process built on structures established following Hurricane Mitch.** The national consultations took place through the Participatory Citizens Commission which includes the following organizations: FONAC (the National Convergence Forum), Interforos (an NGO network), AMHON (the Honduran Association of Municipalities), FOPRIDEH (the Honduran Federation of Private Development Organizations), and the Chamber of Commerce of Tegucigalpa. The meetings with the Participatory Citizens Commission were based on a continuous and stable exchange of views, including technical aspects of the PRSP. Issues discussed and analyzed included a decentralization agenda, electoral, and judicial reform, moderniza-

tion of the labor law, and the need to create incentives for domestic and foreign investment. The authorities have appropriately sought the views of representatives from political parties as a way of ensuring continuity of the strategy onto the next administration. While their involvement has been low given that at that time the presidential campaigns had not begun in earnest, the main political forces endorsed the broad thrust of the strategy and the process that has been followed.

8. **The dialogue and consultation process have been intensive, although the results have been mixed.** Some groups, while endorsing the process, have criticized elements of the PRSP. In particular, they criticized some structural measures (for example, privatization) and raised concerns over the macroeconomic framework which they equate negatively to structural adjustment. Nevertheless, the importance of maintaining low inflation, improving opportunities for exports, and improving the availability of credit through lower interest rates were concerns raised during several participatory forums. Other more vocal groups within Interforos have assessed the PRSP process more negatively and rejected the final PRSP as a document which does not represent a national consensus. According to Interforos, their position was partly motivated by the limited and biased discussion on the macroeconomic framework and more generally by the omission of many of its policy proposals. Most observers, however, agree that the government has made a good faith effort to follow a participatory approach to prepare the strategy, and has laid a solid foundation from which to continue strengthening the participatory process during implementation and monitoring of the strategy through the creation of the Consultative Council for Poverty Reduction..

9. **The PRSP has also benefited from parallel participatory processes taking place in the country.** These include the dialogue promoted by FONAC to reach a national consensus on reform of the education sector, and the National Anti-Corruption Commission, which under its broad-based and independent leadership, is working on the preparation of a participatory anti-corruption strategy. In this regard, the policies in the PRSP are fully consistent with those emerging from other participatory initiatives.

III. POVERTY DIAGNOSIS

10. **The PRSP provides a comprehensive poverty profile and a good analysis of poverty determinants based on available information.** The UNDP and the World Bank have supported the process with poverty assessments and the World Bank has also completed a Public Expenditure Review with the aim of supporting government efforts toward aligning the objectives implicit in the budget and those in the poverty strategy. The poverty profile draws on the Permanent Multi-Purpose Household Survey (EHPM)—a semiannual survey available since the late 1980s—for the analysis of the income dimension of poverty. The profile also includes other dimensions, such as unmet basic needs, UNDP's human development index (HDI), and child malnutrition. The analysis of poverty based on income is more extensive given the existence of time series to observe the evolution of poverty over the 1990s (which are not available for the other poverty definitions).

11. **The PRSP presents a good analysis of urban/rural poverty disparities, and a social and demographic profile of poverty.** Rural/urban poverty is presented according to the income methodology, and regional disparities (at a departmental level) are presented according to the basic needs methodology and the HDI. The PRSP explores the social profile of poverty with special emphasis on ethnic groups, women, disabled people, children, and senior citizens. It also analyzes the impact of Hurricane Mitch on poverty. The social profile analysis highlights the need to improve poverty statistics, especially in areas where there is currently almost no information. For example, although there are indications suggesting a very high incidence of poverty and of serious diseases (e.g., AIDS) among indigenous people, there is no disaggregated data to distinguish between the indigenous and nonindigenous population in a poverty analysis. Likewise, the analysis of the situation of disabled people is limited to an estimate of the number of people suffering from any incapacity.

12. **The PRSP presents a comprehensive analysis of the income and nonincome determinants of poverty.** In the staffs' view, it provides a good analysis of the important role played by economic growth, but it also covers important dimensions such as the labor market (including female labor force participation and child labor), stabilization and adjustment, distributional issues, human capital, population and environment, and governance and democratic participation. It relies on an appropriate mix of quantitative and qualitative information to explore the determinants of poverty, while recognizing that other links can also be established.

13. **The PRSP presents a sound analysis of the relationship between economic growth, savings and investment, and labor productivity and competitiveness.** In the staffs' view, the document appropriately identifies the elements which adversely affect investment, including the legal and administrative framework, the lack of a unified land registry to ensure property rights, the undeveloped financial sector, and the need to modernize labor regulations. On the efficiency of labor, the PRSP appropriately highlights the importance of improving labor productivity, which is one of the lowest in Latin America, and identifies education deficiencies as the main factor behind the lower labor productivity. It also candidly discusses constraints in the labor market and inconsistent and obsolete public and private sector wage policies.

14. **The strategy makes a good effort to evaluate the impact of stabilization and adjustment programs implemented during the 1990s.** It evaluates the effects of structural policies such as financial sector reform, liberalization of prices, and trade and exchange rate liberalization on poverty during the 1990s. The PRSP concludes that only trade liberalization had an unambiguously positive effect on poverty reduction, and the impact of other policies were mixed or have yet to take full effect. The PRSP, however, could have drawn a stronger link between past structural reforms and GDP growth performance, a link that would be important given the ambitious increase in economic growth targeted in the strategy. It argues that Honduras was set on a higher growth path since 1997 as a result of these structural policies, but the continuation of that higher growth path was interrupted by Hurricane Mitch and its devastating effects on the economy. The staffs agree that the structural reforms have helped raise Honduras' potential growth in the late 1990s. Nonetheless, the pace of structural reform would need

to accelerate considerably from its level in the last two years so as to maintain the projected target in the future.

15. **The PRSP includes a solid analysis of the impact of inequality on poverty and the factors that contribute to inequality, but it does not analyze inequality trends during the past decade.** The strategy acknowledges that Honduras' low growth-poverty elasticity is in large measure due to its high income inequality. It also recognizes that inequality is highly related to the limited access to land, credit, secondary education, and training.

16. **The analysis of health, education, and safety net programs and their impact on poverty is appropriate.** However, the impact on poverty and inequality of the social security network (FHIS and PRAF), and of the main programs of subsidies (electricity and transport) could have been further explored. According to the World Bank Poverty Diagnostic 2000 (Report No. 20531-HO), PRAF transfers are the policy instrument with the largest positive impact on inequality, but the electricity subsidy (which has recently been somewhat better targeted) has a negative impact on inequality, suggesting that a reallocation of resources might be appropriate.

17. **The importance given to governance and participation as key for poverty reduction is welcome.** Three issues are identified as important for poverty reduction: (i) transparent public management; (ii) the need for a new government culture; and (iii) modernization of the state and decentralization. The staffs agree with these priorities but also suggest that the decentralization strategy will need to be further developed, including the system of fiscal transfers and the definition of municipal responsibilities.

18. **On the vulnerability side, the PRSP explores the importance of the environment and disaster mitigation for poverty.** The strategy points to Honduras' high population growth rate and the links with rural and urban environmental problems. It also recognizes the urgency of addressing deforestation and the need to encourage sustainable development in the forestry sector.

IV. THE POVERTY REDUCTION STRATEGY

19. **In the staffs' view, the PRSP presents a coherent and credible strategy to reduce poverty in Honduras.** The strategy is consistent with the poverty diagnosis. It presents 11 specific targets to be reached by 2015 through the implementation of policies, programs and projects derived from five broad strategic guidelines (*lineamientos estratégicos*) which serve as a set of principles to define priorities. These strategic guidelines were used as a basis to structure the discussions with civil society, and to agree on the priority policies, programs and projects to be included in the strategy. The resulting policies, programs and projects, which constitute the essence of the strategy, are structured around six programmatic areas: (i) accelerating economic growth; (ii) reducing poverty in rural areas; (iii) reducing urban poverty; (iv) investing in human capital; (v) strengthening social protection for specific groups; and (vi) ensuring the sustainability of the strategy.

20. **The PRSP appropriately stresses the need to accelerate equitable and sustainable economic growth.** Linked to the need for more equitable growth, it places emphasis on the need to improve access to land in rural areas, microenterprise promotion in urban areas, and human capital investment. The strategy stresses the importance of empowerment by: (i) strengthening the participation of civil society in decision making; (ii) improving access to the judiciary and the application of the rule of law; (iii) removing social barriers that result from distinctions of gender and ethnicity; and (iv) pursuing an effective decentralization of functions from the central government to the municipalities. The staffs' view as appropriate the strong emphasis in the PRSP on ensuring the sustainability of the strategy, through improvements in environmental and risk management, as well as transparency and state modernization issues. In addition to the work of the National Anti-Corruption Commission, the PRSP discusses the need to strengthen existing control structures, such as the Comptroller General's Office, and accelerate the modernization process to enhance the transparency and accountability of public administration.

21. **In the staffs' view the identified policies, programs and projects included in the PRSP are appropriate, and the government has developed adequate criteria to prioritize programs and projects, but greater prioritization of policy measures will need to be developed.** The government has developed appropriate eligibility criteria, derived from the strategy's five strategic guidelines, to prioritize programs and projects in line with available financing. The criteria include a focus on benefiting women, environment, participatory mechanisms, and targeting on the neediest regions and groups. The PRSP also describes in great detail the policy measures and responsible agencies within each programmatic area (Annex A), and presents a welcome, detailed and time-bound set of legal and institutional measures to be implemented (Annex A.1). However, in the staffs' view further work will be required to establish priorities among the long list of proposed policy measures. Early attention to (i) civil service reform; (ii) a new education framework law; (iii) the implementation of a basic package of primary health; and (iv) the completion and implementation of an anticorruption plan will be especially important for accelerating growth and reducing poverty. A clear sense of priorities will be important to monitor implementation of the strategy and to make corrections during implementation.

Targets and indicators

22. **In the staffs' view, the PRSP targets are ambitious but attainable.** The targets are established for the short and medium term (annual targets from 2001 to 2005) and for the long term (2015). They include a reduction in the incidence of poverty from 66 percent to 42 percent, and a reduction by half in the incidence of extreme poverty from 49 percent to 25 percent in 15 years. The targets are based on an analysis of historical trends and cross country comparisons that goes well beyond what could be expected in this type of document. Most of the targets have been set using as a baseline a dynamic model that relates social indicators with growth and urbanization rates. The baseline has then been adjusted to take the PRSP implementation into account.

23. **The projected GDP growth rate (averaging over 5 percent per year during 2001–15), however, is ambitious and well above historical growth rates.** The PRSP explains that a less ambitious GDP growth rate (below 4 ½ percent) would not allow the increases in per capita GDP necessary for substantial and effective poverty reduction. According to World Bank staff calculations a 1 percent reduction in the average growth target, assuming no change in income distribution, would lead to a 5 percentage point increase in the projected 2015 poverty rate. This would imply that if actual GDP growth remains at the average of the 1990s and the poverty impact of growth remains unchanged, the target for poverty reduction would have to be cut in half. This indicates the importance of sustained commitment to a prudent macroeconomic framework and the implementation of structural and institutional reforms required for accelerating growth and also of measures to improve the extent to which the poor participate in growth. Although the PRSP does consider the possibility of lower growth as an important risk to the strategy, the staffs recommend that further analytical work be carried out on a sensitivity analysis of the impact of lower than projected growth on the different targets to better understand these risks and monitor implementation.

24. **The staffs recommend that during implementation the strategy add indicators to track disparities by social group, geographic region, and income inequality trends.** Given the current lack of poverty data according to social group, the lack of quantitative targets in these areas is understandable. However, the PRSP will need to make an effort to include geographic indicators, at least for urban and rural areas, particularly since the strategy allocates 21 percent of resources to programs aimed at reducing poverty in rural areas and 17 percent for urban poverty reduction. Similarly, given the importance of income inequality as a poverty determinant, it would be useful to include indicators to monitor inequality levels. In this regard, a social impact analysis of key structural reforms could help to better understand the short-term impacts on the poor.

25. **Additional work will be required to develop indicators to monitor the strategy's intermediate objectives.** Although the strategy clearly identifies key legal and institutional measures, an additional effort will be required to identify intermediate or input indicators. For example, while the PRSP targets an increase in net primary enrollments, and identifies the expansion of schools under the community participation model (PROHECO) and education stipends for poor students, it does not link the number of PROHECO schools or the number of stipends to the enrolment target. It is the staffs' view that the PRSP should be further refined to develop a set of intermediate indicators consistent with the overall outcome targets. It is expected that the Consultative Council that will be created to monitor implementation of the PRSP and the Technical Support Unit (UNAT) will play a leading role in this respect.

Macroeconomic framework

26. **The PRSP considers sound macroeconomic policies and structural reforms as important means of achieving sustainable GDP growth, which in turn is key for poverty reduction.** The macroeconomic framework presented contains all the necessary elements and is fully consistent with the framework agreed with the IMF on the

PRGF for 2001–03, but is outlined in very general terms. The authorities intend to publish the memorandum of economic policies for the remainder of 2001 and 2002, which explains clearly the priorities for macroeconomic policies and structural reform. The PRSP emphasizes structural measures to strengthen private investment and improve its quality, modernize legal and institutional aspects of the labor market, improve export access to international markets, and create incentives for the development of sectors with the highest growth potential (agroindustry, forestry and tourism). The importance of privatization and greater participation of the private sector in the provision of public services is also highlighted as important for growth. The staffs would have preferred greater consideration to pension reform and measures to improve the financial sector soundness (such as bringing prudential supervision gradually in line with Basel Core Principles). Reforms in these areas are crucial for increasing the supply of long-term credit so badly needed in Honduras.

Public expenditure program and financing

27. **In the staffs' view the shortfall in available financing for the PRSP's priority programmatic areas is manageable and could be closed through a combination of domestic and external sources, provided the authorities implement sound economic policies.** The PRSP presents cost estimates for each of the six programmatic areas in the strategy. The overall composition and cost allocations are consistent with the strategic priorities identified in the PRSP, including 40 percent for investment in human capital and 21 percent to reduce poverty in rural areas. The PRSP estimates total costs of programmatic areas of US\$1.7 billion for 2001–05, of which US\$710 million would come from projects and programs under execution and US\$690 million from debt relief, leaving a financing gap of US\$320 million over the period. The PRSP estimates that 85 percent of the financing gap could be met from external sources (about US\$54 million annually on average, or 0.8 percent of GDP) and the remainder from domestic sources. This gap is of the same order as the one estimated in the PRGF medium-term macroeconomic framework, which has incorporated the cost of the strategy. In the event of external financing shortfalls, an additional source could be privatization proceeds—currently not included in the projections—which would be used to fund poverty programs as stipulated in the Poverty Fund Law currently in congress. The PRSP also indicates that the gap could be closed through possible expenditure reallocations and a stronger domestic revenue effort.

28. **The authorities have made a good effort to identify the strategy's costs.** The costing estimates, however, are broad and general, reflecting the methodological difficulties of quantifying the unit costs of attaining the strategy's targets. In the staffs' view the costing estimates will need to be kept under periodic review during implementation of the strategy, as more experience is gained in quantifying the link between actual expenditures and poverty outcomes.

Monitoring of the strategy

29. **In the staffs' view the institutional framework proposed for monitoring and evaluating the strategy is adequate.** The Social Cabinet¹ will be responsible for the implementation of the strategy and will receive advice from a Consultative Council for Poverty Reduction which will be integrated by three government representatives, three elected members of civil society, and one representative of the municipalities. Two representatives of the donor community will be invited as observers.

30. **The monitoring of the PRSP will greatly benefit from the recent creation of a new National Institute of Statistics (INE).** INE will coordinate a nationwide data collection system and maintain the EHPM surveys. This will make it possible to have a continuous and consistent data base to track poverty trends. In parallel, INE has announced a national agricultural survey, which will provide much needed information on issues such as land tenure and use, cropping patterns, the commercial viability of agricultural products, and the use of agricultural technology. In the near future, INE will also begin collecting data to analyze the business sector. It will be important for the authorities to step up their support to strengthen INE, financially and institutionally, given the importance of good statistics in the evaluation of the PRSP.

31. **Financial monitoring and control mechanisms in the PRSP need to be strengthened.** Honduras has made significant progress in improving the quality of expenditure data, and the budget process and presentation, but as noted in the World Bank's recent Public Expenditure Review (PER) there are considerable shortcomings that need to be addressed. In February 2001, a joint Fund-Bank mission agreed with the government on an action plan to upgrade poverty-reducing expenditure tracking capabilities. The mission noted the strong effort made in the past three years to improve budget management, and with the exception of the functional classification of central government expenditures, changes were underway in all areas needing improvement, in many cases with the technical assistance of the World Bank and Fund. An action plan was agreed for implementation over the coming three years and covers four main areas: (i) medium-term capacity planning; (ii) budget classification and comprehensiveness; (iii) internal and external control system mechanisms; and (iv) budget reconciliation and reporting. In addition, recognizing that the PRSP does not yet include a comprehensive medium-term expenditure program and as recommended in the PER, the World Bank will be providing technical support to the authorities through the ongoing Economic and Financial Management operation to prepare a medium-term expenditure framework (MTEF). The MTEF would enable the government to analyze trade-offs between alternative financing scenarios and evaluate priorities in the event that programs and projects have to be adjusted. It is the staffs' view that the first annual progress report of the PRSP should review the progress on the key elements of the action plan to upgrade poverty-reducing expenditure tracking capabilities.

¹ The Social Cabinet, headed by the Minister of the Presidency, consists of the Ministers of Education, Health, Labor, Agriculture, Culture, FHIS, and International Cooperation. The Minister of Finance and the President of the Central Bank, although not formally members of the Social Cabinet, also participate in the meetings.

32. **The PRSP proposes the creation of a virtual Poverty Fund (PF) to track HIPC debt relief channeled to programs identified in the PRSP.** In designing the PF, the authorities reviewed international best practices, in close consultation with the IDB. The PF will be included in the central government budget and administered by a council chaired by the Ministry of Finance (the Social Cabinet will make the allocation decisions). The main aspects of the PF are already functioning, including a line item for HIPC funds in the 2001 budget. In the staffs' view the design of the PF is adequate to ensure an appropriate identification and monitoring of HIPC-financed programs. Operation of the PF should not, however, distract from the efforts to improve public expenditure management systems as a whole.

Risks to the strategy

33. **The PRSP discusses in detail six main factors which could threaten the sustainability of the strategy and the achievement of its objectives.** These are: (i) the possibility that the national consensus could break down, in particular considering the fact that several political administrations will be implementing the strategy; (ii) limited implementation capacity; (iii) fiscal pressures, particularly in election years, which could be the result of demands for public sector wage increases, rescheduling of tax payments, and subsidy schemes to support various groups; (iv) inadequate external support, in particular because implementation of the strategy will rely to a large extent on external sources for its financing; (v) the possibility of a worse-than-expected external economic environment; and (vi) natural disasters. **The staffs agree that these are the main risks of the strategy and would stress the importance of those related to fiscal sustainability and the adequacy of external financing.**

V. CONCLUSION

34. Honduras' PRSP represents an important step in the fight against poverty and provides a good framework for poverty reduction. This framework is based on a sound poverty diagnosis, an extensive consultation process, and proposes a comprehensive and longer-term strategy to reduce poverty. It also defines medium- and long-term goals for poverty reduction outcomes, and proposes adequate monitoring and evaluation systems. While the strategy is very ambitious and there are financing gaps to be filled, the preparation of the PRSP itself has played a catalytic role in stimulating an unprecedented level of civil society participation in national affairs, and in improving donor coordination.

35. The PRSP process represents an opportunity for Honduras that goes well beyond the current document. Despite the skepticism of some civil society groups with respect to the PRSP process, and the need to further refine some consultation mechanisms, civil society participation has reached levels never seen before in Honduras. Poverty, in all its dimensions, is an issue now widely discussed in the media and other public forums. Comprehensive monitoring and evaluation mechanisms for public projects have been designed in parallel to the preparation of the PRSP and are now in the process of being implemented to follow up the overall public investment program. On the donor side, the sector coordination groups, initially established to follow up the MPRT, have

evolved into a key donor instrument to support implementation of the PRSP, and would provide the natural base on which to align donor support for the strategy's priorities and goals.

36. The staffs of the World Bank and IMF consider that the PRSP presents a credible poverty reduction strategy and provides a sound basis for Bank and Fund concessional assistance. The staffs recommend that the respective Executive Directors of the World Bank and the IMF reach the same conclusion.