

GOVERNMENT OF THE REPUBLIC OF HONDURAS

**INTERIM POVERTY
REDUCTION STRATEGY PAPER**

TEGUCIGALPA HONDURAS

I. INTRODUCTION

Given the extent and severity of poverty in Honduras, it is clear that the country needs to take a long-term approach to reducing its incidence to moderate levels. To that end, the current administration is reaffirming its commitment to developing and executing a Poverty Reduction Strategy (PRS). This process is considered closely related to ongoing efforts aimed at moving from the eligibility for the Heavily Indebted Poor Countries (HIPC) Initiative to the decision and completion points, and to the policy framework resulting from the Poverty Reduction and Growth Facility (PRGF) agreement with the International Monetary Fund.

In this regard, the Government of Honduras, with the support of the different representatives of civil society, has established a time horizon through March 2001 for the PRSP. Moreover, at the end of the constitutional term, the current Administration expects to have significantly contributed to establish the framework to guarantee, together the Honduran civil society, the implementation of the different measures, programs and projects included in the Strategy.

The poverty indicators presented in this paper are based on the premise that poverty is a multidimensional concept. To address that multidimensionality, the diagnostic presents poverty indicators based on different methodologies, and examines the relationships between those measures and a number of variables. First, this section looks at the insufficiency of income vis-à-vis a particular standard of living as the most usual way of depicting and measuring poverty. It also looks at other poverty indicators, such as: Unsatisfied Basic Needs (UBN) or those derived from Integrated Method (IM) analysis. In addition, this section analyzes indirect ways of estimating poverty, such as the nutritional status of the school population and the Human Development Index.

The poverty analysis uses the poverty indicators to show how poverty is spatially distributed and how it affects the various especially vulnerable segments of the population. The section also examines other factors that are closely associated with poverty, such as the labor market, the environment, and democratic participation. Based on the household survey conducted in March 2000, an attempt is made to estimate the impact on poverty of the destruction wrought by Hurricane Mitch.

Labor market conditions for the economically active population have, via wages, a direct impact on current poverty indicators. This is a consequence of low productivity, which in turn results from the quality of jobs and human resources. There is also a close link between poverty and ecological degradation. Thus, the degraded coniferous forest areas in the southern and western parts of Honduras are also the country's poorest regions, where the rural population resorts to nonsustainable practices, which in turn lead to further deterioration of their natural means of subsistence. Finally, the link between poverty and democratic participation addresses the need to broaden the range of appropriate mechanisms through which the poor can press their claims to basic human rights, including access to production factors, while at the same time becoming increasingly aware of their own responsibility to discuss and solve their problems.

On the basis of the previous findings, Chapter II, Section F explores the fundamental determinants of poverty. The first conclusion to emerge from the systematic analysis of

economic growth and income distribution is that, although the degrees of concentration of income in Honduras are similar to those in most Latin American countries, the most relevant factor in determining poverty is insufficient per capita income owing to the low rate of economic growth. The analysis also reveals that the determinants of that low economic growth rate are low productivity of labor and of investment, and the rate of growth of the population.

Chapter III reviews public spending on the social sector and its links with the development of human capital and access to basic social services. It shows the extent of government efforts in the health and education sectors, as well as in the more specifically targeted Honduran Social Investment Fund (FHIS), and Family Allowance Program (PRAF). The chapter also examines investments in social security, water and sanitation, housing, and rural development. Finally, the chapter points to existing inefficiencies in such basic sectors as health and education.

Chapter IV deals with poverty and its links with economic growth and macroeconomic and structural factors. As in the previous chapter, it reviews efforts over the past decade to achieve macroeconomic stability, sector reform, and modernization of the State. It also contains a brief survey of various factors related to investment, productivity, and competitiveness in the Honduran economy.

Chapter V focuses on the fundamental aspects of the Strategy, which comprises: an overall view, targets to be met by 2015, and the feasibility of meeting them (indications only). The chapter also looks at a series of strategic guidelines dealing with such topics as: the balance between the alleviation and reduction of poverty; targeted and universal access to subsidies and basic services; the role of accelerated and sustained economic growth; the importance of rural development; the role of municipalities, communities, representative social bodies, nongovernmental organizations, and the business sector; the need to focus on vulnerable groups in terms of gender, age, and ethnicity; and the sustainability, transparency, and monitoring of the strategy.

This same chapter discusses: the general objectives of each area of the strategy; measures and goals; programs and the financing required, by type of source; and the institutional framework. Several of these aspects merit further study and others remain to be developed for inclusion in later versions, especially aspects related to goals, programs, financing, the Special Fund for Poverty Reduction, and mechanisms for monitoring, follow-up, and evaluation.

Finally, there is a set of annexes containing a matrix of measures and goals for each area and sector, and a description of the democratic participation process. At a later date, this section might also include program and project profiles; an agenda for sustainable rural development; and an outline of the institutional framework.

II. DIAGNOSTIC ASSESSMENT

A. POVERTY: A MULTIDIMENSIONAL SOCIAL CONDITION

Poverty is a social condition that takes many forms and has multiple causes. The most usual and simplest way of depicting it is as the lack of income to reach a minimum standard of living. However, poverty goes beyond this economic dimension, and some analysts prefer to broaden the list of conditions in order to reflect the failure to satisfy a set of basic human needs, or the dearth of social opportunities open to groups suffering such conditions.

The study of poverty has made considerable progress in recent decades, and we now have internationally standardized working definitions and measurement tools. These tools allow to trace historical trends and compare countries and subsegments of the population in any country. This chapter presents a diagnostic assessment of poverty in Honduras.

Since 1988 the government of Honduras has applied the methodology recommended by international organizations linked to the United Nations. That methodology measures poverty by using three complementary methods known as the Poverty Line (PL), Unsatisfied Basic Needs (UBN), and Integrated (IM) methods. Nevertheless, other approaches have frequently been used to estimate poverty, depending on the preferences of particular international agencies, nongovernmental organizations, and scholars. All in all and even though each of these procedures produces different figures, the important thing is that all have converged on the same conclusions, namely that the level of poverty in Honduras is high and, moreover, that it has proved to be highly resistant to a variety of strategies aimed at reducing it.

This chapter highlights the trends of the past 15 years, according to various approaches and measurement methods. It also contains a detailed description of a set of characteristics associated with the poverty of individuals, households, and social groups. Finally, it presents an interpretation of the most important factors underlying the persistence of the phenomenon.

1. POVERTY IN HONDURAS: MAGNITUDE AND TRENDS

a) Poverty as measured by income: Poverty lines

This method is based on the identification of an adequate or basic basket of goods that would satisfy basic needs in food, clothing, and housing, and the required income to acquire the basket. That level of income is known as the “poverty line” in the sense of an imaginary frontier between the poor and the economically better-off.

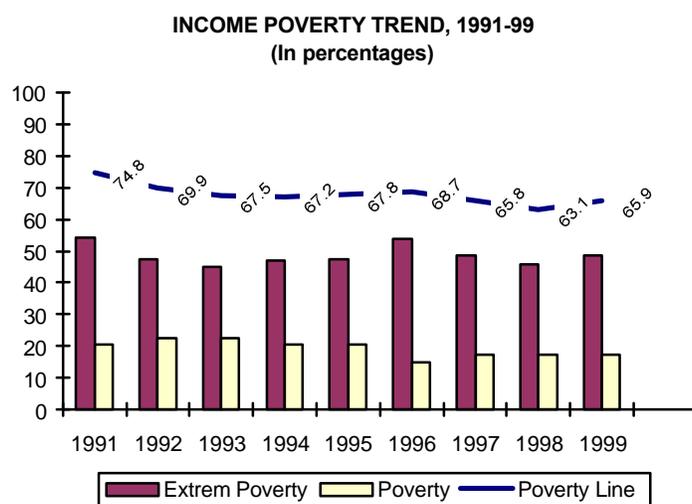
Obviously, not all individuals and groups below the poverty line have the same level of income, so that further subdivisions can be made. This method employs one subdivision, based on an “extreme poverty line.” Below it are all those who cannot even meet minimum nutrition needs.¹

¹ For further details, see SECPLAN, *Honduras, Libro Q: Pobreza, potencialidad y focalización municipal* [Honduras Book Q: Poverty, potential, and municipal targeting], second revised edition (Tegucigalpa, 1994).

HOUSEHOLDS IN HONDURAS BY POVERTY LEVEL									
	1991	1992	1993	1994	1995	1996	1997	1998	1999
Extremely poor	54.2	47.4	45.1	47.0	47.4	53.7	48.4	45.6	48.6
Poor	20.6	22.5	22.4	20.2	20.4	15.0	17.4	17.5	17.3
Below the poverty line	74.8	69.9	67.5	67.2	67.8	68.7	65.8	63.1	65.9
Nonpoor	25.2	30.1	32.5	32.8	32.2	31.3	34.2	36.9	34.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: This table is based strictly on the SECPLAN methodology described in the so-called Libro Q of 1994 and later revised in La pobreza en Honduras: Conceptualización, enfoque metodológico, causalidad y características, sugerencias de políticas [Poverty in Honduras: Concepts, methodological approach, causality and characteristics, policy suggestions] (1995). The figures are still subject to revision. Nationwide, the average number of persons per household is 5.2. Sources: SECPLAN (1991-94); PRODEPAH, for internal use (1995-99). Based on the household surveys conducted in March of each year, except in 1994, when only one survey was conducted in October (further details are to be found in Annex D).

Although the figures in the previous table and in the chart should be viewed with some caution given that they are still subject to revision, they reveal important trends with respect to poverty in Honduras. According to the table, 66 percent (approximately 747,000) of households in the country were living below the poverty line in 1999.² If these figures were to hold, they would indicate a slight improvement (9 percentage points) over the decade, from the 1991 level when the percentage of households below the poverty line was 75 percent. An element of concern about these figures is the high level of extreme poverty, affecting almost 49 percent of households in 1999. For this sub-group of the population, the trend for the 1990s would also appear to have been a moderate decline, since the figure for 1991 was 54 percent.



The same table also shows that the percentage of poor households tended to decline significantly in the first three years of the past decade, but that the pace of change was more moderate thereafter. Spending on the social sector has also increased markedly since 1993, but does not appear to have had an immediate impact on the level of poverty. The decline may be explained, first, by the growth in GDP, which, after stagnating for a decade, grew 3.8 percent in the first four years of the decade (5.03 percent if 1990 is excluded). Since income growth outpaced the growth rate of the population (3 percent), per capita income rose.

² According to the March 1999 survey, the average number of persons per household was 5.2, compared with 5.4 in the May 1991 survey.

It is nonetheless striking that during those years a policy of increasing farm prices was implemented. The impact of this policy is not clear as the level of rural poverty fell 2.5 percent (from 79.6 percent in 1991 to 77.1 percent in 1993) whereas urban poverty declined sharply, by almost 13 percentage points (from 68.4 percent to 55.5 percent in the same period). The slower pace of the decline in the level of poverty over the rest of the decade may be explained by the inflationary problems which arose in 1994, accompanied by the drop in export prices, insufficient electricity generation, and a decline in public and private investment. GDP growth declined that year to -1.3 percent. From 1995 to 1997, GDP once again grew faster than the population (3 percent).

Problems of that kind have a direct incidence on the level of poverty as measured by the PL Method, given the sensitivity of income to macroeconomic imbalances. Furthermore, without going into detail with respect to the efficiency and effectiveness of social expenditure, it can be argued that the effect of an increase in such spending is best seen in the tangible public works resulting from many of the investments made, including, for instance, the Honduran Social Investment Fund (FHIS). That kind of impact on the level of poverty is best perceived with the help of the Unsatisfied Basic Needs Method indicators.

b) Poverty as measured by the Unsatisfied Basic Needs Method (UBN)

The Unsatisfied Basic Needs Method measures poverty on the basis of an identified set of material subsistence needs that are considered fundamental or minimum for any human being. Thus a household is classified as poor if at least one of these needs is not met, while the degree of poverty is determined by the number of basic needs that are not met. The needs considered basic in the case of Honduras are:³

Water

- Access to safe water in or on the property (urban dwellings);
- Access to piped or well water (rural dwellings)

Sanitation

- Access to a sanitary facility, which is not just a latrine (urban dwelling)
- Having at least a latrine (rural dwelling)

Primary education

- Children of primary school age enrolled in school (urban and rural households)

OVERALL INCIDENCE OF UBN					
Total	% of households			Change %	
	1990	1993	1997	93/90	97/93
<i>National</i>					
<i>With SBN¹</i>	33	47	53	42	13
<i>1 UBN</i>	25	28	26	12	-9
<i>2 UBN</i>	20	15	13	-25	-9
<i>> 2 UBN</i>	22	10	8	-55	-20
<i>Urban/1</i>					
<i>With SBN</i>	50	57	65	14	14
<i>1 UBN</i>	24	23	22	-4	-4
<i>2 UBN</i>	13	11	8	-15	-27
<i>> 2UBN</i>	13	9	5	-31	-44
<i>Rural/1</i>					
<i>With SBN</i>	20	38	42	90	11
<i>1 UBN</i>	26	32	29	23	-9
<i>2 UBN</i>	26	19	18	-27	-5
<i>> 2 UBN</i>	28	11	11	-61	0

¹SBN = Satisfied basic needs
Source: Database, EPHPM, DGEC.

³ In Honduras all the suggested needs are taken into account, except household access to electricity. The number of needs included in each country's list ultimately determines the number of poor households identified.

Subsistence capacity

- Head of household has had more than three years of primary education and is employed; and, if not, at least one employed person for every three members of the household (urban and rural households)

Crowding

- No more than three persons per room, excluding bathrooms (urban and rural households)

State of the dwelling

- The dwelling should not be makeshift or built of waste material. Nor should it have an earthen floor (urban dwelling)
- The dwelling should not be makeshift or built of waste material (rural dwelling).

The data used to compute these estimates come from demographic and housing censuses or household surveys, or both.⁴

According to the UBN methodology, there was a marked decline in the proportion of Honduran households with UBNs during the 1990s. At the beginning of that decade, scarcely 33 percent of all households in the country met all their basic needs (SBN). However, the urban sector fared better, since half of all urban households appeared to satisfy their basic needs, whereas only 20 percent of rural households did so. By 1997, the proportion of SBN households had risen to 53 percent (65 percent in the urban sector and 42 percent in rural areas). In absolute terms, the number of households with UBN fell from 564,000 in 1990 to 533,000 in 1997.

At the same time, there was a marked drop in the proportion of the population with more than two UBNs. In 1990, 22 percent of households in Honduras had more than two UBNs (13 percent in urban areas and 29 percent in rural areas). By 1997 barely 8 percent of households had more than two UBNs (5 percent in the urban sector and 11 percent in rural areas). In conclusion, the UBN method reveals much more marked and rapid advances in poverty reduction. This result is undoubtedly related to government action (through social expenditure investments) and the activities of civil society organizations.

An ex post evaluation of FHIS⁵ shows that the UBNs covered by that Fund tended to decline faster than those not so addressed. Between 1990 and 1997 the percentage of households lacking safe water, sanitary facilities, and access to education (the basic needs covered by the FHIS) fell from 72 percent to 31 percent, whereas the percentage of households lacking subsistence capacity or with deficiencies with regard to overcrowding and the physical state of their dwellings fell less: from 69 percent to 49 percent. Even so, during that decade many

⁴ The methodology employed in analyzing UBN in Honduras is explained in the above-mentioned *Libro Q* (1994). However, that study was based on 1988 census data. When the household surveys are used, the procedure is modified somewhat. The data shown here are based on definitions that differ slightly (albeit as little as possible) from those used in *Libro Q*. The changes mainly affect two definitions: access to water in the urban sector and overcrowding. According to *Libro Q*, the access to potable water need is deemed to be met when piped water is available within 100 meters of a dwelling; and overcrowding is estimated on calculations taking into account all rooms, with the exception of the bathroom and the kitchen

⁵ ESA Consultores, Evaluación ExPost del FHIS 2. Final Report, May 1999.

programs adopted approaches similar to that of FHIS, and FHIS investments accounted for no more than 9.5 percent of total social expenditure in Honduras.

More specifically, the above-mentioned study found in its analysis of the 1995–1998 period that 56 percent of new schools, 49 percent of newly constructed classrooms, 72 percent of rural health centers (CESAR), and 56 percent of Municipal Health Centers (CESAMOS) were attributable to FHIS, which thus had a considerable impact on the educational and health infrastructure. Regarding sanitation, it is estimated that FHIS built 23 percent of the latrines constructed in rural areas and 15 percent of those built in urban areas in the 1994–1997 period. As for safe water, FHIS contribution was limited to improving existing systems rather than expanding coverage, and on a very small scale (accounting for 1.5 percent of improvements nationwide). FHIS is also estimated to have contributed to the improvement of 5 percent of all water connections nationwide in 1997.

The advances made in satisfying basic needs have to do with increases in the incomes of poor households. Works carried out, when they are a result of public investment, represent either capital transfers to the poor or the crystallization of private sector fundraising, by the poor themselves, of income from work, rent, or remittances. In this way, the increase in the percentage of households with SBN practically translates into an increase in the capital stock of the poor. Rather than monetary income, it is nonmonetary income which contributes to poverty reduction as regards living conditions and opportunities. Such income offsets, to some extent, the lack of high monetary income in periods in which national income per capita falls or increases only slightly.

c) Nutritional status as an indicator of poverty

In addition to the measurement methods described above, there are other ways of gauging poverty or complementing assessments of poverty. One is based on the data on the nutritional status of the population, which in Honduras are derived from annual censuses of the height of schoolchildren. The premise underlying this approach is that the lack of adequate minimum nutrition is generally associated with poverty and that, in developing countries, this mainly affects children.

<i>CENSUSES OF THE HEIGHT OF SCHOOLCHILDREN IN FIRST GRADE PREVALENCE OF MALNUTRITION, BY AREA OF RESIDENCE 1986 – 1997</i>							
<i>Area of residence</i>	1986	1991	1993	1994	1995	1996	1997
Total	39.8	34.1	35.5	38.1	38.6	38.0	40.6
Urban	-	24.4	26.0	27.2	27.6	26.1	28.5
Rural	-	40.8	40.6	44.1	44.7	44.7	47.6

Source: PRAF, Los Censos de Talla en Honduras: Una Revisión de la Experiencia [Height censuses in Honduras: Another look at the Experience] (Tegucigalpa, 1998).

Malnutrition, in turn, affects the pace at which children grow and will therefore produce a lower height-age ratio. Certainly it is true that the average height of a man or woman in

developing countries tends to be lower than in developed countries.⁶ In that sense, the nutritional status of the child population serves as an indicator of the living conditions of the population as a whole, hence its association with conditions indicative of poverty.

The Census of the Height of Schoolchildren in First Grade entails teachers gathering information on the height of boys and girls enrolled in first grade, aged between 6 and 9 years 11 months, over a given period. The indicator used to establish the nutritional status of the schoolchildren is height-for-age, as measured by comparing the height of a boy or girl against a reference scale, in this case that of the NCHS (4,5).⁷

According to the findings of the first height census, the prevalence of height deficiencies or of malnutrition in 1986 was 39.8 percent. That percentage showed a downward trend in 1991 and 1993, but grew again thereafter. By 1997 it was slightly above the percentage for 1986. The prevalence of urban malnutrition in 1997 was lower than in rural areas (28.5 percent and 47.6 percent, respectively). The trend for both sectors is similar to that found for the country as a whole. The percentage of all schoolchildren suffering from malnutrition in 1997 was 40.6 percent; of those, 26 percent suffered moderate malnutrition, while 14 percent were severely undernourished.

d) The Human Development Index (HDI)

The HDI is not, strictly speaking, an instrument for measuring poverty, but a way to observe the development of a country or other geographical unit from a multidimensional, and not just economic, perspective. Like the UBN method, it measures advances rather than deficiencies, although, inverted, the findings do also reflect the deficiencies experienced in the population under observation.

The human development index is a nonweighted average of disparities in the areas of longevity, education, and economic resources. The variables best suited to measuring such differences are life expectancy, literacy, average number of years of schooling, and a modified measurement of income (based on purchasing power parity). The HDI is estimated on the basis of these variables, which makes it a good indicator of social welfare and, to a certain extent, of poverty. In other words, countries with a low HDI generally suffer from high levels of poverty.

In the Global Human Development Report for 1997, published by the United Nations Development Program (UNDP), Honduras' HDI is 0.575, which places it in the medium HDI group, albeit with an HDI below the average for that category (0.667). The disaggregation of the HDI results in the following subindices: .73 for life expectancy; .69 for education; and .30 GDP.

⁶ The risk associated with this blanket assertion has to do with genetic-racial aspects, which even within a single country may explain some height (and even weight) differences between subsegments of the population.

⁷ See more detailed explanations in PRAF, *Los Censos de Talla en Honduras: Una Revisión de la Experiencia* [Height censuses in Honduras: Another look at the Experience] (Tegucigalpa, 1998) and SEP-PRAF, *VII Censo Nacional de Talla, 1997 Report*

The Human Development Report: on Honduras 1998⁸, explains what the index breakdown shows as follows: “Most progress has been achieved in health and education, where the gap vis-à-vis the targeted ideal levels (85 years life expectancy and 100 percent literacy) oscillates between 20 percent and 30 percent. In ‘income,’ on the other hand, the gap between real and ideal achievements is not only greater; it has also widened over the past few years and today is over 68 percent” (p.15).⁹

In a ranking of countries in descending order for 1999, Honduras is ranked in 114th place out of a total of 174 countries. A comparison of Honduras’s human development index with some Latin American countries shows that life expectancy in Honduras is only slightly lower than in the others. The level of education is lower than that of countries like Costa Rica and Ecuador, but not much lower than Brazil’s or El Salvador’s. In conclusion, what makes a difference is income per capita, which is substantially lower than in the other countries and is, ultimately, the determining factor for a low HDI.

2) POVERTY PROFILE

The data in this section show a poverty profile characterized by the marked prevalence of poverty, and particularly of extreme poverty, in rural areas in the departments of Lempira, Intibucá, and La Paz, part of Santa Bárbara, Copán, Choluteca, the southern part of Francisco Morazán, and El Paraíso, which form a kind of corridor or continuous belt, and other dispersed pockets in the departments of Comayagua, Yoro, and Olancho. Hardest-hit by poverty are households headed by women, especially in rural areas, those with children, with heads of household who have little schooling, or else are elderly, unemployed, or workers in the agricultural sector, and in the informal sector (includes self-employed who do not employ temporary workers, nonremunerated members of the family, and workers in enterprises with three or fewer workers). The Honduran families with the highest number of these elements are those most exposed to poverty.

a) The spatial distribution of poverty

Some of the tools for measuring or approximating poverty lend themselves to geographical observation, that is, they allow to examine the extent and depth of poverty in the different administrative units of a country, by department, municipality, or region. This makes it possible to draw up maps that make it easier to target the various social programs.¹⁰

⁸ Published by UNDP/Honduras (Tegucigalpa, 1998).

⁹ For life expectancy and literacy, “ideal achievements” means the highest found. For income, the ideal taken is the average for Latin America.

¹⁰ One example is the FHIS’s Poverty Map, which that institution uses as a basic tool for allocating its resources nationwide.

b) Rural-urban distribution of poverty according to the Poverty Line Method

Available data based on the poverty line method only allow to distinguish the urban-rural distribution of poverty. In the urban sector, 57 percent of households lived below the poverty line in 1999. In rural areas the figure was almost 75 percent. What is more, in the urban sector almost 37 percent of households are ranked as living in extreme poverty. In the rural sector, the figure is 61 percent.

DISTRIBUTION OF POVERTY BY GEOGRAPHICAL AREA									
<u>URBAN HOUSEHOLDS BY LEVEL OF POVERTY</u>									
	1991	1992	1993	1994	1995	1996	1997	1998	1999
Extremely poor	46.7	39.2	31.6	39.8	40.6	38.7	35.2	35.7	36.5
Poor	21.7	22.4	23.9	22.8	22.2	22.3	23.8	21.3	20.8
Below the poverty line	68.4	61.6	55.5	62.6	62.8	61.0	59.0	57.0	57.3
Nonpoor	31.6	38.4	44.5	37.4	37.3	39.0	41.0	43.0	42.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<u>RURAL HOUSEHOLDS BY LEVEL OF POVERTY</u>									
	1991	1992	1993	1994	1995	1996	1997	1998	1999
Extremely poor	59.9	53.9	55.8	52.9	53.1	66.4	60.0	55.4	60.9
Poor	19.7	22.6	21.3	18.2	18.8	8.9	11.7	13.8	13.7
Below the poverty line	79.6	76.5	77.1	71.1	71.9	75.3	71.7	69.2	74.6
Nonpoor	20.4	23.5	22.9	28.9	28.1	24.7	28.3	30.8	25.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: SECPLAN (1991-94); PRODEPAH, internal use (1995-99). Based on the first survey each year, except in 1994, when only one survey was conducted, in October.

These data indicate that poverty in Honduras is mostly a rural phenomenon, given that 59 percent of poor households are located in rural areas. More specifically, 65 percent of households living in extreme poverty and 41 percent of poor but not extremely poor households are located in those areas. The data also suggest that both in the cities and in rural areas there was a slight reduction in poverty over the decade, but with the pace of improvement favoring the urban sector, where the proportion of the population living below the poverty line fell 11 percentage points, compared with only a 5 point decline in rural areas.

Various studies¹¹ show that poverty tends to be concentrated in the departments of Choluteca, Valle, Intibucá, La Paz, and Lempira, in which three quarters of the combined populations have income below the poverty line. In the departments of Cortés and Francisco Morazán, the proportion of poor households is lower, and approximately 36 percent of the population lives in poverty. Nevertheless, these last two departments contain a third of the total population living below the poverty line in Honduras as a whole, although they only account for a fifth of the total population of the country. The available studies do not

¹¹ Ricardo Paes de Barros et al., Honduras: Un Diagnóstico Social, draft (IPEA, January 2000). The figures are preliminary. Nevertheless, the trends are expected to hold despite some adjustments.

distinguish subgroups of the poor, which would allow to observe whether the poor in Cortés and Francisco Morazán tend to belong to the higher substrata among the poor, or, on the contrary, to the lowest.¹² Given that these departments are relatively better-off in terms of income-generating opportunities, the former is more likely, that is, in the two departments the less poor strata predominate, at least in urban areas. That is what appears to emerge with greater clarity from distribution patterns based on the UBN method.

c) Spatial distribution of poverty based on the UBN method

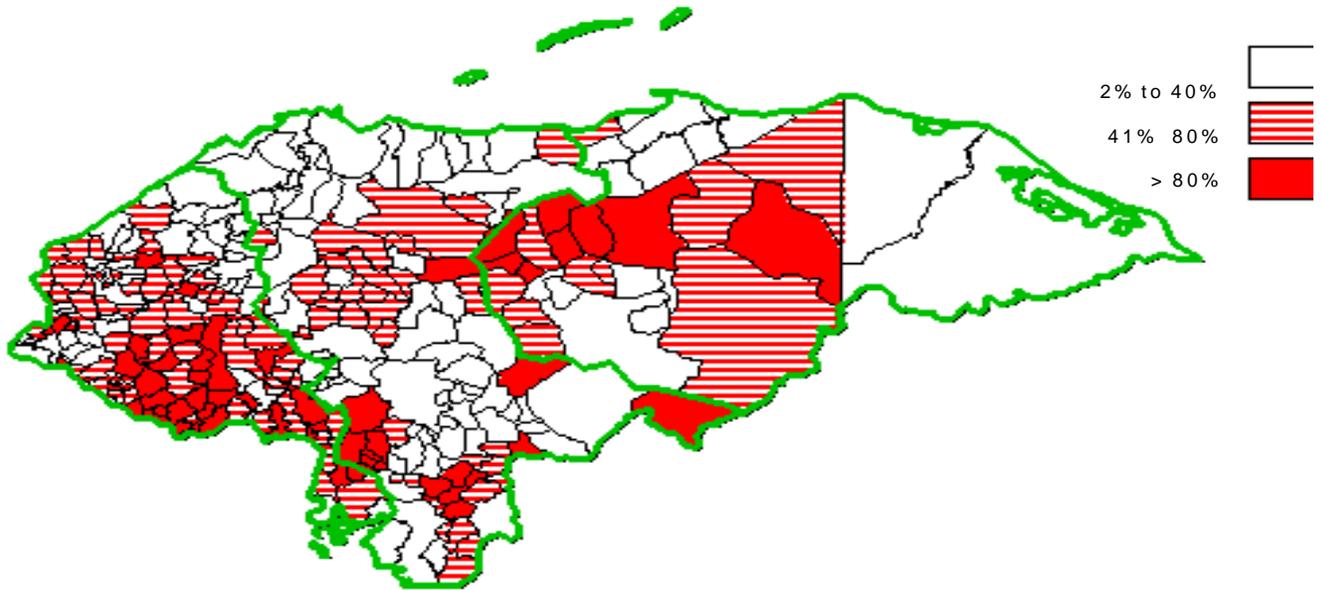
Reproduced below is a map showing the geographical distribution of unsatisfied basic needs, according to the data gathered by the 1988 Demographic and Housing Census. Unfortunately, it will not be possible to update this map until after the Demographic Census of 2000, because the methodology used in the household surveys does not permit a breakdown by municipal unit.

With respect to the rural-urban gap, and particularly to differences between regions within the country, there are a series of interesting trends as far as absolute numbers are concerned. The Central District (the capital and its immediate area of influence) contains 65,260 households with one or more UBN (12 percent of the national total for this category of household), of which 62 percent have only one UBN. The municipality of San Pedro Sula (the second largest city in the country) has 27,497 households with one or more UBN (5 percent of the national total for this category of household), and of these 78 percent indicate only one UBN.

At the other extreme are the southern and western regions. The southern region has 61,778 households with UBNs (11 percent of the national total for UBN households), of which 67 percent are rural (with varying degrees of UBN) and scarcely 43 percent have only one UBN (in other words, the percentage of those with more than one UBN is higher, indicating a higher prevalence of extreme poverty). The western region situation is as follows: 100,106 households with one or more UBN, or 18 percent of all households of this type. Eighty-eight percent of those households are in the region's rural areas and 43 percent have only one unsatisfied basic need (57 percent appear to be living in extreme poverty). In the rest of the country, the numbers are: 287,480 households with UBNs, 53 percent, 74 percent, and 58 percent, respectively.

¹² Nor is a distinction drawn between the urban and rural parts of Cortés and Francisco Morazán. The rural areas in Francisco Morazán, especially in the south, are known to have a high concentration of poverty.

GEOGRAPHICAL DISTRIBUTION OF POVERTY
% of households with 3 or more UBN, municipalities, 1988

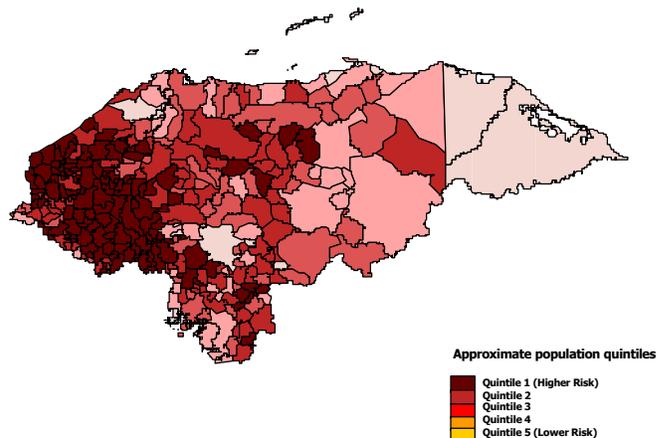


The data from the upcoming Census 2000 will point with greater precision to the changes that have occurred in recent years in the geographical distribution of poverty. In the meantime, other indicators, such as nutrition data, are useful for detecting recent geographical trends in this area.

d) Distribution of poverty based on prevalence of malnutrition (Schoolchildren's Height Census), by department and municipality

The Schoolchildren's Height Census makes it possible to map the information by department and municipality. The map indicates that the worst areas in terms of malnutrition among school-children are in the south and west of the country; specifically, in the departments of Lempira, Intibucá, La Paz, part of Copán and Santa Bárbara, the southern part of Francisco Morazán and El Paraíso and some municipalities in Comayagua, Yoro, Olancho, and Choluteca.

HONDURAS RISK-BASED POPULATION QUINTILES BY MUNICIPALITIES, FOR CHRONIC MALNUTRITION



Source: Seventh Schoolchildren's Height Census for ages 6 to 8, 1997

e) Spatial distribution of poverty based on HDI

HDI data may be calculated not only for countries but also for smaller administrative units within countries, such as departments or municipalities. That is what UNDP did in its Report on Human Development: Honduras 1998.¹³ Broken down in this way, the information also allows to observe geographical differences with respect to human development. The following features are worth underscoring:

The places with the lowest human development indices are in the western region and, more specifically, in the rural areas of the departments of Lempira, Intibucá, Copán, Santa Bárbara, and La Paz. The same can be observed in the municipalities in the southern part of Francisco Morazán, as well as in others in Comayagua, Yoro, Olancho, and El Paraíso. As the 1998 Report puts it: “the principal conclusion is that inequalities in human development in Honduras are both severe and deep-rooted.”

In Honduras, the HDI has tended to increase slightly even when income stagnates; all departments have shown improvements in this index since 1988, with the largest increases occurring in the poorest departments, such as Lempira and Copán. Increases in literacy and life expectancy have been proportional to the increases in the HDI.

Life expectancy is one of the best overall indicators of the long-term impact of the living conditions (health, housing) experienced by the population of a country. In Honduras, life expectancy increased in the 1990s. In some departments, such as Olancho, life expectancy increased by approximately 4 years over the decade and, as with literacy, the greatest increases were to be seen in the departments where life expectancy was lowest.

Progress in education has been modest and mostly focused on the primary level. As a result the figures for literacy and years of schooling grew during the 1990s, thereby helping to improve living conditions. However, those advances were not enough to improve Honduras's position vis-à-vis other countries, because both the literacy rate (71 percent) and the average number of school year attendance (4.8 years) continue to lag behind Latin American averages.

Significant progress was made in preventive health care. There was a pronounced drop in the incidence of infectious diseases and others that can be prevented by vaccination such as measles and whooping cough. International certification of the eradication of the wild polio virus was also obtained. These developments and other measures helped reduce infant mortality and improve living conditions for the population, in addition to increasing life expectancy.

¹³ Unfortunately, the lack of adequate income data at the municipal level led to methodological changes such as imputing income on the basis of educational achievement. Thus, due to this procedure, the estimated overall index would appear to be mainly reflecting coverage and progress in the education sector. That would explain, for instance, why a higher per capita income was assigned to the Central District than to San Pedro Sula, contradicting the trend revealed by the Household Survey.

Poverty is manifested in the malnutrition prevalent among the poor in Honduras. When height/weight is taken as an indicator of malnutrition in children under five years of age, the level of malnutrition in the poorest decile is almost 60 percent; for the first 7 deciles infant malnutrition exceeds 30 percent.

If calorie adequacy is analyzed, adult malnutrition is also more pronounced in the poorest segment of the population. The decile with the lowest income has a calorie intake of less than 60 percent of the daily values required for adequate nourishment. Only the last three deciles consume more than 80 percent of the daily values needed.

Access to primary health care has improved country-wide, thereby enabling the poor to make more frequent visits to health centers. There has been an increase in the demand for reproductive health care on the part of women of child-bearing age. Above all in urban areas, this is having an impact on the reduction of birth and fertility rates.

Nevertheless, despite the achievements in this sector, there are still marked deficiencies in public expenditure on the social sectors. A policy of increasing the volume of financial resources for this sector is probably not going to have the desired effect on health indicators, because the system uses the allocated resources inefficiently. Public spending on health is currently equivalent to 2.6 percent of GDP, but most of the improvements in access and in vaccination coverage were achieved when expenditure was below that percentage.¹⁴

f) Vulnerable groups

Poverty by gender

Poverty tends to affect women proportionally more than men, especially when a woman runs a household without the effective presence of a male companion. The Household Survey conducted in March 1999 shows that the income of households headed by men was 4.6 percent higher (699 lempiras as against 668 lempiras). Consequently, according to Paes's methodology,¹⁵ the percentage of such households living in poverty is lower than for those with female heads of household (58 percent compared with 66 percent). These overall differences may vary, however, in urban as opposed to rural areas. Preliminary studies indicated that urban households headed by women are less likely to be living in poverty than those with male heads of household, while the opposite would appear to be the case in rural areas.

In education, the situation of women is tending to improve and to close the gap with men. The female literacy rate in 1999 was 80 percent, almost equal to the male literacy rate of

¹⁴ Ruta Social, Honduras: El Gasto Social y su Eficiencia [Social Route, Honduras: Social Expenditure and its Efficiency] (1997).

¹⁵ Ricardo Paes de Barros et al., Honduras: Un Diagnóstico Social, draft (Río de Janeiro: IPEA, January 2000). The figures in this study are preliminary and some are expected to change as a result of adjustments to the methodology. However, the trends shown are unlikely to be significantly affected by these adjustments.

81 percent. The average number of years of school attendance for women is 4.7, compared with 4.9 years for men. In university entrances the gap is wider: 4.5 percent of women and almost 7 percent of men in the appropriate age groups have access to higher education.¹⁶

The prevalence of malnutrition among schoolchildren is less marked among girls. In 1986, the incidence was 44.8 percent for male schoolchildren and 34.7 percent for females. In 1997, the figures were still 45.3 percent and 35.6 percent, respectively. Nevertheless, these differences would appear to be more methodology-related than real.¹⁷

Poverty by formal education of head of household

A characteristic feature of the poor segments of the population is the low level of schooling. The percentage of the population living in poverty (by Paes's definition) usually diminishes when the years of schooling of heads of household increase. According to the March 1999 Household Survey, 76 percent of the households in which the head of household had zero years at school were living in poverty. This figure drops to 67 percent with three years of schooling, to 55 percent with between 4 and 6 years of school attendance, and to as little as 3.8 percent in the case of households in which the head of household received post-secondary education.

Poverty by demographic structure

Couples with children are more likely to be poor than couples without children (60 percent vs. 43 percent), according to the March 1999 Household Survey. When the household with children is headed by a woman, the tendency to be poor is slightly greater than when the head of household is male (57 percent vs. 54 percent). That same tendency may be more pronounced in rural areas compared with urban areas.

As regards the age of the head of household, data from the above-mentioned Household Survey show that households headed by elderly persons are more likely to be poor (of such households, 55 percent are poor). The percentage in the case of households with heads under 20 years of age is 43 percent.

Poverty by employment and underemployment

Taking various different employment indicators and applying Paes's definition of poverty, there is a greater propensity toward poverty among households headed by the following: unemployed persons (70 percent), farm workers (76 percent), self-employed workers (who do not hire temporary labor) or nonremunerated family members (68 percent), or workers in enterprises with fewer than three employees (61 percent to 67 percent).

¹⁶ Idem., p. 41.

¹⁷ See explanation in PRAF, *Los Censos de Talla en Honduras. Una revisión de la experiencia (Tegucigalpa, 1998)*.

Poverty by ethnic group

According to a study carried out for the Confederation of Indigenous Peoples of Honduras (CONPAH) in April 1999, there are nine ethnic groups in the country: Garífuna, Isleños, Lencas, Miskitos, Tolupans, Chortis, Pech, Tawahkas, and Nahoas. Together these peoples amount to nearly half a million people (490,553), or 8.7 percent of the total population of the country.

According to the study, these native peoples are spread over 15 of the 18 departments in the country. The study also notes that they are geographically located in the municipalities with the lowest levels of human development, with the exception of the Isleños, who number 80,000 people (16.3 percent of the total ethnic group population). According to the same study and *La Pobreza Etnica en Honduras* [Ethnic Poverty in Honduras],¹⁸ the main problems faced by these minorities are: land tenure, degree of integration in the market economy, unsatisfied demand for land and labor migration, and the dearth and poor quality of basic social services and insufficient infrastructure.

Although no estimates are currently available for the main characteristics of each individual ethnic group that would help us form a better idea of their social and economic circumstances, it is still useful to bear in mind a number of certain aspects that will be of considerable help in devising and targeting policies. The Lencas, to begin with, are one of the more numerous ethnic groups, with 110,000 people. They live mainly in the departments of La Paz, Lempira, and Intibucá, which are the departments with the highest incidence of poverty, and in the depressed areas of Francisco Morazán, Santa Bárbara, and Yoro. By contrast, other relatively numerous groups, such as the Garífunas and Isleños, are concentrated in the departments of Cortés, Atlántida, Colón and Bay Islands, which have a lower incidence of poverty and the best human development indices in the country.

In light of this distribution, the Government directs many of its poverty mitigation programs at these geographical areas, while paying particular attention to land titling programs, as a way of establishing and legitimizing ethnic group ownership.

Some ethnic groups are facing increasing threats to their livelihood as a result of the rapid advance of farmer and stockbreeder settlements. To the extent that their ways of life require a natural habitat with extensive areas for their agricultural and extractive activities, in considerable harmony with the environment, any outside activity restricting their access to forests or limiting its size becomes a hindrance for their cultural survival.

The quest for solutions to such disputes must take cultural differences into account and avoid forcing the ethnic group to change its form of production to one that does not satisfy its aspirations or match its expected way of life. The position taken by other ethnic groups has been to ask the Government actively to defend the protected areas, which would include considering the native groups settled in those areas as their natural protectors, inasmuch as they maintain ancestral practices of peaceful coexistence with the

¹⁸ IDB, Washington, September 1999, Utta Von Gleich and Ernesto Gálvez.

environment. The recent declaration of the Tawahka-Asanghi biosphere by the National Congress, and the spirit underlying it, reflect this approach.

In the case of the Garifunas another factor to be borne in mind is the concern over the high incidence of HIV/AIDS, which is often not admitted for fear of discrimination. This situation has added an additional ingredient to the poverty prevalent among members of this ethnic group.¹⁹

Other special groups

Other groups exposed to extreme poverty are many of the elderly, street children in several cities, and a large number of people suffering from physical or mental disabilities.

Unfortunately, few statistics are available to enable us evaluate their living conditions with any precision and to assess their relation with poverty. This lack of information and the exclusion of such groups from society that manifests itself in begging on the streets will have to be addressed by appropriate policies that will form part of this Poverty Reduction Strategy.

The determinants of income: overall analysis

A quick way to observe the impact of the characteristics of the poverty profile sketched above is to calculate regression models relating those characteristics to income. Preliminary calculations made using the 1999 Household Survey data show that the following factors have significant and inverse relationships with income:

- Geographical location of residence, that is to say, the above-mentioned corridor or poverty belt;
- Number of children, especially those under five years of age;
- Female head of household, especially in the absence of a male companion and in rural areas;
- Head of household with little schooling, when the gains obtained via education are high;
- Being unemployed;
- Being a worker in the agricultural and livestock sector;
- Being a low-level wage earner, or, much more so, being self-employed (without hiring temporary workers) or a nonremunerated family member; and
- Being underemployed.

These results reinforce the impressions created by other analytical procedures, but should nonetheless be treated with caution inasmuch as they will subsequently need to be revised.

¹⁹ ESA Consultores, report 18/02/2000, pp. 15–16.

B. THE LABOR MARKET²⁰

Including a review of how F functions in the poverty analysis is justified by the fact that over 80 percent of family income derives from job earnings. The study conducted by IPEA shows that during the 1990s, the Honduran labor market performed rather well, judging by labor force absorption and utilization indicators and international comparisons.²¹ The lower per capita income causing high levels of poverty would be a product of the low wages paid to the labor force, a situation which, in turn, would derive from both poor quality human capital and the unskilled nature of the work available, above all the latter.

1. LABOR FORCE ABSORPTION AND UTILIZATION

In March 1990, Honduras' working-age population (of over 10 years of age) totaled 3.1 million people, a number that increased over the decade by 3.5 percent a year. By 1999 working-age population totaled 4.2 million, of which 56 percent made up the economically active population (EAP). At the beginning of the decade the EAP totaled 1.6 million people. By its end, the figure had risen to 2.4 million, which implies a growth rate of 4.6 percent a year in the period under review. That growth was due in part to continuous increases in women's participation in the labor market, which rose from 29.8 percent to 39.1 percent.

The fact that the EAP grew faster (4.6 percent) than the rate of growth of the working-age population (3.5 percent) suggests that there was a reasonable capacity of the labor market to generate employment. In 1999, barely 4 percent of the total EAP was unemployed (some 90,000 people). Over the decade, approximately 800,000 new jobs were created, implying a growth rate of 5 percent a year: i.e., higher than the growth rate of the EAP. This situation also led to a fall in the level of underemployment (defined as less than 36 hours worked per week), from 13.8 percent (some 250,000 people) to 7.5 percent (50,000 fewer people). Other unemployment indicators also show improvements over the period and lead to the conclusion that by 1999 barely 12 percent of the labor force was underutilized, be it in terms of underemployment or unemployment. The upshot would appear to be that the occupied and fully occupied population grew by more than 51 percent and 65 percent, respectively, over the period.

The capacity of the Honduran economy to create jobs faster than the growth of output (the EAP grew 35 percent and GDP 30 percent) needs to be explained. It is thus worth exploring the performance of wages and the quality of the jobs created.

²⁰ This section is based almost entirely on the above-mentioned IPEA study. It summarizes the findings of a team. For further methodological or factual details, the reader is referred to the study.

²¹ IPEA explains that the rate of participation of the different groups of the population is similar to the Latin American average, which suggests that the working age population is adequately utilized, although one exception to the rule would appear to be women's participation in rural areas, which is particularly low (which would explain the greater propensity of this subgroup to emigrate to the cities in a higher proportion than is the case for men). Indeed, increasing the percentage of women's participation in rural areas could be a key factor in poverty reduction.

2. WAGES

The IPEA data show that, from a family perspective, wage levels are low, so much so that poverty would appear to be related more to this variable than to underutilization of the working-age population. In other words, poverty would appear to have little to do with the inability of individuals to find work or with the economy's ability to supply such opportunities, and much more to do with the level of wages available for existing jobs.

Nevertheless, it is important to point out that the above-mentioned study does not consider households' other income or nonmonetary resources. In any event, household income from wage earnings is also related to the size of the household and the number of its members who work (dependency ratio). The average hourly wage per person (the sum of wages in principal and secondary occupations divided by the total number of hours worked per month) was L 9.6 per hour, or 2/3 of US\$1,²² in March 1999. A quarter of the labor force earned wages of less than L 6.75 per hour, while the rest of the workers earned less than L 12.

All in all, the average hourly wage in a principal occupation grew 12 percent in real terms over the past decade. The following sections analyze worker and job quality, with a view to determining which of the two factors is more responsible for the low wages.

3. HUMAN CAPITAL

Compared to other Latin American countries, Honduras' labor force is relatively less qualified and has been so, with few variations, for several decades.²³ The average number of school attendance years for Honduran workers of over 25 years of age in 1999 was 5.3, compared with 6.2 years in Mexico (1994 data), Colombia 6.4 (1995), Costa Rica 7.0 (1995), and Panama 8.4 (1995). The illiteracy rate (for persons 15 and over) is also high in the Honduran case (21 percent) compared with those found in the same countries, where the highest rate was 15.3 percent (Mexico). Honduras' figures are comparable only to those of El Salvador, where average schooling is 4.9 years and the illiteracy rate for the same segment of the population is 23.5 percent.

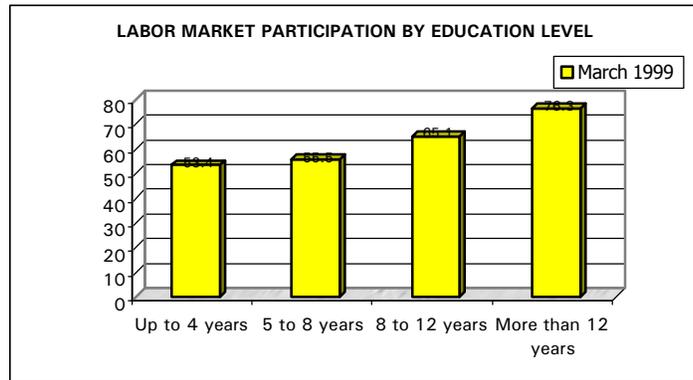
This is why it is possible to interpret the big differences in wages for workers with different degrees of schooling as the market's response to the shortage of skilled labor. Secondary education carried a particularly high premium: extra year of secondary education raises wages by 15 percent, compared with a 10 percent premium for an extra year of primary school education.

Education also makes it easier to enter the labor market, especially for women, which means that their participation rate increases with increases in the number of years of school attendance.

²² At the exchange rate of US\$1= L 14.

²³ For the decade, average schooling for this population increased only one grade. The women in this subgroup of workers had one more year's schooling than men throughout this period.

The unemployment rate, however, appears to behave rather differently, because it is higher among those with secondary education. This may be interpreted either as an indicator that employers are not very demanding with respect to schooling, or as an indicator of the low average quality of education.²⁴

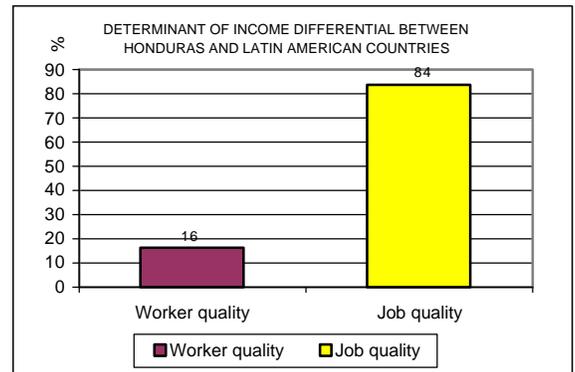


Experience acquired on the job is also a factor in worker quality and thus has an impact on an individual's wages. The available data show that an additional year's experience tends to increase wages by 3 percent and 4 percent; however, after age 35 the impact of experience on wages begins to show decreasing marginal returns and ceases to have any effect by age 52. At the same time, it appears that the specific experience of a worker acquired over time in a single enterprise does not command a premium: a sign that employment relations are of such short duration that there are no incentives for either workers or employers to invest in raising the quality of the labor force.

4. QUALITY OF JOBS

Job quality is determined on the basis of three indicators: the size of the wage-earning population, the relative weight of nonagricultural labor, and the proportion of enterprises with 10 or more employees. As the reader can see, these are indicators of modernity providing indirect evidence of the level of technology and investment, of the way production is organized, and of the type of labor relations in a given economy.

The data analyzed indicate that although job quality improved over the past decade, it remains low compared with other countries. The percentage of wage earners in the EAP rose from 45 percent to 47 percent; that of wage earners in enterprises employing ten or more people rose from 25 percent to 28 percent; the EAP in agriculture fell from 45 percent to 35 percent, while, simultaneously, the proportion of the labor force employed in manufacturing and productive services increased from 16 percent in 1990 to 19 percent in 1999. According to the analyses contained in the IPEA study, job quality in industrial countries²⁵ turns out to be 3.5 times higher than in Honduras, while worker qualifications are only 0.8 times higher. Hence, while both job quality and worker qualifications are important, the crucial factor is job quality.



²⁴ Ministry Of Education, Sectoral Study. Ten-year Plan, Volume I, 1997, p.195.

²⁵ Measured in this case by the average hourly wage in the principal occupation.

In measuring the impact of these factors on productivity, job quality would explain 2/3 of the difference between the productivity of Honduran workers and that of workers in industrial countries. Job quality alone accounts for over half the difference in income per capita between Honduras and the industrial countries. However, a comparison with countries that are so much more advanced economically may seem somewhat exaggerated, and a comparison with the Latin American average more appropriate. Nevertheless, in this case, the power of job quality to account for productivity is even greater. In that exercise, poorer job quality explains 84 percent of the difference in productivity. If the comparison is restricted to Costa Rica, the findings are similar, with job quality differences being more important than differences in the workers' qualifications.

In a more disaggregated analysis of job quality,²⁶ IPEA found that:

- The best jobs are those reserved by employers for themselves and those held by government employees. The worst are jobs related to the informal sector, represented by self-employed workers who do not hire labor, and by domestics.
- Regarding sectors of activity, the best jobs are more or less equally distributed between the secondary (manufacturing) and tertiary (services) sectors. Related to this is the clear evidence that urban wages tend to be between 20 percent and 40 percent higher than those in rural areas. In rural areas, the departments in the west of the country, Comayagua in the center, and Choluteca in the south are all at a disadvantage.
- Job quality tends to increase along with the size of an enterprise.

5. WORK DONE BY MINORS, YOUNG PEOPLE AND WOMEN

The percentage of children (aged 10–14) on the labor market was 12.5 percent in 1998 and 17 percent in 1999, an increase that may have been a consequence of Hurricane Mitch. This percentage tends to be higher in Honduras than in other Latin American countries. In rural areas the proportion is as high as 20 percent, and it may be even higher in the poorest regions of the country. On average these children work 33 hours a week, but the contribution they make to total family income barely amounts to 9 percent (the work they do is largely unremunerated family work). Work by the very young interferes with education and is, indeed, one of several reasons why children drop out of school, have to repeat grades, or have poor schooling in general.

Because of the premature entry of minors into the labor market, the participation of young people (aged 15–17) in that market also turns out to be high (47 percent) by Latin American standards. Even so, it is not always easy for this subgroup of the population to find a job, given that the unemployment rate for this group is as high as 8 percent, twice that for other age groups. As a result of this high rate of unemployment, almost 60 percent of the unemployed are young people, despite the fact that they account for a little under 30 percent of the EAP. Unemployment for young people is nevertheless of short duration: 85 percent of the unemployed spend three months looking for a job. In addition, the hours worked and

²⁶ In this case, the job quality indicator is the hourly wage in a principal occupation that a typical or average worker would earn in each sector.

underemployment rate of young people are similar to the averages for the population as a whole, a sign that those young people who do have a job are utilized as intensively as adult workers. Finally, the average wage of young workers is approximately 2/3 lower than average wages for workers of all ages. On the other hand, young people have a much greater propensity to be family workers than do the other groups of workers.

Women's participation in the labor market increased by 9 percentage points in the 1990s (from 30 percent in 1990 to 39 percent in 1999), while the proportion of men virtually stagnated (73 percent and 75 percent, respectively). The proportion of working women in Honduras is similar to that found in Costa Rica, Panama, and El Salvador, and not very different from that of Venezuela and Mexico. There is a higher proportion of women on the labor market in urban areas (47 percent) than in rural areas (32 percent), although most progress has been achieved in the latter (the proportion grew by 12 percentage points over the period, as opposed to 6 points in urban areas). Women work shorter hours (39 hours a week), and their unemployment and underemployment rates, as well as the average period of time they spend unemployed, are greater than for men, even though they are almost as equally keen to find jobs as men. Women's jobs tend to be concentrated in certain types of employment, such as jobs in the public sector, followed by jobs in domestic service and as self-employed workers who do not hire labor, the latter being very low quality occupations.

6. THE RURAL LABOR MARKET

The rate of participation of the rural population in labor markets is similar to the urban rate. Working hours tend to be shorter in rural areas, even though there is also less under-employment: an indication that the number of hours worked may be the result of a voluntary decision that is undoubtedly related to the cultural patterns of traditional small-farmer output.

It is worth noting that there is less unemployment in rural areas and its average duration is similar to that in urban areas. This would appear to suggest that there is room to absorb more labor, if one discounts the excess population, especially women, who migrate to the cities.

The main differences between urban and rural labor markets are the importance of wage labor, the level of remuneration, and worker skills.

- In the rural market, wage labor accounts for barely 36 percent of the total, compared with 59 percent in urban areas. Consequently, rural areas have higher percentages of self-employed workers and unpaid family workers, who largely make up the subsistence farmer economy.
- The average hourly wage and length of schooling are 150 percent and 85 percent higher, respectively, in urban areas than in rural areas. Average school attendance in the urban areas is 7 years and barely 3.8 years in rural areas; while the average urban hourly wage is 12 lempiras, compared to L 4.8 in rural areas.

In addition, the Human Development Report, Honduras 1998, points to the diversity of regions and farmers. In particular, it notes the existence of a broad sector of medium-sized farmers or *finqueros* (approximately 122,000 out of a total 330,000 farmers) who grow

coffee, vegetables, tobacco, beans, corn, and root crops. These farmers would appear to be one of the most numerous and broadest sectors and one with more opportunities for business expansion if linkages with the agroindustrial sector and poorer farmers were boosted. In this regard, it is worth recalling that poor farmers and farm workers make up the bulk of the extremely poor population located, especially, in the poverty belt of the departments in the west and south of Honduras.

Likewise, the World Bank's 1994 Economic Memorandum and Poverty Assessment²⁷ makes a number of points that are still relevant. According to this report, inequality of land distribution continues to be one of the principal factors in rural sector poverty. At the same time, small farms (55 percent of the total, with only 8 percent of the land) have considerably lower quality soil than do other types of farms, inasmuch as they tend to be located on sloping ground (such as those found typically in the extreme poverty belt shown on the maps reproduced above). According to this memorandum, the low income of small farmers is attributable to the shortage and poor quality of the land they have at their disposal, as well as to their lack of access to new technology. This situation, in turn, would appear to be a reflection of the low levels of education in rural areas and of the inefficiency and inequality of the agricultural research and extension system.

C. EFFECTS OF HURRICANE MITCH ON POVERTY

Hurricane Mitch had a severe impact on living conditions in Honduras and this in turn affected poverty levels nationwide. It is estimated that the percentage of poor households rose from 63.1 percent in March 1998 to 65.9 percent in March 1999, that is to say, by 2.8 percentage points. In absolute terms, the number of poor people increased by approximately 165,000.

Although the damage wrought by the hurricane affected the entire population of Honduras and all sectors of society in one way or another, it is worth noting the direct effects on the level of poverty, such as the loss of dwellings and household goods, and on the variables with a direct effect on poverty such as employment, sources of income, and production factors.

Housing

The hurricane is estimated to have destroyed approximately 35,000 homes and to have caused 10 percent to 50 percent damage in some 50,000 additional dwellings. Most of the homes hit were located on alluvial slopes alongside rivers, owing to the desire farmers feel to have homes adjacent to their plots despite the dangers entailed, and to the high cost of safer ground in cities like Tegucigalpa. The upshot was that 441,150 people either lost their homes or suffered damage to them.

According to ECLAC, total damage to the housing sector amounted to L 4,646 million (US\$344 million), comprising direct damage amounting to L 2,984 million (US\$221 million) and indirect damage (cost of shelters and relocation) valued at L 1,662 million

²⁷ Taken from the *Country Memorandum/Poverty Assessment of November 17, 1994*, Washington, D.C..

(US\$123 million). Included in the damage estimate for the sector was damage to furniture and household effects that ECLAC calculates at L 399 million (US\$30 million). At the same time, it is estimated that rehabilitation and reconstruction will cost no less than L 6,545 million (US\$485 million).

Employment

According to ECLAC,²⁸ one immediate effect of the hurricane was to increase unemployment and cause a shift from formal to informal employment. By mid-November 1998, the Ministry of Labor had received requests to suspend the labor contracts of 18,174 people. At the same time, further unemployment and underemployment was thought to have been generated in agriculture, commerce, transportation, and banking, owing to the decline in productive activity. However, because of the reconstruction work, more people were expected to find jobs in the construction sector.

Similarly, it is assumed that the decline in agricultural and livestock output and the subsequent reduction in its contribution to GDP in 1998 and 1999, exacerbated the country's employment problem, owing to the fact that this sector employs approximately 34 percent of the economically active population. This figure is important if it is considered that poverty is even more severe in rural areas, where the level of extreme poverty rose to 61 percent of the population in 1999.

On the other hand, Paes (2000) maintains that, in terms of labor market absorption, Hurricane Mitch appears to have stimulated, rather than inhibited, job creation, but that the brunt of the negative impact was felt in terms of job quality.

Undoubtedly, one of the main impacts of Mitch on employment was the sudden surge in children's participation in the labor market because, according to the data available, the economically active population grew faster than the rate of growth of the population of working age, which denotes a substantial capacity in the economy to generate jobs. In that sense, the percentage of children aged 10 to 14 in the labor market is considerable. In 1999, 17 percent of children aged 10 to 14 were either working or looking for work, whereas in 1998, barely 12.5 percent of children aged 10 to 14 were engaged in economic activities, a proportion that had remained relatively stable since the start of the decade. All the same, the persistence of child labor prior to Mitch is rather high compared to levels observed in the other Latin American countries.²⁹

²⁸ ECLAC, Honduras: Evaluación de los Daños Ocasionados por el Huracán Mitch (1998) [Honduras: Evaluation of the Damage Caused by Hurricane Mitch (1998)].

²⁹ Paes (2000).

Income

The increase in poverty in 1999 is mainly due to a fall in average household income. Comparing household survey data for March 1998 with data for March 1999, income can be observed to decline from L 758 to L 693. Another fact emerging from those surveys is that in the last year the increase in poverty was extremely concentrated in rural areas, accounting for 2/3 of the increase in the number of poor people in the country as a whole.

However, one mitigating factor that prevented an even greater increase in poverty was the fact that the average income of the very poor (by remaining practically constant) fell less than the average income of the very rich, which declined 15 percent compared with a 2 percent increase prior to that period, according to analysis based on this kind of survey.

Factors of production

The damage done by Mitch to Honduras' capital stock and output was extremely severe and had a major impact on the principal economic variables and thereby on their ability to reduce poverty. According to ECLAC total damages amounted to US\$3,800 million, equivalent to approximately 70 percent of GDP. In addition, replacement costs are estimated to exceed US\$5,000 million (almost 100 percent of GDP). Of the total damages, US\$2,005 million corresponds to damaged stock, while US\$1,789 million reflects indirect effects affecting production.

In ECLAC's view, these damages will be felt for at least four years. According to Central Bank of Honduras estimates, the damage done to output caused real GDP growth to decline from 5.2 percent to 3 percent in 1998 and from 5.5 percent to -2 percent in 1999.

D. POVERTY, POPULATION, AND THE ENVIRONMENT

The last population census (1988) showed that Honduras had a population growth rate of approximately 3 percent per year. According to official projections, the current rate would be 2.8 percent. These figures make Honduras one of the countries with the fastest population growth rates in Latin America. It is estimated that by 2025, the population of Honduras will be between 10 and 15 million people.

The available figures show the death rate falling from 22.3 per thousand in the 1950s to 8.1 per thousand in the 1990s. For its part, the fertility rate is estimated to have fallen from 51.4 per thousand to 39.8 per thousand in the same period. The overall birth rate for Honduras as a whole was approximately 5 children per woman in 1988. Data gathered in surveys shows women in rural areas having on average between 6 and 7 children during their reproductive period, while those in urban areas have four.

Internal migration is moderate. In 1974 the rate was 19 percent and it rose only to 19.5 percent by the next census year in 1988. The population has tended to shift from the poorer and more rural departments of the west and south toward the center, north, and east of the country. The rural-urban drift had been the major factor. However, the last census put it in third place, with the principal destinations being the major urban centers: Tegucigalpa and San Pedro Sula in particular. The currently predominant migration flow is from city to city, followed in second place by migration from one rural area to another, as the population

moved toward the less populated departments in the east of Honduras. This last migratory movement was in part a response to government rural settlement incentives, and partly spontaneous; either way, it brought pressure to bear on extensive forest regions in the country.

Although partly related to the above, the rapid loss of resources and the environmental degradation, along with increasing vulnerability to natural disasters, have a number of causes, mainly related to poverty, the irrational and disorderly use of land, poorly enforced sectoral policies, an ineffective legal and institutional framework, and the lack of an environment-conscious culture among the population.

As it was previously noted, the highest indices of rural poverty are for areas in the west and south of Honduras, and south of the department of Francisco Morazán. In these areas, the inhabitants largely engage in farming and livestock activities on land ideally suited for forestry. This inappropriate use of soils has led to rapid environmental degradation, with a negative impact on the productivity of farming activities and hence on the poverty indices for these regions.

Inappropriate use of the soil stems from a number of factors, the chief one undoubtedly being inequality in the distribution of land. This situation has prompted a high proportion of small farmers to settle in areas that are poorly suited to farming and livestock activities, thereby creating a vicious circle of poverty-environmental deterioration-further poverty.

Data in the National Program for Sustainable Development (PRONADES) document show 72 percent of productive units administering 11.6 percent of area under cultivation, while 1.7 percent (representing farms of over 100 hectares) administering more than 39 percent of the land. Of a total of approximately 330,000 agricultural producers, 205,000 (62 percent) are poor small farmers or farm laborers. Of the latter, 19.7 percent are temporary farmers (*precaristas*) and 42.4 percent are small farmers who own land but who have settled on plots as sharecroppers of various kinds (*aparceros, medieros*), lessees, authorized colonists, or as mere occupants. That leaves 57.6 percent, or 118,000 farm laborers, who are landless.

The high indices of poverty and exclusion from social services coverage prevalent in rural areas, especially in the southern, central-southern, and western regions of the country, have led the population to shun them. Above all in recent years, the population has migrated to the major cities, as well as to rural areas that constantly attract migrants but which are highly vulnerable because of their ecological characteristics, such as coniferous forests. According to data from the latest National Demographic Surveys, migration from one rural area to another is between 28 percent and 33 percent, compared to 14 percent for migration from the countryside to urban areas. These migratory movements have led to rapid depletion of natural resources and increasing environmental degradation in both urban and rural areas.

Migration from one urban area to another and rural-urban migration has generated a trend toward increasing urbanization. This growing group of migrants has settled spontaneously in places with a high degree of risk of floods, landslides, and collapsing ground, thereby greatly increasing the vulnerability of cities such as Tegucigalpa, San Pedro Sula, Puerto Cortés, and other towns in Valle de Sula.

Urban growth, combined with a lack of land and urban development planning, has also exacerbated the environmental degradation and pollution problems in those cities, with a negative impact on human health.

A study conducted by ESA Consultores³⁰ notes that water resources bear the brunt of the country's environmental problems in the sense that they are hit by hydrofecal pollution caused by the lack of sanitation infrastructure, and by sediment coming from degradation of the higher river basins, not to mention increasing chemical contamination by waste waters discharged by industrial plants and solid waste dumped on the sides of the rivers running through the major cities. This situation is especially bad in the case of the Choluteca, Chamelecón, and Ulúa rivers.

The same document reports that air contamination studies carried out by the Municipal Statistics Research Directorate in San Pedro Sula in 1994 showed a daytime concentration of 0.029 ppm of nitrogen dioxide: a higher than normal reading. Another study³¹ in Tegucigalpa showed up to 8.96 g/m³ of lead in the air, and in 1995 a report by Rivera FM on lead intoxication in first grade schoolchildren attending public schools in Tegucigalpa found high levels of intoxication in the children. These data show the high levels of atmospheric pollution in the country's major cities.

The study also notes that contaminants in the soil and water are responsible for a high index of diarrheic diseases in Tegucigalpa, where, according to official statistics, some 7,000 people suffered from these kinds of illnesses in 1990. According to data released by the Ministry of Health, in 1996, the principal diseases were still those related to parasites and intestinal infections, affecting mainly children under five years of age.

Respiratory diseases are also common, especially among children under five. They are partly a product of atmospheric pollution caused by the increasing number of cars and the presence of factories that are not subject to any kind of environmental regulations.

Soil and water pollution is compounded by solid waste dumping, especially in Tegucigalpa and San Pedro Sula, where much of the population is concentrated. This problem has to do with the low coverage of garbage collection services, poor waste management, and the lack of sanitary landfills, in addition to the fact that most of the population lacks environmental education. It is estimated that in 1998, Tegucigalpa and San Pedro Sula between them generated between 1,300 and 1,500 gallons of garbage per hectare per day.³²

At the same time, migration from depressed zones to poles of attraction in rural areas have

³⁰ ESA- Consultores, *Síntesis del Perfil Ambiental de Honduras/ (1998) [ESA-Consultants, Synthesis of the Environmental Profile of Honduras] Draft.*

³¹ CESSCO, COSUDE-EPFL, Government of Honduras, OPSA-ECO, *Cuaderno sobre el Estado Sanitario Ambiental de Honduras [Workbook on the Sanitary and Environmental Status of Honduras], No 3/ (1995).*

³² ESA-Consultores, *Síntesis del Perfil Ambiental de Honduras [op.cit.] / (1998). Draft.*

contributed to a build-up of the population in areas such as the eastern part of Colón, Olancho, and Gracias a Dios. The main motive underlying such migration is the search for farmland. This has greatly expanded the total area under cultivation, through what is known as migratory agriculture, whereby migrants form agricultural outposts for cattle breeders and farmers prepared to buy land that has already been deforested.

This process begins with cutting down and burning the forest areas in order to engage in farming and livestock subsistence farming on soils meant for forests, and which, because of their texture and slopes of over 25 percent, are unsuited to sustaining activities of this kind. Such practices lead to the abandonment of these lands and the search for new lands covered with forests, to recommence the cycle. This constitutes one of the main causes for the reduction in forested areas and for increasing soil erosion. A diagnostic assessment of the sector before the Master Plan for National Reconstruction and Transformation (PMRTN) was drawn up³³ reports that approximately half the originally forested areas are currently being used for crops and cattle breeding, which suggests that Honduras's forestry potential has yet to be properly appreciated.

According to OAS/COHDEFOR³⁴ data, approximately 32.2 percent of the national territory is subject to overexploitation, in the sense that 73 percent of annual food crops, 62 percent of perennial crops, and 40 percent of extensive stock farming is carried out on hillsides where almost 56 percent of the rural population live.

All this has led to high indices of deforestation in important basins such as those of the Cajón, the Yojoa y Aguán lake (60 percent), the Nacaome river (70 percent), Choluteca and Litoral Norte (74 percent), and Lean (86 percent). Reduced forest cover in most watershed areas has led to lower water catchment and storage capacity, on the one hand, while, on the other hand, generating water system instability problems, including droughts and floods entailing extensive human and economic losses.

Another major cause of deforestation in Honduras is firewood consumption. Every year some 7 million cubic meters of wood are harvested in order to provide a source of energy for Honduran families.³⁵ Indeed estimates have it that about 65 percent of the energy generated in the country comes from firewood. Obviously, the areas that consume most are the large population centers such as Tegucigalpa, San Pedro Sula, and Choluteca, where an estimated 75 percent of the population uses firewood for household purposes, with an annual consumption of 1.7 cubic meters per person. In addition, businesses such as bakeries, limestone quarries, and salt works, and others use firewood as their principal source of energy, accounting for approximately 15 percent of domestic consumption.

³³ Flores Rodas, José G. and Santos Zelaya José A. "Plan Maestro de la Reconstrucción y Transformación Nacional. Lineamientos del Sector Forestal" [Master Plan for National Reconstruction and Transformation] (1999).

³⁴ ESA-Consultores, Síntesis del Perfil Ambiental de Honduras [Summary Environmental Profile of Honduras] (1998).

³⁵ Flores Rodas, José G. and Santos Zelaya José A. "Plan Maestro de la Reconstrucción y Transformación nacional. Lineamientos del Sector Forestal" [Master Plan for national reconstruction and transformation: guidelines for the forestry sector] (1999).

E. POVERTY AND DEMOCRATIC PARTICIPATION

Poverty is part of an institutional context, and this context can either encourage poverty to grow or decline. Macroeconomic and sectoral policies form part of that context, but so do social and political institutions. The peculiarities of Honduras's political institutional setup could have a bearing on various factors that have allowed poverty to subsist, and especially those that have hampered participation by the poor in policy formulation. Devoid of the means of participation, the poorest groups have failed to draw adequate attention to their problems and priorities.

However, over the past two decades traditional political institutional arrangements have been yielding in the face of a series of reforms that are enhancing citizen participation. Governments have succeeded one another in an environment of stability (5 consecutive presidential elections). New institutions have been created, such as the National Elections Tribunal, the National Commission of Human Rights, and the Attorney General's Office (*Ministerio Público*). A start has been made on modernizing the State and strengthening municipal governments. And various civil society organizations have been formed. FHIS has improved its procedures for consulting communities by encouraging ways of reaching consensus on the order of priority of the projects it finances. In this way, the inhabitants of remote villages have been able to make themselves heard and, in the best of cases, have had their requests met. Such actions have a demonstration effect that will undoubtedly lead to changes in the traditional forms of consultation employed by the municipalities, other government bodies, or civil society organizations.

The process of strengthening democratic participation has its ups and downs and needs to be continuously reviewed, but has nonetheless gained sufficient momentum to justify the hope that the poor will find in it the opportunities they need to discuss their problems and seek solutions to them.

No extensive study has yet been done in Honduras to show that increased democratic participation has been a favorable factor in poverty reduction. However, the available international experience indicates that political stability and democratic participation are factors promoting economic growth, which in turn helps to reduce poverty. Honduras has consolidated its democracy in the last two decades, and its citizens are increasingly able to bring their concerns to the attention of government institutions.

Civil society is better organized than ever before. The rights of women, children, and consumers are now better recognized by society as a whole. Other achievements have brought greater stability to the country. These include less military participation in government; greater participation by municipalities in national and local problems; and the formation of new social groups.

F. THE DETERMINANTS OF POVERTY

Poverty in Honduras is the historical outcome of high population growth combined with low economic growth. During some periods, income per capita fell, which led to an increase in poverty, both relatively (as a percentage of the total population) and in absolute terms (the actual number of poor).

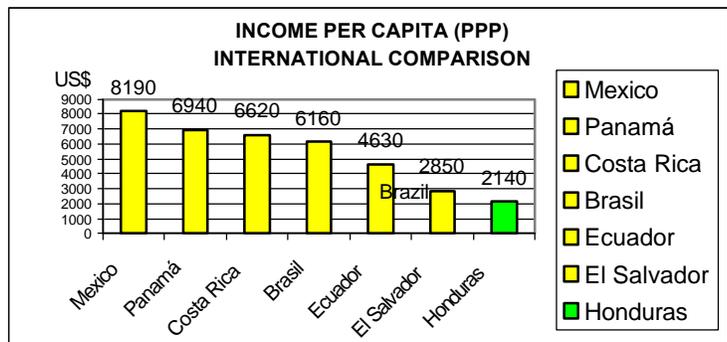
Since Honduras is one of the lowest-income countries in Latin America, its poverty is evident, especially given that it affects over half the population, in both the cities and rural areas. Some analysts and numerous representatives of civil society organizations are convinced that poverty in Honduras is principally attributable to the high concentration of wealth and, for that reason, demand that the government provide more resources and social compensation programs. Indeed, commitments to help the poor have become a key item on political agendas.

Nevertheless, when that assumption is tested against the facts, poverty is found to be a problem of insufficient access to means with which to generate income. To discover what causes this, it is necessary to analyze both the incipient nature of the country's economic growth, which manifests itself in low GDP per capita, and the high level of concentration of national income. No attempt is made, in the rest of this section, to provide absolute answers to the dilemma, but rather to examine the historical period under review on the basis of the information available.

1. INCOME PER CAPITA

For country comparison purposes, it can be observed that only Haiti and Nicaragua have lower per capita incomes than Honduras [in Latin America]. Adjusted for purchasing power parity, per capita income in Honduras is US\$2,140: considerably higher than nominal per capita income. However, when that adjustment is made, per capita income in most countries also rises in the same proportion.

Average income adjusted according to purchasing power in Central America and the Caribbean is US\$5,400 and for Latin America it is US\$6,780.³⁶ Given the high degree of correlation between individuals' low income and poverty, high poverty levels are to be expected in Honduras.



A more efficient way of determining whether poverty in Honduras is generated principally by low income per capita is to begin by asking to what extent poverty levels would change if Honduras had the income per capita of

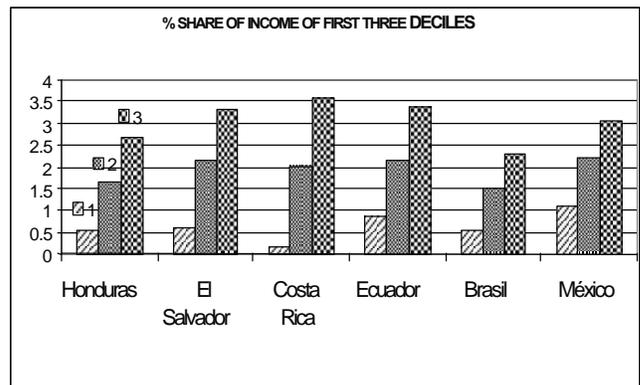
³⁶ Banco Mundial, Informe sobre el Desarrollo Mundial [World Bank, World Development Report], 1999–2000.

other countries,³⁷ assuming that the same wealth distribution pattern remains constant. the results of this exercise are surprising: extreme poverty would decline from 57 percent to approximately 35 percent if honduras had the same income per capita as guatemala (us\$4,000), and to 23 percent if it had the same income as Costa Rica. given these findings, one may conclude that an effective way to reduce poverty would be to achieve sustainable rates of growth of per capita GDP.

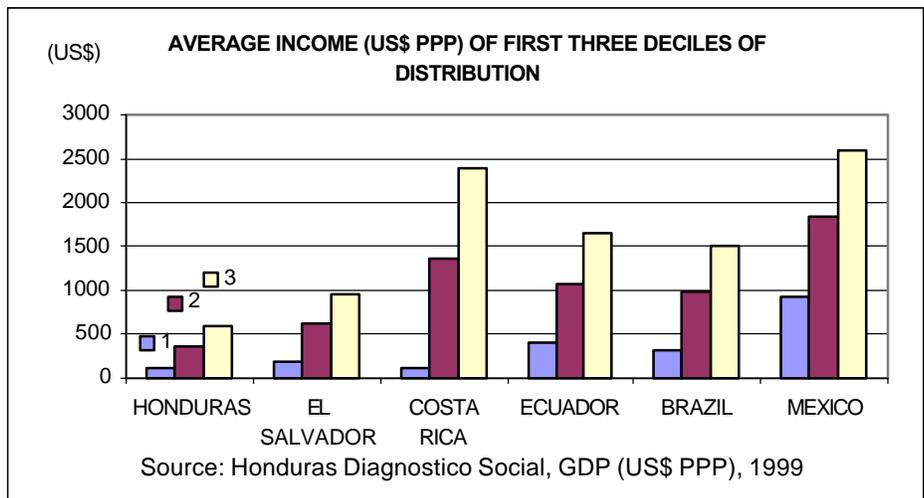
2. INCOME DISTRIBUTION

Evidence has been presented that insufficient income is a determinant of poverty in Honduras. However, it has also been argued that unequal distribution of income explains as much or more. Compared with other countries, the distribution of wealth in Honduras is poor, but it is not one of the world's most skewed. It would be more accurate to state that income distribution in Honduras comes roughly in the middle of a scale ranking countries with the best and the worst distributions.

The two bar charts in this section show two aspects of income distribution in several Latin American countries, including Honduras. The first shows the share of national income corresponding to the poorest deciles of the population, that is to say, the extremely poor. In this case, the structure of income distribution in those deciles appears to be highly similar in each of the countries with which Honduras is compared.



In the second bar chart, showing the *average income* corresponding to each of the very poor decile in the different countries, those living in extreme poverty in Honduras can be seen to have lower average incomes than those in the other countries. This suggests that extreme poverty conditions in Honduras are worse than in other



³⁷ Taken from Ricardo Paes' country comparisons published in the paper entitled "Honduras, un Diagnostico Social."

countries with roughly similar income distribution patterns.

It may be concluded from these two charts that poverty in Honduras has more to do with insufficiency of income than with unequal distribution of wealth. Thus, improving the distribution would help to alleviate the plight of the poorest, but would do little to reduce poverty.

If Honduras had the same income distribution as Costa Rica (a country considered to be one of the most advanced in Latin America as regards social policy), extreme poverty could decline from 57 percent to approximately 50 percent. This 7 percent reduction thanks to improved distribution is considerably lower than the 34 percent reduction that could be obtained if Honduras's income per capita were the same as Costa Rica's.

These findings would appear to solve the dilemma of which poverty determinant is more important. Economic growth becomes the principal vehicle for raising income per capita, and the latter will have a significant impact in terms of poverty reduction. This does not preclude parallel programs aimed at redistribution of income, because it should not be forgotten that significant increases in income per capita require long periods (10 to 15 years) of sustained growth, and the poorest segments of the population need some relief from the burden of poverty while awaiting the opportunity to shed it.

3. DETERMINANTS OF LOW ECONOMIC GROWTH

Having resolved the first dilemma, it is worth asking why Honduras has (and has had) economic growth that has not enabled it to increase income per capita. A range of possible answers exists, from the low level of educational attainment of the work force to corruption. It is possible that all the variables explaining the poor performance of the economy are correlated to a certain extent, but the important thing is to identify which of them most affects the ability to generate a rate of economic growth sufficient to raise income per capita.

According to recent United Nations estimates, after adjusting for cost of living differences, income per capita in Honduras is barely one third of the average income per capita in Latin America and one tenth of the average for industrial countries. Theoretically, income per capita can be derived from the productivity/demographic dependency ratio. Thus, Honduras's low income per capita would appear to be due basically either to the low average productivity of the labor force or to high demographic dependency, or both.

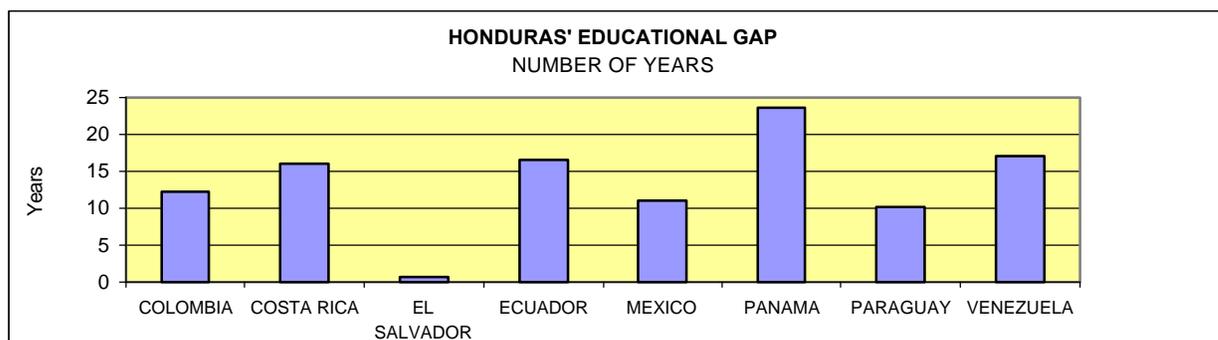
The IPEA study makes it clear that both factors help explain the difference between productivity in Honduras and in other countries, but the average productivity factor has greater explanatory power, especially since demographic indicators account for less of the change in income per capita than do average productivity indicators. The following sections focus in greater detail on the part played by each factor in the explanation of economic growth.

a) Labor productivity

The average productivity of a Honduran worker is barely US\$4,800 (US\$ PPP) per year, compared with average productivity in Latin America and in industrial countries of US\$11,000 and US\$31,000, respectively. In neighboring countries, such as Costa Rica and

Panama, average productivity is around US\$10,000 per year. The figure for Honduras is thus definitely low and needs to be explained in connection with two factors: the quality of the work force and the quality of jobs. In the case of Honduras, the second factor has greater explanatory power with respect to international productivity differentials.

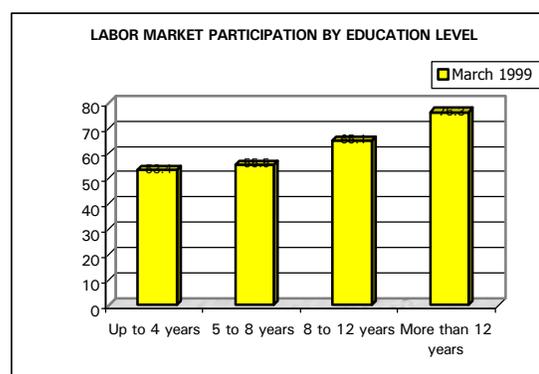
The work force in Honduras has one of the lowest levels of education in Latin America, which is why many industries that require highly skilled labor discard the possibility of investing in the country. The educational gap vis-à-vis other countries in the region is so wide that it would take Honduras over 15 years to attain the educational levels that Costa Rica has today, and almost a quarter of a century to reach levels comparable to Panama's.



One of the major effects of having a better educated work force is that it is conducive to greater participation in the labor market (as the chart shows) and to placement in higher-income producing sectors. Industries producing goods and services with higher value added tend to hire better-educated workers.

The quality of the work force is related to both its levels of education and its production capacity. However, from an economic point of view, the important thing is to observe whether the low productivity of labor is due to the low level of education or to the choice of technology for a particular activity.

Surprisingly, Honduran workers differ very little from workers in the rest of Latin America as regards productivity associated with a poorly educated work force. If Honduran productivity is compared with the rest of Latin America, it turns out that its productivity is lower, in part (16 percent) owing to the poor quality of the workers, but to a far greater extent (84 percent) owing to low job quality.³⁸



³⁸ Average hourly wage in a principal occupation was used in this comparison as a job quality indicator. See IPEA, op. cit., p. 61. The usefulness of this indicator for explaining job quality differences (i.e. quality of the physical capital or of technological know-how) has been pointed out by several authors. IPEA also employs other indicators that approximate to that variable. See pp. 20 and 24.

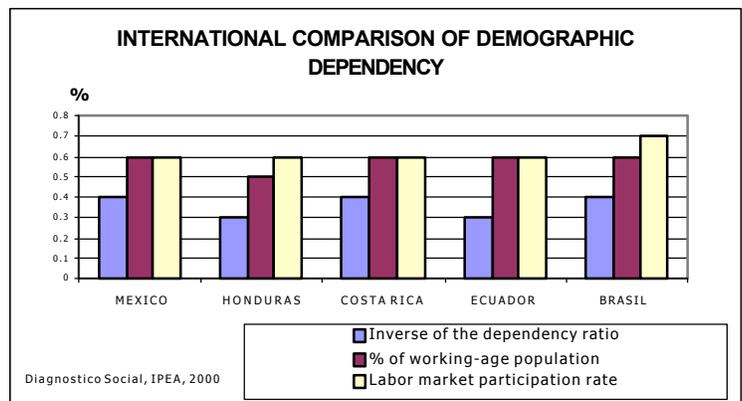
b) Population growth

The debate about the part played by population growth in economic growth can be brought to bear on a concrete case by observing the specific role of demographic dependency, understood as a ratio between two factors: the proportion of the working-age population and the degree of utilization of that working-age population.

The so-called demographic dependency ratio used in the IPEA study refers to directly demographic factors, to the percentage weight of the working-age population in the total population of a country, and to socioeconomic labor market factors that help define the intensity with which the population of working age is utilized for productive purposes. By this token, the demographic dependency ratio turns out to be high (or, looked at from another angle, becomes an obstacle to economic growth) if the percentage of the working-age population is small and there are constraints on the intensity with which this population is utilized.

In Honduras, barely 52 percent of the total population is of working age (most of the population is young and a much smaller percentage represents people who have retired from the labor force), compared with 68 percent on average in the industrial countries. Even compared to Latin America and the higher-income countries in Central America, the proportion of the population of working age in Honduras is low: the average for the Central American subregion is 58 percent, whereas in both Costa Rica and Panama, the figure is closer to 60 percent. In any event, within the regional context, this factor does not account significantly for differences in economic growth. In fact, only 22 percent of the difference in per capita income between Honduras and Latin America is explained by the small percentage of the population of working age. Still, it is sufficiently high to be borne in mind when proposing corrective policies.

With regard to utilization of the working-age population, the best indicator for which is the rate of participation in the labor market or Economically Active Population, Honduras may be said, once again, to have a low level of participation. In Latin America as a whole, the EAP is equivalent to 68 percent of the working age population, compared to 59 percent in the case of Honduras. There is less of a difference with Costa Rica and Panama, and the percentages turn out to be similar. However, the gap vis-à-vis industrial countries is even greater. For them the same indicator is 72 percent.



Thus, the dependency ratio in Honduras is due to the existence of both a relatively smaller proportion of the working-age population and less intensive economic utilization of that population. Compared with industrial countries, two-thirds of the difference in the dependency ratio is purely demographic in origin (i.e. the percentage of the population of working age predominates). Compared to Costa Rica and Panama, the entire difference is

explained by the demographic factor when, as in this case, differences in the percentage weight of the EAP are practically zero.

III. SOCIAL SPENDING AND DEVELOPMENT OF HUMAN CAPITAL

A. SOCIAL SPENDING: IMPORTANCE AND TRENDS

As seen in the diagnostic assessment section, low Human Development Indices are an important factor behind poverty in Central America in general and in Honduras in particular. Costa Rica's comparatively better position is largely due to its progress in terms of the variables that determine that index. Thus, improving human development through investments in education, health, and other social sectors is an essential component in the poverty reduction strategy.

Given this situation and paralleling reform and macroeconomic adjustment, since 1990 the government of Honduras has been promoting a state modernization process that seeks, among other things, to direct a growing percentage of spending to social ends, to improve the effectiveness of its social programs, and to create new programs targeting the alleviation and reduction of poverty. After ten years, Honduras has made significant progress and has recognized the importance of improving the coverage and quality of primary or basic services using social targeting criteria directed to poor communities and families.

In this area, the FHIS has played an important role with investments that help to meet the basic needs of the population and generate income. In addition, the PRAF has distributed bonuses for mothers in poor households. The Ministries of Health and Education have emphasized the coverage and quality of primary services and improving the efficiency of public spending. However, the process of institutional modernization in health and education has barely begun.

As a result, the magnitude of social spending and its distribution express the care that the state provides to society. In countries with a high incidence of poverty, social spending plays a fundamental role in providing health services, education, water supply, support for housing programs and other programs intended to combat poverty and extreme poverty. However, the magnitude of social spending in poor countries is limited by the size of their gross domestic product, by the volume of fiscal revenues, and by the limitations imposed by obligations such as external debt payments.

1. RECENT TRENDS IN SOCIAL SPENDING

During 1996-97, social spending in Honduras amounted to 7.2 percent of GDP, a level similar to that of countries such as Mexico, Paraguay, and El Salvador (7.7-7.9 percent), and even higher than that of Peru (5.8 percent), the Dominican Republic (6.0 percent), and Guatemala (4.2 percent). The dynamic of social spending is for the most part determined by economic growth, although in per capita terms economic growth is also related to the magnitude of GDP. This is what allows a country such as Guatemala, with its lower social

spending/GDP ratio, to at the same time have per capita social spending that is higher than that of Honduras.³⁹

In absolute amounts, social spending in Honduras in 1998 was close to L 5 billion in current terms, which represented a real increase of 17 percent during the period 1990–1998, although the largest increases occurred between 1990 and 1993, largely as a consequence of new entities such as the FHIS and the PRAF and the urban transport subsidy. As shown in the following table, 1993 is the year with the highest social spending in the decade, coinciding with the electoral process leading to a change in government. The relative importance of these entities has been decreasing in subsequent years, and with it the rate of growth in social spending. One example of this is that the combined spending of the FHIS and PRAF in 1993 represented about 90 percent of Ministry of Health spending, while that percentage was 97 percent in 1997.

DEVELOPMENT OF PUBLIC SOCIAL SPENDING In Millions of Lempiras									
	1990	1991	1992	1993	1994	1995	1996	1997	1998
<i>CURRENT LEMPIRAS</i>									
<i>EDUCATION SECTOR</i>	527.6	714.0	834.9	1114.5	1137.9	1575.2	1884.8	2501.1	2744.2
<i>HEALTH SECTOR</i>	344.7	418.3	495.3	625.1	735.1	1146.5	1245.4	1242.0	1362.6
<i>OTHER</i>	125.0	166.8	193.3	249.5	306.9	281.9	425.3	515.3	888.5
<i>TOTAL</i>	997.3	1299.1	1523.5	1989.2	2179.9	3003.6	3555.5	4258.3	4995.3
<i>TOTAL IN 1996 LEMPIRAS</i>	3078.1	3184.1	3423.6	3931.2	3343.4	3689.9	3555.5	3481.9	3593.7

Source: Ministry of the Presidency, Estudio Sobre el Gasto en Servicios Sociales Básicos [Study on Spending in Basic Social Services], 1999.

Note: The education sector includes spending by the Ministry of Education, the UNAH, UPN, FHIS (Education), IMPREMA, PRAF (Education), and INFOP. The health sector includes spending by the Ministry of Health, SANAA, IHSS, FHIS (health), and PRAF (health). The category "other" includes spending by FOSOVI, the Ministry of Labor, the National Social Welfare Board, INJUPEMP, and other spending by FHIS and PRAF.

Another way to measure the priority and evolution of social spending is in terms of its weight within total government spending. In this regard, during the period 1994–96 Honduras allocated 34 percent of its total spending to the social sectors, slightly less than the 36.6 percent allocated in the Dominican Republic and the 37.2 percent in Colombia, but much less than spending in countries such as Chile and Costa Rica (both at approximately 62 percent). Nonetheless, in recent years Honduras has been making greater efforts to prioritize social spending, in consequence of which it has grown from 40 percent in 1999 to more than 42 percent in 2000.

In addition, spending on basic services that are directed more to the poor population⁴⁰ absorbed an average of 47 percent of total public social spending during the period 1990–

³⁹ Economic Commission for Latin America and the Caribbean (ECLAC). Social Panorama of Latin America, 1998.

1998. This figure fell to 38 percent in 1998, owing in part to the results of Hurricane Mitch. The following table shows the trends in spending for basic social services during the 1990s at constant 1996 prices.

SOCIAL SPENDING ON BASIC SOCIAL SERVICES As a Percentage of Total Social Spending									
	1990	1991	1992	1993	1994	1995	1996	1997	1998
Education sector	50.9	55.5	53.3	58.5	50.5	54.2	51.6	49.3	44.9
Health sector	32.6	42.9	42.8	39.5	38.6	38.1	45.9	49.4	44.4
Other	63.5	48.4	41.3	41.8	36.5	99.4	32.3	18.9	11.3
Grand total	46.2	50.5	48.3	50.4	44.5	52.3	47.3	45.7	38.8

Source: Ministry of the Presidency, Estudio Sobre el Gasto en Servicios Sociales Básicos [Study on Spending in Basic Social Services], 1999

Based on the Study on Spending in Basic Social Services, cited above, the following considerations are presented on spending levels in education and health, as well as on aspects relating to the prioritization and efficiency of that spending.

2. PROGRAMS TARGETING SOCIAL INVESTMENT

a) Honduran Social Investment Fund (FHIS)

The FHIS, founded in 1990, is a social compensation instrument directed primarily to alleviating poverty in the short term. The Fund was originally conceived as a temporary agency. With the creation of FHIS-2 in 1994, the institution's life was extended and in 1999 the National Congress of the Republic decreed that the Fund's operations would be extended until 2012. In order to ensure its effectiveness in implementing projects, a series of administrative and legal rules pertaining to procurement and the civil service were made more flexible.

To improve the targeting of its programs, the FHIS developed poverty maps based on indicators of unsatisfied basic needs. Resources will be distributed according to the population in the cities and their relative level of poverty, with more resources per capita being allocated for the poorest cities. From the outset, the FHIS adopted the concept of selecting "demand driven" projects, that is to say, projects are conceived at the local level by the future beneficiaries. The process fostered the development of participatory democracy under the leadership of local governments.

The FHIS has developed close working relationships with the communities, municipal governments, and civil society organizations, incorporating them in the cycle of formulating, executing, and maintaining projects. In this way, the FHIS has strengthened the operational

⁴⁰ In the health sector, basic services include the Environmental Sanitation Programs, Control of Communicable Diseases, Ambulatory Care, and Nutritional Assistance (all under the Ministry of Health); Water and Sanitation and Health (FHIS); Mother-Child Bonus and Nutritional Bonus (PRAF).

capacity of the cities and has promoted citizen participation. In addition, it has established coordinating mechanisms with the line ministries, foundations, and other organizations responsible for maintaining the infrastructure and operating programs delivering social services.

The operations of the FHIS are generally directed to small social infrastructure projects. More than half of the projects consist of investments in the area of primary and preschool education. Significant amounts have been invested in health stations, water and sanitation projects, and municipal projects. The evaluations that have been conducted on the programs confirm that the fund is having significant positive effects in the areas of health and education.

The FHIS has received strong financial support from the international community. The largest collaborators have been the World Bank, the Inter-American Development Bank, the Organization of Petroleum Exporting Countries (OPEC), the German cooperation agency (KfW), the Swedish Agency for Cooperation in International Development (ASDI), and USAID. National counterpart funds range between 5 percent and 10 percent of the institution's total budget.

Since its creation, the Fund has carried out some 9,800 projects for a total amount of approximately US\$300 million. By itself, FHIS-2 (1994-97) invested US\$111.5 million, while the investment originally scheduled for FHIS-3 (1998-2001) came to US\$115 million. The emergency programs associated with the damages caused by Hurricane Mitch have considerably enlarged this figure. Currently under negotiation are new financing operations with the World Bank and the IDB relating to the process of decentralizing the FHIS and the growing role of municipalities in the management of its resources.

With a view toward strengthening local management, the FHIS is laying the groundwork that will enable it to decentralize its operations in the medium and long term. In this regard, 30 municipalities have been selected for developing pilot experiments. In addition, various technical instruments are being designed to carry out this process, and the municipalities' administrative capacity to take on this new challenge is being analyzed.

b) Family Allowance Program (PRAF)

The major objective of this program is to provide additional income for single mothers, school-aged children, and the elderly, who are at risk in terms of food and nutrition. At the same time, the mechanisms used by the PRAF contain elements for the permanent reduction of poverty in that they offer incentives for continuing school attendance and mother-child health care, as well as training to strengthen the business skills of mothers.

The PRAF distributes bonuses to the families of boys and girls who are enrolled in primary school and take part in the growth check-up and vaccination programs of the Ministry of Health. These bonuses bolster family income and also provide an incentive for the use of primary programs. There are also programs for the elderly, business training for women, gender and equal opportunity, and socially excluded groups.

The PRAF has the financial support of the Inter-American Development Bank (IDB), the government of the Republic of China, the Central American Bank for Economic Integration

(CABEI), the World Food Program (WFP), OAS/CIM [Inter-American Commission of Women], the European Union, and UNESCO, as well as national funds.

From its creation in 1990 to the present, the PRAF has provided services to an average of 308,816 people each year throughout the decade, with an average growth rate of 27.6 percent. In its first year, it successfully reached 69,131 people and by the end of the decade the number of beneficiaries had risen to 405,415. The investment required to implement the institution's various projects throughout the period amounts to L 974.2 million, with an average annual requirement of L 97.4 million, or slightly less than 10 times the initial figure invested in the year of its creation.

Currently, the PRAF is carrying out its projects in 16 departments in the country. The large majority of the beneficiaries in all projects developed in the last year are children (90 percent), with the remainder distributed among mothers and the elderly.

c) Other Targeted Programs

Honduran Childhood and Family Institute (IHNFA)

The Honduran Childhood and Family Institute was created in 1997. The budget implemented by the Institute during 1999 was L 78.5 million. Its major objectives are to:

Formulate and implement state policies in the areas of childhood and the family, giving priority to the most vulnerable groups;

Coordinate the participation of state and private institutions in the programming and execution of actions for comprehensive protection of children and families;

Support citizen participation and community organization to build a system of opportunities for children and families, for which the Institute's management has been strengthened with the support of grass-roots organizations, communications media, private companies, universities, religious groups, and civil society institutions; and

Establish a system of measures and services to provide an alternative to the confinement of children and adolescents.

The Institute has developed the following strategic programs to reduce poverty:

- *Family Welfare and Community Development Program*, under which it has served 4,674 children between the ages of 0 and 6 and subsidized 3,095 children. It has organized 3,847 adolescents into youth clubs and vocational and cultural workshops and has served 8,027 victims of Hurricane Mitch. The program has reached a total of 22,434 beneficiaries.
- *Intervention and Protection Program*, which has served 8,825 cases, including 5,060 reports on children at social risk. In addition, it has provided protection to 2,660 children in public and private centers.

- *Program for Reeducation and Social Re-entry*, under which the IHNFA has served 4,192 adolescents in trouble with the law. The program includes rescuing children who are part of mobs or gangs, through efforts coordinated with civil society organizations and families in the communities.

The major limitation on IHNFA's programs is the limited availability of resources compared to the magnitude of the problem of extreme poverty in the country and given the need to keep total public spending within the established limits. To achieve the sustainability and expansion of its programs, the Institute will seek financing through nonreimbursable funds from foreign cooperation agencies and will carry out campaigns to gather domestic resources. For this same purpose, the IHNFA will sign international cooperation agreements with nongovernmental organizations, religious groups and other civil society organizations, and with private enterprise. The financial limitations underscore the need to prioritize activities in the context of a well-defined strategy.

National Women's Institute (INAM)

The National Women's Institute was created in 1998 as an autonomous social development institution, its purpose being to fully integrate women into the process of sustainable development. INAM's budget for 1999 was L 3.7 million. The budget approved for 2000 is L 6.0 million.

The major objectives of INAM include contributing to full and comprehensive realization of Honduran women, ensuring that women and children enjoy human rights, ensuring equal opportunity between men and women, and promoting the integration of women into the country's economic, political and social development.

Its principal functions include the following:

- Formulating and promoting the National Women's Policy in Honduras;
- Monitoring and ensuring implementation of and compliance with laws providing protection for women;
- Integrating and coordinating with municipalities regarding the development of plans, programs, and projects to promote women;
- Promoting the effective participation of women in the community; and
- Negotiating technical and financial cooperation in support of the plans, programs, and projects of public and private sector institutions involved in women's issues.

As a new institution, INAM is still in the process of establishing, in concert with the rest of the public sector, the business sector, and civil society, the coordination and monitoring mechanisms needed to achieve its objectives.

3. SOCIAL SPENDING ON EDUCATION AND HEALTH

a) Education Spending

The average percentage allocation for spending on education is 4.2 percent of GDP, of which 2.3 percent of GDP is allocated to basic social services. In terms of total spending by

the central government, total education spending amounts to 18 percent, while the percentage for spending on basic educational services is 9.6 percent.

The structure of spending according to educational level is as follows: preschool–1.2 percent; primary school–60.7 percent; secondary school–19.5 percent; and higher education 19.7 percent. Public spending appears to be highly progressive in that it allocates a high percentage to the primary level. However, it should be pointed out that there is a serious problem of equity in spending, based on the structure of the school-aged population by level, high deficits in the lower levels and the relatively high proportion spent on higher education aimed at middle- and upper-class students. This problem is exacerbated by low levels of cost-effectiveness and quality in educational centers.

An evaluation of spending on education leads to the conclusion that human and physical resources at the primary level are not being allocated where they are most needed. As a result, they are not helping to substantially increase the coverage, quality, or efficiency of the system, particularly with respect to the public sector. In this regard, it bears noting that net and gross coverage levels continue to be low. The student/teacher and student/center ratios show a declining trend at all levels during the period 1990–1997. This limits the possibility of increasing enrollment and thus of reducing the current deficits.

In addition, the comparison between the public and private sectors shows the following: a) at the primary level, the grade repetition rate is 9.7 percent in public schools versus 2.9 percent in private schools; b) in secondary education, the difference is less, from 10.3 percent in the public sector to 8.7 percent in private secondary schools; and c) in higher education, the grade repetition rate in the public sector (UNAH) is 17 percent, nearly 100 percent higher than in the private sector with a rate of 8.6 percent.

These qualitative differences could be attributable to higher costs in the private sector. However, estimates of public sector costs per student at the different levels reflect amounts similar to those in private schools. The opposite occurs in respect of the recovery of these costs, particularly in the case of higher education where the average cost per student at the UNAH is almost equal to that at various private universities.

Performance levels in terms of results are even more serious in public education. Estimated pass rates for the primary school mathematics and Spanish courses show an average of 39 percent for third and sixth grade students in 1997. In addition, the estimated average academic index for the UNAH in 1995 was 37.3 percent as compared to an estimated 79 percent for private universities in 1997.

b) Health Spending

In GDP terms, Honduras allocates 2.6 percent of total public spending to health, while the percentage for spending on basic services is 1 percent of GDP. In terms of central government spending, total health spending accounts for 11.1 percent, while spending on basic social services represents 4.7 percent.

The distribution of spending by health care levels is as follows: primary care–51.6 percent; secondary care–23.6 percent; and tertiary care–24.8 percent. The favorable emphasis on the primary care level is sensible in that a significant percentage of the Honduran population

(18 percent) will continue for some time to be the target of mother-child care. In addition, the conditions of poverty and the characteristics of morbidity indicate that additional efforts are required in terms of preventive medicine and environmental clean-up.

Nonetheless, spending in the health sector has not had the required coverage, as its growth in terms of constant prices shows a rate of -0.7 percent per annum, which is not consistent with the morbidity and mortality characteristics of the population. Fortunately, spending on primary health care (8 percent) exceeds the population's growth rate (2.7 percent), but the Hospital Medical Care Program shows a marked decline.

According to the World Bank's Study on Access, Efficiency, and Equity, public sector ambulatory care tends to be concentrated in the lower-income population, as opposed to care in private clinics which is concentrated in the higher-income population. In addition, the Ministry of Health concentrates its services delivery on the three lowest income quintiles, whereas the IHSS and the private sector finance to a greater extent the healthcare of population groups in the upper quintiles.

Although the above reflects a growing trend in public spending on health, we should not overlook that fact that the urban bias of public health services and the more serious problems of efficiency and quality in small cities and rural areas are factors that continue to limit the redistributive effect of spending among the poorest segments of the population. In addition, as is to be expected, the nonpoor account for most of the private spending in health, but the percentage share of income is much higher among the poor who must pay nearly 10 percent of their incomes for health care.

B. TRENDS IN THE DEVELOPMENT OF HUMAN CAPITAL

1. EDUCATION SECTOR

There is growing awareness that the crisis in the Honduran educational system is essentially a crisis of quality,⁴¹ associated with the lack of mechanisms that demand quality services from institutions, teachers, and the students themselves. Instead of the current system, what is needed is a new system aimed at producing educational results that are consistent with the requirements of the labor market and with the self-improvement aspirations of students and parents.

The Francisco Morazán National Pedagogical University (UPNFM), which prepares teachers for secondary education, has few qualified professionals. In addition, more than half of the enrollment is represented by distance learning students, who receive certain training only on weekends. Teachers in the normal schools (institutes of secondary education) are, for the most part, graduates of the UPNFM and it is they who prepare, without much academic rigor, the future teachers of the primary schools. Thus, it is easy to see the clear need for quality control mechanisms (such as external knowledge assessments conducted by independent organizations) at all levels of the Honduran educational system.

⁴¹ SEP/GTZ, Sectoral Study and Ten-Year Plan (1997), p. 267.

Another serious problem in the educational system relates to its internal effectiveness and efficiency. Even though gross coverage at the primary educational level exceeds 100 percent, net coverage is approximately 86 percent, indicating that there is much room for improving efficiency at this level of education. The dropout rate has declined, probably as a result of programs such as the PRAF that seek the greater well-being of children. However, the fact that the drop-out rate tends to be increasing in urban areas is a concern.

Net coverage of secondary education has remained stable at about 22 percent, a percentage that reflects the low efficiency of the primary level and the economic needs that affect the lives of many school-aged youth. Grade repetition and dropout at the primary level are factors that represent disincentives for continuing in the formal educational system. Many students abandon school after the sixth grade, particularly in rural areas, in order to contribute to family income. Public and private schools at the secondary level show similar levels of low efficiency. However, there are large differences between the urban private schools attended by students seeking a better education and those private schools that operate because there is no public school in the area.

2. HEALTH SECTOR

Honduras is a country in full epidemiological transition, wherein the diseases typical of developing countries are giving way to the diseases more characteristic of the industrial countries. Cancer and cardiovascular diseases are on the rise, while some gastrointestinal diseases are declining.

Life expectancy in Honduras continues to improve (68 years for 1997) as a result of timely preventive medicine programs such as: i) strengthening of the horizontal program of the Extended Immunization Program (PAI) and the continuation of annual vaccination campaigns conducted by the Ministry of Health; ii) awareness campaigns regarding the use of polluted waters; iii) greater access to health centers for the population with limited resources; and iv) other activities being carried out by a large number of NGOs.

Despite the above, serious problems such as the following persist:

- High levels of child malnutrition.
- Respiratory diseases have become the primary cause of death among children under the age of 5, as a result of the deteriorating environmental conditions in which many families live.
- Maternal mortality is still very high.
- The tertiary health care level is characterized by deficient administrative structures, seriously affecting the population seeking these services.

3. SOCIAL SECURITY AND WELFARE

The Honduran social security system is based on the distribution approach and operates through various institutions that have been organized on the basis of the different population groups they serve. The system began in 1959 with the creation of the Honduran Social Security Institute (IHSS), which serves two functions: the provision of hospital care, and social insurance.

Subsequently, other social insurance organizations came into being, such as the National Institute for Retirement and Pensions of Public Employees (INJUPEMP), the National Teachers' Insurance Institute (INPREMA), the Military Insurance Institute (IPM), the Journalists Social Security Institute (IPSP), the Insurance Institute of the National Autonomous University of Honduras (INPREUNAH), the Social Welfare Program of the Central Bank of Honduras (PAS), and other programs established by professional associations, as well as pension plans administered by the private sector which are a recent creation.

The system provides coverage for the contingencies of sickness and accident; maternity and breast-feeding assistance; occupational disability; disability, old-age and death; and other services and benefits such as personal and mortgage loans. The coverage of the system is among the lowest in Latin America, amounting in 1999 to 28 percent of the economically active population (EAP) and barely 11 percent of the total population.

Disability and old-age pensions vary greatly, depending on the regulations governing each agency within the system. In the case of the IHSS, which represents more than 80 percent of the system's coverage, the maximum pension is L 600 per month, with a minimum of L 75. In the other agencies, pensions generally vary between L 1,500 and L 4,000, as in the case of INJUPEMP, or between L1,800 and L 6,200, as in the case of INPREMA. Similarly, the percentages used to calculate pensions vary between 40 percent and 65 percent of nominal wages, as in the case of the IHSS, and 80 percent under INJUPEMP and INPREMA.

The factors mentioned above, such as low coverage, the low levels of the pensions received, and lack of equity in the distribution of benefits within the system, contribute to increasing the incidence of poverty among the elderly. In addition, this situation may be aggravated because the financial position of the system's institutions has been deteriorating for a number of reasons. Some of the main problems in this respect are:

- Low IHSS contribution rates linked to the ceilings subject to contribution bear no relationship to continuing increases in the cost of hospital care. This is compounded by the rapidly mounting number of retirees.
- In institutions such as the INJUPEMP and INPREMA, there is a pronounced tendency to use accumulated resources for purposes other than the objectives of a pension program. This relates to the lack of a clear definition of the rights of participants.
- There is no proportional relationship between a worker's savings effort and the benefit the worker receives.
- Workers have no opportunity to choose the agency with which they want to affiliate.
- There is no regulatory framework for private pension systems.
- The state maintains an inequitable system of contributions. In the case of INJUPEMP and INPREMA, the state makes more than 60 percent of the contributions whereas in the case of IHSS it makes only 25 percent, despite the fact that this system has the

highest percentage of affiliated population and the workers with the lowest average wages.

A draft Framework Law for the Social Security System has been recently drawn up, which contemplates a series of reforms that will allow for separating the disability, old-age, and death systems from the sickness, maternity and work-related accident systems. In addition, it seeks to redefine the state's new role in the system and to promote private sector participation in the system. The option being suggested is a system in which public and private institutions functioning as Pension Fund Administrators would coexist within improved coordinating and competitive mechanisms.

4. WATER AND SANITATION

According to a study conducted by ESA Consultores, water coverage has improved significantly over the last decade. When poverty is analyzed according to unsatisfied basic needs, it can be seen that the lack of water fell from 18 percent to 7 percent between 1990 and 1997 in urban areas and from 33 percent to 9 percent in rural areas (including water from pumped winch wells). The impact of investments in this sector is reflected in increased life expectancy (indicated earlier). Unfortunately, Hurricane Mitch damaged many water and sanitation systems, which must be repaired in order to restore previous coverage levels.

In addition, Honduras has had no single institution tasked to guide actions with respect to the water and sanitation systems. Various institutions and organizations are working to resolve the sector's problems, but without the necessary coordination. SANAA, which manages the aqueducts of Tegucigalpa and some other cities, is the largest institution of this type. However, the municipalities currently provide most of the drinking water connections in the urban sector. In the rural sector, Water Boards supported by NGOs are the decisive providers. The sector is facing an institutional crisis that is now being resolved through a gradual process of municipalization and enactment of a coherent regulatory framework.

5. HOUSING

Having a decent home is essential to the development of a human being. The lack of an acceptable habitat constitutes an enormous obstacle for the formation of the "human capital" needed to be competitive and to achieve sustainable development.

Honduras, like many other developing countries, has not yet found a solution to the problem of housing for low-income families. Public funds for housing have gone to projects in the formal sector that are beyond the reach of poor families, and poor families have been allowed to solve their problems by invading public or private lands. The result is the existence of marginal neighborhoods. These are often constructed in places that are not suitable for habitation, that lack basic urban services, are plagued by environmental problems, and are exceptionally exposed to natural disasters such as Hurricane Mitch. It is estimated that one-third of the population of Tegucigalpa lives in such conditions.

This problem is even greater when one considers the inevitable process of urbanization that Honduras will undergo in the next 20 years. Currently approximately 52 percent of the population is urban. Based on the experience of other countries in the region, this figure can

be projected to increase to about 80 percent in 20 years' time. Using the most optimistic scenario of an overall population increase of 2 percent, the urban population would increase from 3 million in 1999 to 7 million in 2019, an absolute increase of 4 million people. This would generate the need for nearly a million new homes, or 50,000 per year. If overall population growth were 3 percent, the total would increase by 5.5 million to 8.5 million, leading to a need for more than 65,000 new urban homes each year. Under all scenarios, the rural population decreases in absolute terms.

It is thus conceivable that, in the absence of a satisfactory model for providing basic housing under satisfactory urban and environmental conditions, Honduras would be condemned to repeat the experiences of countries such as Brazil and Venezuela, where economic growth combined with unregulated urbanization have resulted in urban disasters in the principal growth centers.

Fortunately, it is still possible to avoid this outcome. However, there is an urgent need to develop a sustainable model that places emphasis on the role of secondary urban centers and gives priority to providing formal basic housing under financial terms that are accessible to families with limited resources.

6. RURAL SECTOR DEVELOPMENT AND ASSISTANCE PROGRAMS

The magnitude of the problems and challenges being faced in the rural sector necessitates a new approach to rural development, one that entails a comprehensive vision for the sector itself and greater coordination with the urban centers. In this respect, the rural development strategy requires support to supplement the efforts of the population, greater participation by the population in the development process, higher levels of investment in human capital, and measures aimed at preserving the environment.

The structural problem of the lack of economic and social equity in Honduran agriculture, in conjunction with the highly concentrated land ownership pattern and with subsistence production systems that do not respond to market signals or to the sustainable use of natural resources, justify government actions to afford the rural population access to the productive use of land resources and the benefits of a market economy.

Widespread rural poverty necessitates a balance between the economic and social dimensions of government actions in this area. In addition, income levels have been identified as the most important factor in food security in terms of the nutritional status of the country's households. From this perspective, food security becomes a problem of the security of minimum income levels, which is closely linked with poverty, particularly rural poverty.

Thus, rural development policies must combine different mechanisms to promote better living conditions in rural areas. On the one hand, economic surpluses, employment, and income must be generated in order to move ahead with the process of reducing rural poverty. In this context, there must be coordination of fiscal, monetary, and trade policies; promotion of goods with high economic and social content; natural resource protection and conservation; reconstruction and maintenance of the road infrastructure; the provision of public utilities and services, irrigation, and credit; and the targeting of supplemental programs to combat poverty. In addition, there must be investment in human capital, in

areas such as administration and management, product and market development, diversification of production, better use and protection of natural resources, and warning and prevention of natural disasters.

In order to make this new approach viable, the National Program for Sustainable Rural Development (PRONADERS) has been implemented. By definition, it involves job creation, increased production and productivity, interinstitutional coordination (including civil society), and institutional transformations to strengthen decentralization and citizen participation. Policy measures include the rehabilitation of productive units, the reactivation and sustainable growth of the agriculture and livestock sector, and land management based on the management of water resources. In this context, it is expected that PRONADERS will serve as a general policy framework for the implementation of rural development programs and projects.

Rural development is currently being supported through the implementation of actions in various areas, notably the:

a) National Program for Small-Scale Agriculture

- Rural credit is being supported through the implementation of four projects amounting to a total of US\$31.3 million for small farmers, particularly coffee growers, throughout the country.
- To promote production and increase productivity, eight projects amounting to US\$34 million are being implemented, particularly in the departments of Lempira, Olancho, Choluteca, Colón, Atlántida, Yoro, Islas de la Bahía, Cortés, Gracias a Dios, and Comayagua.
- To rebuild and maintain rural roads, three projects at a cost of US\$11.4 million are being carried out in different areas of the country.

b) National Program for Development of Agribusiness and Agricultural Exports

- In the area of irrigation, a project is being carried out in the department of Santa Bárbara at a cost of US\$16 million.
- In the area of technology transfer, twelve projects are being carried out in the departments of Comayagua, Yoro, Olancho, Choluteca, El Paraíso, and Valle in particular, at a cost of US\$26.04 million.

c) National Program for Sustainable Rural Development (PRONADERS)

- The promotion of sustainable rural development is supported by eleven projects at a cost of US\$84.9 million in the departments of Choluteca, Comayagua, Copán, Francisco Morazán, El Paraíso, Lempira, Ocotepeque, Atlántida, Valle, Colón, Olancho, Cortés, and Santa Bárbara.
- Food security is being supported with the implementation of four projects at a cost of US\$24.3 million with influence in the departments of Intibucá, La Paz, Lempira, Choluteca, Copan, Santa Bárbara, and Francisco Morazán.

d) National Forestry Program

- For protection and conservation of forest resources, US\$68.9 million is being invested, with particular emphasis in the departments of El Paraíso, Olancho, Copán, Santa Bárbara, and Islas de la Bahía.

e) National Program for Security in Landholding and Access to Land

- Clean-up and landholding through two projects at a cost of US\$3.4 million on the titling of lands and modernization of Property Registries in the Departments of Olancho and Colón.

In addition, SAG and the public agricultural sector contribute resources to develop systems or services to support agricultural food and rural development programs, including the following:

- Development of Land Markets, (SAGIPAAR)
- Development of Rural Financing, (SAG, BANADESA and FONAPROVI)
- Development of Markets for Agricultural Production, (SAG/IHMA, and SIC)
- Development of Sectoral Technological Innovation, (DICTA/PROMOSTA/FIIA)
- Agricultural Health, Food Quality and Safety (SAG/SENASA / Health)
- Sustainable Use of Natural Resources (SAG/PAAR-Management)
- Integration of Basins and Protected Areas. General Irrigation Administration
- Rehabilitation and Improvement of Irrigation Systems.

IV. POVERTY, GROWTH, AND MACROECONOMIC FRAMEWORK

By using the concept of poverty-GDP elasticity, it is possible to reflect the degree to which a country has been able to translate increases in GDP into reductions in poverty. Technically speaking, it is the ratio between the rate of growth of GDP per capita and the rate of poverty reduction, which most commonly is measured on the basis of individual or household income.

In the 1990s, the countries of Latin America achieved on average a 0.94 percent reduction in the percentage of the poor for each 1 percent increase in per capita GDP.⁴² However, for Honduras, the reduction was only 0.65 percent, which would suggest that it is necessary to substantially boost the rate of per capita GDP growth in order to make significant headway in terms of poverty reduction.

All the same, the conclusions set forth in the previous paragraph apply solely to cases in which poverty is measured by the inadequacy of income. This said, if UBN or HDI in health and education were used as poverty indicators. It is very likely that poverty-GDP elasticity

⁴² Quentin T. Wodon et al., *Poverty and Policy in Latin America and the Caribbean* (Washington, D.C. World Bank), p. 33.

would be somewhat greater, owing to the progress that both types of indicators reflect and to which reference was made earlier on.

Ultimately, it is a question of two sides to the same problem: one showing poor performance with regard to improving the monetary income of the poor, owing to only meager achievements in growth of GDP per capita and other concomitant factors, and the other revealing more acceptable performance in increasing the capital stock of the poor via satisfaction of part of their basic needs.

There is no doubt at all that the greatest challenge has become how to increase national income so as to stem and diminish the trend toward a widening income gap vis-à-vis the countries of the region, while hoping that such an achievement will also translate into a satisfactory reduction in the number of households with Low average productivity is the main factor responsible for the income difference between Honduras and the other countries to which it has been compared in previous sections. It has also been noted that this low productivity derives, in part, from the low caliber of workers, but above all from the use of inappropriate technologies that lower per capita output.

Bearing this in mind, an analysis will be made of the most important reasons for Honduras's failure to carry out investments necessary for improving the technologies used by the labor force. The explanation for this failure may reside in the following two factors:

- an economy that is slightly open to the international free market; and
- macroeconomic conditions that are unfavorable for attracting new investment.

The national economy's lack of openness to the international market prevents domestic producers of goods and services from competing with foreign producers. This situation is a disincentive to the competitiveness of domestic producers, resulting, in turn, in low productivity. The Honduran economy could increase its openness to the external market, but if it maintains macroeconomic conditions unfavorable to trade and investment, it would make productive investment in the country less attractive.

Using Luxembourg, the country with the most open economy, as a reference (with Luxembourg = 100 percent), the openness of Honduras's economy rates as 46 percent, a level that could be described as a semi-open or semi-closed economy, depending on the point of view. When other factors favoring investment, such as infrastructure, finance, institutional efficiency, and government are analyzed, Honduras also rates low.

COMPETITIVENESS FACTORS AND RELATIVE POSITION OF HONDURAS

	<i>Infrastructure</i>	<i>Finance</i>	<i>Technology</i>	<i>Quality of Institutions</i>
Country with 100 percent	Singapore	United Kingdom	Finland	Singapore
Honduras	22 percent	22 percent	5 percent	15 percent

Source: Honduras Siglo XXI, Agenda para la Competitividad y Desarrollo Sostenible [Twenty-First Century Honduras, Agenda for Competitiveness and Sustainable Development], ESA Consultores, INCAE, 1999.

If these countries' achievements in terms of factors that promote competitiveness are defined as optimal, Honduras rates low in all areas, but particularly in technology. Thus, the crux of the matter is to analyze how progress can be achieved in the relevant sectors and to decide whether it makes sense for Honduras to promote efforts to improve each of these sectors.

A. DEVELOPMENT OF THE PRIVATE SECTOR

1. SAVINGS AND INVESTMENT TRENDS

In the last 15 years, capital formation has been increasing, particularly the accumulation of private capital. While savings represented less than 20 percent of GDP in 1987, they exceeded 25 percent by 1998, the highest levels of capital accumulation were reached in 1993 and 1994, when this figure exceeded 30 percent of GDP, as a result of a relatively high level of public capital formation. The increase in savings made it possible to increase investment, which represents approximately 30 percent of GDP and is more than 75 percent financed with domestic capital.⁴³

INVESTMENT TREND (IN PERCENT OF GDP)

Investment	1988	1990	1992	1994	1996	1998
Private	18	20	22	28	25	23
Public	3	3	4	10	5	7
Total	21	23	26	38	30	30

SOURCE: IAN WALKER, *HONDURAS EN EL SIGLO XXI*, 1999, CITED ABOVE.

The increase in domestic savings has resulted in large measure from the decreased risk associated with holding capital. Many people now maintain savings accounts in dollars. It is important to remember the 1980s, when political instability and restrictions on capital mobility triggered a massive flight of foreign exchange that reduced investment levels. Another incentive to capital formation was the result of the high interest rates that were being paid on the securities markets for investments in bonds. However, this method of increasing savings was seriously affected by the effects brought on by Hurricane Mitch, when many enterprises damaged by this meteorological phenomenon lost the capacity to meet their financial commitments.

Nevertheless, savers have been regaining confidence in the capital markets, particularly after the government ensured the return of savings to persons with deposits in one of the banks that had to close as a result of the problems referred to above. This renewed confidence will make possible the resumption of economic growth during the current year, when even the interest on loans in private banks appears to be falling, a factor which should provide a greater incentive to investment.

⁴³ The data on savings and investment are taken from "Tendencias recientes en el crecimiento" [recent growth trends] in the document "Una Agenda para la Competitividad y Desarrollo Sostenible," ESA Consultores, 1999.

2. PRODUCTIVITY OF INVESTMENT

In Honduras, investment is equivalent to 30 percent of GDP, which is higher than the average for Latin America (22 percent),⁴⁴ suggesting that the growth of the Honduran economy should also be greater than that of the region as a whole. However, this is not the case, due to the fact that the productivity of investments in Honduras is lower than in the other countries.

The decline in the economy's productivity has more to do with the use of poor technologies than with the caliber of Honduran workers. This suggests that Honduras needs investment, with technology transfers, in order to improve work conditions and thereby the productivity of workers. Worker training, *per se*, is important, but the productivity of investment cannot be improved significantly by this means. One test of this is in the experience of the *maquiladoras*, where workers with minimum training have achieved productivity equal to that of workers in more developed countries under similar conditions.

3. FACTORS SUPPORTING INVESTMENT AND COMPETITIVENESS

a) *Infrastructure*

Among the infrastructure works most important for improving the competitiveness of the economy are highways, the provision of electric power, water and sanitation systems, ports, and telephone systems. Until now, most investment in infrastructure has been made by the public sector, generally with resources from external sources, but in the short term, greater participation by the private sector is anticipated.

In terms of developing infrastructure, the following points are notable:

- Honduras has historically placed greatest importance on the primary road system, consisting of the highways that interconnect the country's major cities. However, this system has gone through periods of neglect as well as periods of reconstruction during the last 20 years. Currently, the focus is on rehabilitating and rebuilding the road grid that was seriously damaged by Hurricane Mitch.
- In the 1990s, major efforts were made to bring electric power to rural areas, promoting increased quality of life for many rural inhabitants. Unfortunately, the growth in demand for electricity was greater than the growth in supply (added to rural demand was the demand from the *maquiladoras* in the northern part of the country), leading to a scarcity in supply, which in the end prompted the government to allow private enterprise to engage in electric power generation.
- Until now, the fixed telephone system has been a state monopoly, but the introduction of cellular telephones by private suppliers has provided telephone consumers with a new option. HONDUTEL has already begun the process of

⁴⁴ World Bank, World Development Report 2000, data for 1998.

privatization, which will allow for the modernization of the sector, with the possibility of other cellular telephone companies entering the market in the near future.

- Investments that the government and nongovernmental agencies have made in the water and sanitation sector have been focused at the household level, with the aim to improve the access to basic needs. Water projects designed to ensure supply to agricultural and industrial regions have been given lower priority; thus it would be useful to evaluate the economic growth that would be generated by water projects for irrigation and for industrial uses in regions that do not have adequate supply.

b) Financial Sector

The revitalization of productive activities requires a dynamic and competitive financial sector, such that it becomes an instrument for the development of the domestic economy, channeling resources to production in an efficient and timely manner.

However, the domestic financial system does not yet offer a real incentive to attract savers. During the previous decade, the real interest rate on deposits was, on average, negative, i.e., deposits lost purchasing power over time. However, intermediation spreads charged by banks were higher than those in more financially competitive economies. The small size of the economy, the high level of national indebtedness to external financing sources, and the macroeconomic and legal conditions prevailing in the country are factors not conducive to promoting the participation of international private banking in Honduras's domestic market.

For this reason, there has been increasing impetus to modernize regulation of the financial system, adapting it to international standards, strengthening supervision, ensuring the stability of the system, and providing resources to finance the rebuilding, rehabilitation, and modernization of productive units. New laws are also being promoted in the areas of deposit insurance, capital markets, insurance and reinsurance companies, and private pension funds.

c) Technology

An analysis of the reasons for the economy's poor performance shows that technology plays a fundamental role in increasing productivity. However, the adoption of improved technologies is closely linked to investment, thus the factors affecting investment are of great importance.

d) Legal and Administrative Framework

In the last 10 years, Honduras has made the legal and administrative climate more favorable to investment, particularly in relation to foreign investment. A new investment law was passed, establishing that foreign investors shall receive the same treatment as Hondurans in terms of ownership rights, freedom to carry out production and marketing in the local market and abroad, and the use of the national system of foreign exchange and capital markets. Foreign investors may also repatriate their capital and dividends to their countries of origin, and can submit disputes to international arbitration. The country has signed trade agreements with international organizations, strengthening the rights of investors in regard to:

- Intellectual property;
- Trademarks and patents; and
- Investment guarantees.

Despite the fact that substantial improvements in the legal framework have been made, there remains considerable room for improvement, such as in the area of simplifying bureaucratic formalities, providing more expeditious service by authorities granting licenses and permits, improving information on formalities that investors must complete, improvement in the property records system, and the elimination of procedures that give rise to corruption and extortion. To address this problem, it is necessary to modernize the judicial system, particularly in terms of hiring skilled staff, as the Honduran system of higher education is turning out graduates in law with major academic and administrative deficiencies, leading to complications and delays in resolving conflicts, and producing unpredictable results.

e) Property Records

The acquisition of land and property is recorded in deeds that, for the most part, have no maps or geographic points of reference, thus opening up the possibility, particularly in places where the price of land is high, of multiple and overlapping claims on the ownership of a parcel of land. A master file with geographic references is necessary in order to provide the purchaser with security. Some tourist investments require the acquisition of extensive tracts of land, and to the extent that the ownership of such land is insecure, few investors will be willing to risk their capital. The land titling program being carried out by the National Agrarian Institute (INA) is increasing the confidence of investors in rural areas and is facilitating credit for legal land owners.

f) Labor Regulations

In Honduras, progressive laws have been adopted for the protection of workers. However, these laws have not had the anticipated results: most employees are not able to retire through the IHSS (Honduran Social Security Institute), since the institution has financial problems arising from a long history of inefficiency and failure to meet its obligations. At the same time, the benefits given to an employee if he or she is laid off represent a problem for enterprises: some employees may see them as an incentive to get themselves fired, and, at times, an enterprise may find itself unable to fire an employee because of the consequent obligation to pay the benefits.

The flexibility of work days should be something negotiated between the enterprise and the worker, according to the needs of the enterprise and the preferences of the worker. Partial contracts and half-time work days can help take more efficient advantage of the labor force.

Collective contracts at large enterprises often act as straightjackets that prevent enterprises from reallocating their human resources in the best way. These contracts should be negotiated between the employer and workers' representatives, provided that the majority of the workers agree to have union representation. In practice, many of the unions come to acquire a power parallel to that of the employer, in terms of decision making; some enterprises have to be certain of the approval of the union before they make a decision that, strictly speaking, is not labor related.

4. REGIONAL INTEGRATION

Trade between Honduras and the rest of Central America has been underexploited. Honduras conducts more trade with countries outside Latin America than with nearby countries such as Nicaragua and El Salvador. The lack of economic integration is a consequence of the scant attention given to reducing transportation time and of the minor customs formalities and permits for trade in goods and services that must cross the borders. Despite the progress achieved in integration, it has not been sufficient to allow citizens of Central America to feel that they can move between countries as easily as inside their own countries.

Some of the critical points that continue to be a source of problems are:

- The time it takes for individuals and merchandise to travel is far too long, given the proximity of the neighboring countries.
- Customs formalities have been simplified with the CA4, but it is still necessary to eliminate the elements that cause corruption, so that crossing the borders does not become a negative experience.
- Visas should only be required for persons outside the region. Permits for stays in the Central American countries (maximum one month) are too short, particularly for persons who intend to establish long-term enterprises.
- There is no financial integration that makes it possible for investors to move capital easily within the region. Currently, few Central American banks have operations in other countries of the region. It will probably not be possible to establish a single Central American currency in the short term, but it is necessary to begin moving in that direction inasmuch as the creation of such a currency would help stabilize inflationary processes in the region, increase regional investment and trade, and thus increase the economic growth of the countries.

Central American economic integration is of paramount importance for Honduras because of its geographic situation and its history. The problems of neighboring countries will always have an impact on Honduras; therefore, there must be efforts to seek solutions for the region as a whole. Economic integration with Mexico is equally important in the medium and long term, while it is also important to promote trade with all of the countries of the world and, above all, make efforts to open and increase markets with a large potential for expansion.

5. MICROENTERPRISES AND SMALL AND MEDIUM-SIZED ENTERPRISES

The damage sustained directly by this sector as a consequence of Hurricane Mitch, added to the structural problems predating the disaster, exacerbated the already difficult situation, demonstrating the vital importance of taking urgent measures to promote development and sustainability. To this end, activities aimed at rehabilitating and revitalizing microenterprises and small and medium-sized enterprises, through training, credit, marketing, and institutional organization of the sector have been carried out.

In order to support these sectors as part of a prospective strategy to improve income distribution, a draft Law on Tax Incentives for Industrial Microenterprises and Small and Medium-Sized Enterprises has been prepared, and an office to meet the needs of the social sector of the economy (*campesino* associations and cooperatives, etc.) has been put into operation. It should be pointed out that funding earmarked for microenterprise and small enterprise production, particularly agricultural production, faces the constraint of lack of financing guarantees, resulting in difficulty in accessing such financing, while private financing channeled through NGOs is insufficient to meet the demand and the additional needs brought on by Hurricane Mitch.

B. MACROECONOMIC STABILIZATION AND ADJUSTMENT MEASURES ADOPTED IN THE 1990S

Several of the points presented in the preceding section are closely related to having a macroeconomic and sectoral framework favorable to economic growth. This subsection summarizes the measures adopted during the 1990s, and some of their probable short- and long-term effects are identified.

1. STABILIZATION POLICIES AND TRENDS IN THE CONSUMER PRICE INDEX (CPI)

Inflationary processes have a negative effect on poor families, especially in urban centers, who have little access to mechanisms to protect them against rises in the cost of living. Thus, controlling inflationary pressures through sound fiscal and monetary policy is a high priority as a means of reducing poverty.

In the 1980s, the rate of inflation remained low, despite the high fiscal deficits, because these were financed primarily with external grants. Furthermore, inflationary pressures were held in check through a number of price controls, including a fixed exchange rate in the face of a deterioration in the balance-of-payments current account.

Although this situation seems to have had positive effects on the poor population in the short term due to limiting year-to-year rises in the CPI (an average of 3.9 percent annually from 1984 to 1988), price controls negatively affected prospects of long-term economic growth. At the end of the decade, it became clear that the high levels of external grants were not sustainable. Furthermore, the country had lost access to funds from international financial institutions (IFIs) as a result of having accumulated arrears in debt payments to these entities. In view of this situation, the country had to choose between planned and orderly macroeconomic adjustment and a disorderly adjustment.

In 1990 the country opted for orderly adjustment, in order to correct the serious and growing imbalances in the domestic and external accounts and to restore access to IFI funds. The package of reforms adopted included a devaluation of the Lempira and the liberalization of various prices. These measures contributed to an acceleration in the growth of the CPI, from 9.8 percent in 1989 to 23.3 percent in 1990 and 34.0 percent in 1991, with negative short-term effects on poverty. However, this acceleration in the CPI did not represent an "inflationary" process, but rather an adjustment in price levels, which had been held in check during the 1980s. In other words, the trend in the CPI in the years 1989-91 was not due to stabilization measures, but rather to the flawed policies of the 80s. The long delay in correcting the imbalances of the 1980s aggravated the negative effects of the necessary adjustment process. It should be borne in mind that the alternative of a disorderly adjustment, without the support of IFIs, would have had greater negative effects on poor households.

Fiscal and monetary discipline in 1990 and 1991 resulted in a sharp improvement in the behavior of the CPI, whose increase was limited to 8.7 percent in 1992, most likely contributing to the reduction in the incidence of poverty, from 74.8 percent in 1991 to 69.9 percent in 1992. Unfortunately, the loss of this discipline in 1992, and especially in 1993, stimulated the inflationary process, such that the increase in the CPI reached

29.5 percent in 1995. At the same time, there was a fiscal expansion that stimulated an increase in the GDP of 5.6 percent in 1992 and 6.2 percent in 1993, as well as a reduction in the incidence of poverty, to 67.5 percent. These advances, however, were not sustainable.

In 1994, the new government took measures to reestablish the process of fiscal stabilization. Although GDP fell 1.3 percent this year, the incidence of poverty declined slightly, to 67.2 percent, for reasons that at present are not entirely clear. [It is hoped that this phenomenon will be explained in the final version of the strategy.]⁴⁵

The incidence of poverty rose slightly in 1995 and 1996, reaching 68.7 percent, in part because inflation canceled the positive effects from the growth in GDP (an average of 3.9 percent annually in these years). However, maintenance of fiscal discipline (and the effective appreciation of the Lempira in real terms) eventually had a favorable impact on the rate of inflation, which fell to 12.8 percent between December 1996 and December 1997.

The CPI rose 15.8 percent between December 1997 and December 1998, but fiscal and monetary discipline prevented a greater rise as a result of the effects of Hurricane Mitch. The combination of moderate inflation rates and economic growth, of 5 percent or more, helped reduce the incidence of poverty to 65.8 percent in 1997 and 63.1 percent in 1998 (before Mitch).

In 1999, the country continued to maintain fiscal and monetary discipline following Mitch. The fiscal deficit was less than planned, and inflationary financing of expenses for rebuilding and change was avoided, taking advantage of the availability of external financing for those purposes. Inflationary pressures on basic grains were avoided, through foreign grants and a program that provided incentives for production of these products immediately after the disaster. Between December 1998 and December 1999, the country managed to reduce the growth of the CPI to 10.9 percent. The expansion of the Honduran Social Investment Fund (FHIS) and the Family Allowance Program (PRAF) helped alleviate poverty in the short term. Despite a reduction of approximately 4.5 percent in per capita GDP in 1999, the incidence of poverty only rose to 65.9 percent.

Some observers believe that the adjustments in economic policy in 1990 introduced elements of "cost inflation" to the inflationary process, making a faster reduction in inflation to bring it in line with international rates difficult, even with sound fiscal policies. This phenomenon has also been observed in other Latin American countries, such as Costa Rica, Chile, and Colombia.

2. STRUCTURAL ADJUSTMENT MEASURES

In the long term, structural adjustment measures should have positive effects on the rate of GDP growth and should also, therefore, reduce poverty. However, in the short term, several measures could have a negative influence on vulnerable segments of the population. In

⁴⁵ Part of the phenomenon can perhaps be explained by the fact that the figure reported above for 1994 is for October of that year, while the data for other years are for the first quarter (generally March).

these circumstances, it is important to expand highly focused assistance programs to compensate for these negative but temporary effects.⁴⁶

a) Exchange Liberalization

The devaluation of the lempira from L 2.00 to L 4.00 per U.S. dollar in 1990, along with subsequent adjustments, stimulated exports and the production of certain import substitutes. In the course of the decade, exchange liberalization contributed to economic growth, primarily through incentives to farmers who produce goods for markets abroad. However, in the short term, the higher cost of imports, including food products, had a negative effect on consumers of imported products, a group that includes many poor families.

Since the 1990 devaluation, exchange policy has undergone several changes to introduce greater flexibility. The current adjustments are determined based on the differential between anticipated inflation in the country and that of countries that trade most with Honduras. Despite an effective appreciation of the lempira in real terms in the second half of the 90s, exports have not lost their competitiveness, and the exchange rate has remained more favorable than the level prior to the devaluation of 1990. This appreciation of the currency has had a positive effect on poor households through its effects on the price of imported products, contributing to the gradual reduction in the inflation rate.

b) Price Liberalization

In the first part of the 1990s, domestic trade was liberalized by eliminating the buying and selling activities – with the exception of operations for maintaining a strategic reserve of corn and beans -- of the Honduran Institute of Agricultural Marketing (Instituto Hondureño de Mercadeo Agrícola, IMHA). The IMHA also stopped setting price guarantees, in the framework of a broad liberalization of prices for all agricultural products, except for lower-quality coffee. In the short term, these measures had a favorable effect on small producers of basic grains, a group that is part of the poorest segment of the country's population. At the same time, poor consumers in urban centers were affected negatively in the short term.

For the medium and long term, it was hoped at the beginning of the 1990s that liberalization of agricultural prices would stimulate productivity in the production of basic grains, reducing imports of these products and making possible some exports to neighboring countries, with mixed results for producers (e.g., a sharp increase in production would lower prices) but positive results for consumers. However, the production of basic grains has not changed as anticipated, because such production also depends on other factors, including access by small producers to factors of production. Also, uncertainty about free trade with other Central American countries in these products acts as a disincentive to production.

⁴⁶ This preliminary version of the strategy does not attempt to identify and precisely quantify all of the effects of various policies on the incidence of poverty. In many cases, the lack of adequate data makes such calculations impossible. In the final version of the strategy, this discussion will be taken up in greater detail, to the extent possible, making use of research being carried out by the World Bank and other researchers.

In the forestry sector, the Law on the Modernization and Development of the Agricultural Sector (LMDSA, 1992) attempted to stimulate production and improve its efficiency and sustainability, through plans for sustainable management and a system of auctions to sell timber on state lands, thus eliminating the high subsidies previously granted to purchasers of this timber. However, the system of auctions has not functioned properly, and the sector is not creating the production and employment that was anticipated.

c) Monetary and Credit Liberalization

Prior to 1990, monetary and credit policy was characterized by controls on interest rates, subsidized lines of credit, and the use of bank reserves as the main instrument for controlling monetary variables. These measures resulted in an inefficient allocation of resources, limiting the process of economic growth and, thus, poverty reduction. Although a certain number of poor families benefited in the short term from subsidized interest rates, it did not give them sufficient incentive to adopt improved techniques that would increase the productivity of their farms. Furthermore, the negative borrowing rates, in real terms, resulting from this policy, limited the supply of funds for loans.

As a result of the above, in 1990 the government initiated a gradual process of liberalizing interest rates, and by November 1992 these became freely determined. Bank reserves, however, remained high, ranging from 31 percent to 42 percent in the period 1990-97. This level of reserves represented a significant cost for banks and contributed to the banking system's high intermediation margin, although the reserve is not the only reason that interest rates were maintained at the levels mentioned. Once the interest rates were liberalized, this margin resulted in high real interest rates on loans, which has limited the demand for investment funds, therefore restricting GDP growth and poverty reduction, although these effects have probably not been great. It should also be mentioned that the reserve was an imperfect instrument of monetary control, because banks either found mechanisms for evading it or stopped complying with the requirements, having little concern about being fined owing to the lack of an adequate system of prudential regulation and supervision.

This situation changed in 1997, when a minimum reserve of 12 percent was established for all deposits, with a requirement to purchase government bonds (mandatory investments) for an additional 19 percent, at rates of interest close to those of the market, resulting in total effective reserves of 31 percent for banks. Mandatory investments fell to 17 percent before the advent of Hurricane Mitch, and in order to facilitate the availability of credit after the disaster, this was lowered to 13 percent, for a total of 25 percent in current reserves. Further, in 1997, for the first time, significant open market operations were initiated, with the intention of having these become the main instrument of monetary policy. Despite these actions to reduce the cost of the reserves, intermediation margins have not been reduced, perhaps because commercial banks are maintaining them at high levels in order to compensate for the portfolio losses caused by the natural disaster.

Although many small producers have complained of the high interest rates, their main problem is not the level of interest rates, but the lack of access to credit from the formal system, which is closely related to the insufficiency of real guarantees.

Trade Liberalization

At the beginning of 1990, Honduras had a fairly high average tariff, and the large spread in tariff rates (from 1 percent to 90 percent) resulted in high effective rates of protection for local production. In March 1990, the maximum rate dropped to 40 percent and the minimum rate was increased to 2 percent. At the beginning of 1991, the level moved to 4 percent/35 percent, and one year later, to 5 percent/20 percent. In August 1990, the country applied for full membership in the General Agreement on Tariffs and Trade (GATT) and in 1994 gained final admittance to this organization, which later became the World Trade Organization (WTO).

Honduras also participated in negotiations for adopting a new scheme for regional integration, which included a common tariff that entered into force in April 1993, with tariffs of between 5 percent and 20 percent—a level that Honduras had adopted one year before. Since 1993, additional reductions have been achieved.

In January 1995, under the terms of accession to the GATT, the effective tariff dropped, owing to the elimination of the remaining surcharge of 10 percent and the reduction of customs fees from 5 percent to 3 percent (and to 1.5 percent in January 1996). In 1996, Decree PCM-028-96 established a timetable for eliminating tariffs, under which the tariff for raw materials was reduced to 1 percent and the rate for intermediate goods was reduced to 5 percent at the end of 1998. The rate for final goods is being gradually reduced, and is due to reach 15 percent by the end of 2000.

The process of trade liberalization has had generally positive effects on poverty. First, it has contributed to the expansion of exports, both to other Central American countries and to countries outside the region, many of which use labor to a high degree. Second, imports have become cheaper, and this competition has had favorable effects on productivity and on the cost of domestic production. Although some workers have lost their jobs as a result of foreign competition, the number of persons affected is small.

d) Tax Reforms

The greatest motivation that a private investor (domestic or foreign) has for carrying out a project is its return. Direct taxes, such as the income tax or indirect taxes, such as import and export tariffs, distort prices which, by being very high, can make investments in a country unattractive. The dilemma for Honduras is that society demands a higher level of public social spending, which is financed for the most part with tax revenues and with loans from foreign financing sources, which must be repaid in the future with increased tax revenues.

During the 1990s, measures designed to strengthen the fiscal accounts were implemented, through the improvement of tax administration and the restructuring of the tax system, while at the same time attempts were made to improve incentives to investment. The principal and most recent changes (April 1998) were: (1) a reduction in the income tax rate, from 42 percent to 25 percent, with a broadening of this tax's exemption for individuals; (2) an increase in the sales tax, from 7 percent to 12 percent; and (3) a significant reduction in taxes on exports.

Although it is generally believed that the taxes on consumers are regressive, this is not always the case. One of the very few studies on the effect of indirect taxes in developing countries found that the effect of the value added tax (VAT) in the Philippines was essentially neutral with respect to income deciles.⁴⁷ In Honduras, however, it is important to take into account that there is a basket of basic consumer products that is exempt from the VAT, which benefits low-income consumers.

While the reduction in the income tax and in taxes on exports did not directly affect the poor population, it is anticipated that these reductions will stimulate investment, with positive medium- and long-term effects on employment and, consequently, on poverty reduction.

3. MODERNIZATION OF THE STATE AND DECENTRALIZATION

The low performance of Honduran public institutions is a result of the inefficient use of available human capital. Many public employees change jobs every four years when a new government comes to power. As expected, the efficiency of public institutions is low, thus creating a high cost to society, caused by a waste of resources and, at times, by establishing obstacles that impede greater economic growth.

The solution to this problem is neither simple nor short term, as it requires a change of culture in how things are done. However, efforts have been made to promote a Program to Reform Public Administration (PRAP), which seeks to achieve tangible short- and medium-term improvements in the efficiency of state operations, through programs aimed at:

- Privatization and concessioning of public services, particularly telecommunications, energy, and airports;
- Administrative reforms, especially in the sectors of education and health, and in programs for children and women; and
- Reforming public management, including the rationalization of employment, improved administration of resources, and the adoption of an Integrated System of Financial Administration (SIAFI).

To date, some progress has been achieved with regard to structuring a more efficient state, centered around the objectives of accelerating economic growth and reducing poverty. Between January 1994 and November 1999, the efficiency of public administration was improved through a reduction of 18 percent in the number of public employees in the central government and a reduction of 15 percent in decentralized institutions. This process may have had negative short-term effects on poverty that have yet to be assessed. Some employees who were laid off found other employment quickly in the private sector, but others did not; further, changing jobs usually has numerous effects on wages and benefits. The number of persons affected is relatively small, and it is to be expected that the negative

⁴⁷ Shantayanan Devarajan and Sharkh J. Hossain, "The Combined Incidence of Taxes and Public Expenditures in the Philippines," *World Development* 26, No. 6 (June 1998): 963-977.

short-term effects will be more than compensated for in the long term by the positive impact on the efficiency and productivity of public sector policies, programs, and projects.

Likewise, the process of modernizing the public sector envisages greater participation by municipalities in the financing and operation of municipal social projects, under the framework of the 1991 Law on Municipalities. However, the process of decentralization has been slow, due in large measure to the fact that many municipalities still have not developed the technical capacities to assume the tasks carried out by state institutions.

Most municipalities are in need of institutional strengthening before taking on new responsibilities. Many have current expenditures that exceed 80 percent of municipal revenues, an indication of the inefficiency of municipal spending. Decentralization should continue, but municipalities, along with the central government, should be monitored in regard to the efficiency with which they spend their resources.

The program of municipal decentralization envisages transferring 5 percent of the total state budget to municipalities. It has not been possible to make the entire transfer in a direct way, due to fiscal pressures. However, the government has brought to the municipalities projects in education, health, and water and sanitation that are executed primarily by the FHIS, and this is considered to be one way of transferring resources to the municipalities. It is, in fact, the communities that act as the decision makers on how to allocate FHIS resources within their respective areas.

Due to the consequences of Hurricane Mitch, there has been extensive activity on the part of domestic and international NGOs, interacting with municipalities and directly with the communities in carrying out various projects, primarily in the sectors of water, sanitation, and housing.

- Many municipal water projects are carried out by the National Autonomous Water and Sewerage Service's PS2 program, together with the beneficiary communities, and there is extensive experience with joint financing involving NGOs (such as Agua para El Pueblo and CARE), municipalities, and the communities.
- Construction has also begun on more than 50,000 homes, under the primary sponsorship of NGOs that provide the main resources, with the communities (generally organized by the municipalities) contributing the local materials and labor. Municipal governments are also taking part, along with the central government, in providing plots required to implement the project, and with installation of basic services.

In the area of decentralization, there has also been progress in terms of specific actions, such as FHIS's "Town Meetings" and the PROHECO project, both drawing on broad community participation in their respective areas. Likewise, regional and local structures of the Standing Committee on Contingencies (COPECO) are being consolidated, working in other sectors as well as in transferring water and sanitation systems to the respective municipalities.

4. REFERENCE MACROECONOMIC FRAMEWORK FOR THE PRSP

(considers PRGF elements; detailed in attached matrix)

The program of stabilization and reforms executed by Honduras in 1999 to support the post-Mitch recovery and rebuilding efforts and to lay the foundation for sustainable growth was successful in many areas. The reduction in GDP was 1.9 percent, end-year inflation fell to 10.9 percent, and reserves were equivalent to 4.3 months of imports. The central government's fiscal deficit was 4.1 percent of GDP, and public savings were 3.4 percent of GDP. Structural reform continued, particularly with privatization and financial sector reform. Despite this progress, higher growth is needed, in view of the fact that more than half of the Honduran population lives in poverty. There is a firm commitment to consolidate macroeconomic stability and implement faster structural reform in order to attain higher, poverty-reducing growth. Greater emphasis will be placed on policies to increase growth in the framework of the medium-term program, from March 1999 to February 2002, for which the IMF is providing financial assistance under a Poverty Reduction and Growth Facility (PRGF) agreement.

a) Macroeconomic Objectives and Policy Framework

- In the medium term, 6 percent growth and single digit inflation can be achieved. In 2000, growth is anticipated to be 4-5 percent of GDP, with inflation in the 9-11 percent range. In regard to the balance of payments, there will be greater efforts to limit the current account deficit in 2000 and to reduce the deficit in the following years. Reserves are expected to be maintained at the equivalent of 4 months of imports in the medium term. The overall deficit of the public sector in 2000 is expected to reach 4.1 percent of GDP and will be fully financed from external resources, maintaining a declining trend in the following years. A high level of savings in the public sector will free up resources to the private sector and will help promote long-term growth.
- To achieve these objectives, it is necessary to continue prudent fiscal and monetary policies and intensify the process of structural reforms. Fiscal policy will be designed to contain current spending while allowing for an increase in social spending, investment in rebuilding, and public savings. Monetary policy will remain prudent, to achieve the program's inflation target. Structural reform will be designed to promote private sector initiative and investment, in order to create rapid and sustained growth.
- Priorities in the structural area will include continuing progress in privatization and reform of the financial sector, as well as the implementation of policies such as deregulation to improve the investment climate and improve export incentives. There is also a commitment to executing a comprehensive governance strategy to promote good governance, including measures to increase transparency in fiscal and monetary policy and make transparency more wide reaching. It is anticipated that these measures will benefit from a continuation of needed assistance from the international community, in order to achieve the proposed targets.
- Annex E of this document describes a Macroeconomic Scenario, with selected economic indicators for the period 1997–2002. This scenario constitutes part of the Memorandum on Economic Policies to be considered in the PRGF program currently negotiated with

the International Monetary Fund. The scenario shows performance to 1999 (preliminary data) and projections through 2002 for variables on national income and prices, the exchange rate, money and credit, the financial public sector, savings and investment, and the balance of payments.

b) Fiscal Policy

- Fiscal policy will be designed to consolidate the basis of medium-term fiscal viability and increased social spending. In 2000, attempts will be made to contain the central government deficit, while allowing for an increase in social and capital spending. These objectives are attainable, since it is anticipated that revenues will be sustainable and that growth in nonsocial current spending can be contained.
- Continued improvements will be made in tax administration in order to maintain the central government's current revenue above 18 percent of GDP. Among the steps taken to this end will be firm application of the penalties contemplated in the 1997 Tax Code, and the submission to the National Congress of proposals for improving the income tax system so as to take it to internationally comparable standards through clarifications in the definitions of income and costs.
- Moreover, efforts will be made to restrict current expenditure and transfers not related to social and poverty reduction programs. It is anticipated that capital expenditure will increase in the next few years in order to continue with reconstruction and national transformation projects and social programs. Most such expenditure will be supported by grants, debt relief, and borrowing on concessional terms.
- A key aspect of social policy will be the reform of social security and the pension system. This will contribute to the reduction of poverty, particularly that of the elderly, and will promote investment through the increased availability of long-term funds in the financial system.
- The country is also committed to improving fiscal transparency and accounting, using simple and transparent procedures for public sector procurement.

c) Monetary Policy and the Fiscal Sector

- Reducing inflation to single digits in the medium term is one of the main objectives of the macroeconomic stabilization program. Lower inflation contributes to a less volatile exchange rate and facilitates investment and business decisions, strengthening the potential for economic growth. Price stability also directly benefits the poor who, due to their preference for keeping cash, suffer disproportionately from the tax represented by inflation.
- The inflation targets are expected to be met through an increase in open market operations as necessary. Net international reserves will be maintained at US\$1,000 million or more, and it is expected to increase the efficiency of monetary policy, facilitated by the establishment of market interest rates that promote economic activity.

- Honduras is committed to continue the strengthening of financial regulation and prudential supervision, as a sound financial system is a prerequisite for efficient intermediation, macroeconomic stability, and growth. A set of new laws will be submitted to the National Congress for approval, covering areas such as insurance and reinsurance companies, deposit insurance, and pension funds. In addition, the National Banking and Insurance Commission (CNBS) will continue its program of on-site inspections so as to cover all banks this year.

d) Structural Policies

- Reducing the growth of poverty will be difficult without increasing the productivity of investments. Given the country's limited resources, increasing foreign investment could play an important role in this context. In addition, the prevalence of poverty, especially in rural areas, makes it necessary to eliminate obstacles and improve agricultural production and export incentives. Emphasis will be placed on accelerating privatization and reducing regulations and red tape. There will also be attempts to improve the perception of transparency, which promotes a climate for investment and favors economic growth and social well-being in Honduras.
- There is a firm commitment to improving policies for good governance. This is a complex problem that should be approached on many levels—emphasizing prevention and legal processes. There exists a readiness to structure a comprehensive policy on good governance in order to deal with these issues. In a globalized environment, the transparency of policies is also critical to maintaining the confidence of the country's external financing, as well as that of trade and development partners.

e) External Sector

- In terms of exchange policy, the system of allocating foreign exchange through the auction system which reflects market signals will be continued. Likewise, in order to improve the competitiveness of exports, the remaining taxes on exports will be eliminated. Efforts will be made to continue prudent administration of the debt, with a view to seeking access to concessional loans. In addition, all possible efforts will be made to conclude the pending bilateral negotiations with Paris Club creditors to reschedule debt related to Mitch by March 2000. Efforts of the HIPC to reach the decision point will be continued in the year 2000, in order to reduce pressure of the debt service on the country's resources.

V. STRATEGY

A. OVERALL VISION

The Poverty Reduction Strategy is a historic effort on the part of Honduran society as a whole, aimed at significantly reducing the country's poverty through measures, programs and projects executed in a sustained manner up to at least the year 2015, with intermediate stages, demarcated by the accession to power of different Governments.

The sustainability of the strategy will be based on a commitment by Honduran society as a whole, through its representative authorities at the State level, as well as by the country's

political parties and social and entrepreneurial organizations. Organized civil society, through a broad participatory process, and strengthened through specific programs for this purpose, will be the crucial element in guaranteeing the strategy's commitment to sustainability.

1. TARGETS FOR 2015

The Government is duly committed to the need to carry out a series of measures, programs, and projects, set forth in the Poverty Reduction Strategy, so as to achieve a substantial reduction in the number of persons living in poverty and extreme poverty by 2015.

No specific targets are available at this writing, although work is proceeding on them, as shown by the second section of Annex D. That annex provides several projections of key indicators, prominent among which are those pertaining to the health sector, education sector, access to water, and decrease in poverty and extreme poverty at the national level.

B. STRATEGIC GUIDELINES

1. Balance Between Alleviation and Reduction of Poverty

As part of the approach adopted, the strategy seeks to establish an appropriate balance between the various measures, programs, and projects whose specific objectives are to alleviate and reduce poverty.

- a) Programs for poverty alleviation are conceived as being part of the commitment to protect society's most vulnerable groups (the extremely poor) in normal periods, as well as during emergency situations such as those caused by Hurricane Mitch. While programs to alleviate poverty are typically short term and temporary in nature, in reality some of these contribute to reducing poverty over the medium and long term, since in addition to meeting immediate needs, they support investment in human capital and infrastructure development which, in turn, requires productive activities and access to markets on the part of small producers.
- b) Programs aimed at poverty reduction proper are intended to reduce, in a significant and sustained manner, the number of persons living below the poverty line. Thus, measures, programs, and projects will be designed to attack the roots of poverty that as such have been identified in the diagnostics section. It is anticipated that most of the results in poverty reduction indicators will be achieved in the medium and long term, due to the fact that these indicators respond to factors that are structural in nature and change slowly over time.
- c) Consequently, while programs to alleviate poverty targeting the poorest population will continue, the strategy will emphasize measures, programs, and projects designed to actually bring about a significant reduction in the incidence of poverty in Honduras.

2. Targeted Access and Universal Access

The poverty alleviation component translates to programs or services targeting particular vulnerable groups, using criteria of cost effectiveness and given limited resources. Thus, the following factors should be taken into consideration:

- a) It will be necessary to maintain certain programs (FHIS, PRAF) that are highly targeted, based on existing poverty maps. This has been shown to be effective in reaching regions with the highest indices of poverty, as well as for meeting the needs of specific groups, such as school-age children, women heads of household, the elderly, and members of ethnic groups. The attempt would be to improve targeting and establish objective selection criteria, with broad participation by the community.
- b) Due to the fact that in certain cases targeting measures may result in high administrative costs and may be somewhat ineffective, a balance will be sought between this type of program and others that are more feasible, such as the reallocation of expenditures to areas or sectors in which the distribution of benefits favors the poor population to a greater extent, rather than restricting access.
- c) In line with the above, it is not considered feasible to implement measures that are designed to exclude certain strata of the population from using the public health or education system on the basis of means testing. In such cases, efforts will be made to reallocate resources from urban hospitals to health clinics in rural areas and in marginal urban areas, as well as to transfer resources from higher education to primary and secondary education.

3. Rapid and Sustained Economic Growth

One fundamental requirement, though not the only one, for reducing poverty is achieving rapid economic growth, which in turn creates permanent jobs and is the basis for real increases in per capita income.

- a) It should be taken into consideration that a rapidly growing economy, in addition to creating jobs in greater numbers and of higher quality, also facilitates access to fiscal resources necessary for increasing public investment in physical and human capital, which in turn is needed in order to sustain rapid economic growth in the long term, as well as to finance programs for the alleviation and reduction of poverty in different areas.
- b) In this sense the role of the public sector is fundamental to creating, maintaining, and strengthening the conditions that foster increased private investment, taking into account aspects such as the macroeconomic framework, the role of the financial sector, and infrastructure development. It is up to the private sector to take advantage of investment opportunities, a task which, in broad terms, is the responsibility of large enterprises, as well as of businessmen from small and medium-sized enterprises. As a supplement to the above, it is necessary, in certain

strategic areas, to initiate joint efforts involving the state and the private sector in order to achieve the desired results.

- c) One essential element in achieving the rapid economic growth which the Strategy seeks involves implementation of the recommendations derived from the Agenda for Competitiveness and Sustainable Development for the Twenty-First Century, approved by the presidents of Central America. Specifically, joint actions with the private sector will be sought in order to promote key activities such as: tourism, agricultural businesses with a high value-added component, forest products, and *maquiladoras*.
- d) In addition, as part of establishing conditions favorable to increasing investment, the government will expedite the implementation of measures necessary for increasing the participation of the private sector in managing public services such as telecommunications, mail, energy, airports, port and airport services, water and sanitation, and the road system.

4. Sustainable Rural Development

Poverty and extreme poverty are largely concentrated in the rural environment and affect small farmers, *campesinos*, and workers without land, primarily in hillside and watershed areas with limited access to the productive resources needed to generate sufficient agricultural income. Thus, the following elements are of paramount importance to the Strategy:

- a) Consolidating and strengthening efforts within the framework of a Sustainable Rural Development Program (PRONADERS), which seeks to implement transformation processes in rural areas, with an emphasis on individuals, using participatory methods and specific policies designed to reduce the social and ecological vulnerability of this sector of Honduran society.
- b) Accelerating the development of the agrifood processing sector since, as the basis of the rural economy, it can produce more direct and indirect jobs in the short and medium term than any package of targeted programs and projects with a similar objective. Special attention is also given to nonagricultural rural activities, in order to serve significant populations in the rural setting living in poverty and with scant agricultural opportunities. Efforts will be made to attract investments in numerous activities in the rural environment linked to ecotourism, commercial fishing, processing agroindustries, industrial parks, etc. Microenterprises and small enterprises engaged in businesses such as crafts, woodworking, and small manufacturing will also be promoted.
- c) At the same time, to combat rural poverty efforts to increase investment in physical and human capital are envisaged, targeting rural communities with the highest poverty indices; along with programs to increase access to productive land, help guarantee ownership rights, and provide entrepreneurial training and retraining for *campesinos*.

- d) It is anticipated that this set of actions, integrated and focused to improve the living conditions of the rural population, will help reduce pressures on the land factor as the single element for improving rural income, as well as provide for orderly and balanced migratory flows, without producing a negative impact on any sector of Honduran society.

5. Role of Municipalities, Communities, NGOs, and Private Enterprise

The Poverty Reduction Strategy, in addition to including the responsibilities appropriate to the government, should give high priority to programs and projects that municipalities, communities, NGOs, and private enterprise can carry out. In this context, the following factors are relevant:

- a) It will be necessary to provide greater support for decentralizing public services, since this can help improve the efficiency and quality of programs by allowing for greater flexibility and facilitating adaptation to specific local conditions. Due to the fact that there are many differences between municipalities, particularly in regard to technical and management abilities, it is anticipated that the process of decentralization will be gradual, according to the ability of each to absorb change, employing intermediate actions designed to strengthen the technical and management abilities of municipalities.
- b) Rural and urban communities can also promote participation in economic development processes and poverty reduction. In the case of education, it is important to increase the scope of the PROHECO program, under which Community Educational Associations (AECOs) participate in administering central government resources for basic education in rural areas. Likewise, it is essential to strengthen mechanisms that allow for joint planning by all sectors involved in the local community, in regard to: (i) preparation of municipal social investment plans that include social projects of high priority to the community and also take account of the need to maintain works that have been built; and (ii) actual execution of the works.
- c) At present, a large number of NGOs are carrying out activities in most sectors and areas of the Master Plan for National Reconstruction and Transformation (PMRTN). These entities not only contribute to combating poverty through their own programs, but also play an important training role, especially in poor urban and rural communities, by facilitating the execution of other programs. On the basis of this experience, new mechanisms are being sought to improve the integration of the activities of NGOs with the objectives and goals of reducing poverty, and of the corresponding public and private activities.
- d) It is anticipated that, as a complement to this group of nongovernmental actors, private enterprise will become more aware of the issue of poverty and become more involved in direct and indirect efforts to achieve this goal. Private enterprise can provide support in areas such as: investment in training of human resources, moral and technical support for reforming the educational and pension systems, signing of contracts with agricultural microenterprises and small enterprises for the purchase of their products, and financial and technical support for NGOs.

6. Ethnic Groups, Gender, and Age

The poverty profile in Honduras clearly indicates that the incidence, nature, and causes of poverty vary between different groups within Honduran society, according to gender, ethnicity, and age. For this reason, a strategy for poverty reduction should consider policies, programs, and projects that specifically target these groups.

- a) In terms of the gender approach, the Strategy includes, among other things, measures for improving access to the labor market and to educational services. It also takes account of programs to reduce the high incidence of maternal mortality and the expansion of microcredit programs geared to women, given that it is women who invest more earnings in human capital.
- b) It is also recognized that ethnic populations should participate effectively in designing and executing programs for rural development, forestry, tourism, and the environment, in order to allow them to benefit from the fruits of the expansion of such activities and ensure the sustainable growth of these sectors, economically and ecologically, thus benefiting all Hondurans.
- c) In terms of the different age groups that make up the population, it is intended that the programs targeting children should continue to emphasize successful vaccination campaigns, strengthening other activities such as preventive health care and nutrition, as well as substantially expanding preschool education. Efforts aimed at young people should focus on rapidly expanding opportunities for secondary or technical education, among other things, in order to reduce the high level of delinquency among youth and provide them with the ability to escape poverty, using their own abilities. Further, in order to deal with the problem of poverty among the elderly, the strategy envisages measures designed to expand and undertake major reform of the pension system.

7. Sustainability, Transparency, and Monitoring

Due to the structural and historical nature of the causes of poverty, successful solutions need to include a process for carrying out measures, programs, and projects that are sustainable over the long term. Accomplishing this involves taking into account fundamental aspects such as: macroeconomic stability and debt sustainability; modernization of the State and decentralization; strengthening governance; reducing ecological vulnerability and providing improved risk management. Sustainability is also related to areas such as the maintenance of works, transparency in the use of resources, and oversight and monitoring of programs. Democratic participation in this context plays a vital role and should be encouraged, primarily at the community level.

C. GENERAL OBJECTIVES

1. ALLEVIATION OF POVERTY AND PROMOTION OF HUMAN DEVELOPMENT

- a) Mitigate extreme poverty in the short term, through specific programs targeting the most vulnerable groups, with priority given to children, women heads of household, and members of ethnic groups.
- b) Substantially increase the per capita income of Honduran workers, through an increase in average schooling and the implementation of appropriate employment policies that help raise the productivity of workers and reduce the level of dependency.
- c) Strengthen and intensify sustainable rural development, through an appropriate institutional framework, provision of incentives for agricultural activities and for rural microenterprises and small enterprises, as well as through improved access to markets.
- d) Reduce deficits in the coverage and quality of basic social services, primarily in the sectors of education, health, water and sanitation, and housing.

2. REVITALIZATION AND ACCELERATION OF ECONOMIC GROWTH

- a) Achieve higher levels of investment and job creation in the medium and long term, through an increased leadership role by the private sector, in a framework of legal security, macroeconomic stability, and increased competitiveness.
- b) Expedite and intensify the process of reforms and strengthen the financial system, leading to an increase in savings and a reduction in the cost of credit. In order to achieve this, a series of measures aimed at improving prudential supervision and regulation of the system are necessary, along with the passing of necessary legal reforms and the reduction of reserve requirements.
- c) Expand and improve the support infrastructure for the productive sectors, especially with regard to the road system, ports, airports, energy, and telecommunications. To achieve this objective, the complementary efforts of the public sector, along with private sector initiatives will be marshaled.
- d) Strengthen units of production of small producers, through programs providing financial and technical assistance and greater access to markets.

3. BASIS FOR SUSTAINABILITY

- a) Maintain and deepen macroeconomic stability, in tandem with sustainable management of the external debt, greater private participation in the administration of public services, and efficient public administration.
- b) Strengthen governance, through increased and improved participation of civil society, a strengthened justice system, greater public safety, and decentralization of public services.
- c) Give special attention and support to mechanisms for social audits, in order to promote efficient and transparent management, including not only public entities, but the range of nongovernmental organizations that develop programs and projects.
- d) Protect natural resources and the environment, through more efficient execution in the area of planning, environmental regulation and land management. Moreover, rely on an efficient system to manage risk and deal with disasters, under a new legal and institutional framework.

Abbreviations

AECOS	Community Education Associations
AHDEJUMUR	Honduran Association for the Development of Youth and Rural Women
AHMUC	Honduran Association of Rural Women
AMHON	Association of Municipalities of Honduras
ASEPADE	Asesores Para El Desarrollo
ASONOG	Organismo Cristiano De Desarrollo Integral De Honduras
BCH	Central Bank of Honduras
CABEI	Central American Bank for Economic Integration -
CEDOH	Centro De Documentacion De Honduras
CODEH	Asociacion Hondureña De Cooperacion Al Desarrollo Humano
CODEM	Municipal Development Council
CODIMCA	Council for the Comprehensive Development of the Peasant Woman
COFADEH	Committee of Relatives of the "Disappeared" in Honduras
COHDEFOR	Honduran Forest Development Corporación
COHEP	Honduran Private Enterprise Council
COIPRODEN	Coordinator of Private Institutions Pro-children and their Rights
COMPAH	Confederation of Indigenous Peoples of Honduras
COPECO	Standing Coordinating Committee for Contingencies
COSIBAH	Coordinadora Latinoamericano de Sindicatos Bananeros
FEHMUC	Honduran Federation of Peasant Women
FEREMA	Ricardo Ernesto Maduro Andreu Foundation For Education
FHIS	Honduras Social Investment Fund
FONAC	National Forum of Convergence
FONAPROVI	National Production and Housing Fund
FOPRIDEH	Federacion De Organizaciones Privadas De Desarrollo De Honduras
FOSDEH	Social Forum of the External Debt in Honduras
FUNDEMUN	Municipal Development Foundation
HIPC	Heavily Indebted Poor Countries
IDB	Inter-American Development Bank
IHSS	Honduras Institute for Social Security
INAM	National Institute for Women
INHFA	Honduran Institute of the Family
INJUPEMP	Institute of Retirement for Public Employees
INPREMA	Institute of Retirement for Teachers
INTERFOROS	(Coalition of NGOs)
PDCH	Democratic Party of Honduras
PINU	Party for Innovation and Unity
PUD	Democratic Unification Part
PMRTN	Master Plan for National Reconstruction and Transformación
PRAF	Family Allowances Program
PROHECO	Honduran Community Education Project
PSRP	Poverty Reduction Strategy Paper
M.A.	Ministry of Agriculture and Stockbreeding
M.F.	Ministry of Finance
M.N.	Ministry of Natural Resources
M.P.W.	Ministry of Public Works, Transport and Housing
SECPLAN	Ministry of Planification
UNAT	Technical Assistance Unit of the Ministry of the Presidency
COCOCH	Honduran Coordination Council of Peasant Organizations

Ⓢ

ANNEX A

MATRIX OF MEASURES OF THE POVERTY REDUCTION STRATEGY

Sector/Objectives	Measures/Goals	Institution Responsible
POVERTY ALLEVIATION AND PROMOTION OF HUMAN DEVELOPMENT		
TARGETED ACTIVITIES		
Mitigate extreme poverty in the short term, through specific programs	<ul style="list-style-type: none"> ▪ Assessments of impact of programs conducted by FHIS and PRAF. ▪ Updating of poverty maps and other FHIS and PRAF targeting tools. ▪ Creation of the National Council of Ethnic Groups ▪ Comparative study focusing on description of the socioeconomic conditions faced by ethnic groups ▪ Direct the “Our Roots” program toward greater and more equitable integration of ethnic groups with the rest of the population. ▪ Conclude land-titling for indigenous and Afrohonduran communities. ▪ Take the gender perspective into account in the various projects that are promoted. ▪ Promote the participation of women in careers and professions traditionally reserved for men. ▪ Widen access to education for girls and adolescents. ▪ Creation of nonformal education programs for teenage girls. ▪ Grant land ownership titles to XX women heads of household. ▪ Strengthen microenterprise programs directed at women. ▪ Enactment of the Law on Gender Equity. ▪ Expand family counseling services. ▪ Continue providing targeted assistance through maternal-child and student projects. ▪ Increase the efficiency of family and community development programs and social intervention and protection programs carried out by IHNFA. ▪ Strengthen and monitor the Children’s Code. ▪ Implement the Child Information System. ▪ Strengthen child care programs designed to reduce child labor. ▪ Continue providing subsidies for the elderly. ▪ Improve the pension and retirement system. ▪ Oversee enforcement of laws benefiting the elderly. 	FHIS and PRAF FHIS and PRAF
ETHNIC GROUPS		C.N.
GENDER		FHIS INA
CHILDREN		Ministry of Educ (M.E.) M.E. INFOP INA
THE ELDERLY		C.N
		PRAF Ministry of Finance (M.F) IHNFA IHNFA
		PRAF
SOCIAL SECTORS		
Reduce shortfalls in coverage and quality of basic social services	<ul style="list-style-type: none"> ▪ Increase SBN (satisfied basic needs) by ___% in rural areas ▪ Increase SBN by ___% in urban areas ▪ Increase educational coverage in its various forms: <ul style="list-style-type: none"> Net preschool enrollment xx Net enrollment in primary education xx Net enrollment in secondary education xx ▪ Increase mean primary school attendance by two years. ▪ Lower the illiteracy rate to XX ▪ Ensure that xx primary school teachers have a degree awarded by the <i>Universidad Pedagógica Nacional</i>. ▪ Expand scholarship programs for low-income students in duly certified institutes. ▪ Improve basic health indicators: 	
EDUCATION		Ministry of Education (M.E)
HEALTH		M.E. M.E. M.E. M.E. and M. F.
		Ministry of Health

MATRIX OF MEASURES OF THE POVERTY REDUCTION STRATEGY

Sector/Objectives	Measures/Goals	Institution Responsible
	<p>Lower the infant mortality rate to ___%</p> <p>Lower the mortality rate in children under five years of age to ___%</p> <p>Lower maternal mortality to xx</p> <ul style="list-style-type: none"> ▪ Increase life expectancy at birth by xx years ▪ Improve health care: <ul style="list-style-type: none"> - Update hospital recovery quotas. - Increase the utilization of health care units providing underutilized services. - Increase spending on basic health care services by XX ▪ Finish building 60,000 homes under the NMPRT initiative ▪ Ensure that XX homes in poor sectors have access to at least XX basic services: ▪ Creation of a special fund for the self-help construction program and improvements to housing in rural areas and shanty towns 	(M.H.)
<p>HOUSING AND BASIC SERVICES</p> <p>RURAL DEVELOPMENT</p> <p><i>Increase in a sustainable manner the level of employment and income of the rural population, thereby contributing to an improvement in the living conditions of the poor.</i></p>	<ul style="list-style-type: none"> ▪ Construct and improve infrastructure supporting rural development by: <ul style="list-style-type: none"> - Rehabilitating roads in rural areas (XX km.) - Rural electrification (XX km. of electricity lines) - Irrigation systems (No. Hectares irrigated). - Telephony in rural areas (No. of new lines) ▪ Ensure the effective integration of at least 11 rural development programs currently being executed within the framework of the National Program for Sustainable Development (PRONADES) ▪ Prepare the regulatory framework for small agricultural financing entities ▪ Devise a National Training Program for small farmers with the participation of beneficiaries. ▪ Promote successful experiments in sustainable hillside agriculture. ▪ Strengthen access to secure landownership through: <ul style="list-style-type: none"> - No. of land titles granted. - No. of hectares of adjudicated land. - No. of hectares of land purchased through the market. - Modernized property registry. 	<p>M.H.</p> <p>FHIS ENEE Ministry of Agriculture (M.A.)HONDUTEL M.A.</p> <p>M.A. M.A./INA M.A. INA</p>
REACTIVATION AND ACCELERATION OF ECONOMIC GROWTH		
INFRASTRUCTURE		
Expand and improve infrastructure supporting the productive sectors.	<ul style="list-style-type: none"> ▪ Conclude the rehabilitation and reconstruction of the road network damaged by Hurricane Mitch: <ul style="list-style-type: none"> -Km. of roads -Mts. of bridges repaired ▪ Extend by xx Km. the primary and secondary road network ▪ Permanent upkeep of 6,542 km of roads using the road conservation fund ▪ Design and implement a Master Plan for port development ▪ Conclude the Central American electricity grid connection 	<p>Ministry of Public Works (M.P.W.)</p> <p>M.P. M.P./ National Port Authority ENEE</p>
STRENGTHENING OF FINANCIAL SECTOR		
Foster the stability and strength of the financial system, turning it into a dynamic facilitator of investment.	<ul style="list-style-type: none"> ▪ Continuous application of prudential regulations and on site inspections of financial institutions. <ul style="list-style-type: none"> - No. of on-site inspections of banks - No. of financial institutions included in on-site inspections - Application of capital adequacy rules (10%) to all banks based on Basle Committee standards - Application of corrective measures and No. of contingency plans 	<p>Banking Commission (CNBS)</p>

MATRIX OF MEASURES OF THE POVERTY REDUCTION STRATEGY

Sector/Objectives	Measures/Goals	Institution Responsible
	<ul style="list-style-type: none"> - Strengthen technical skills of all CNBS inspectors 	
	<ul style="list-style-type: none"> ▪ Seek Congressional approval of bills designed to regulate the financial system as a whole. <ul style="list-style-type: none"> - Deposit insurance law - Stock market law - Law on Insurance and reinsurance companies ▪ Submit the Private Pensions System Law to the National Congress 	CNBS
DEVELOPMENT OF THE PRIVATE SECTOR		
Raise the level of investment and production in a framework of administrative simplification and promotion of competitiveness.	<ul style="list-style-type: none"> ▪ Simplify the freight transportation regulations. ▪ Submit to Congress the law simplifying procedures for establishing a company ▪ Establish a public/private working group to review regulations and permits with a view to their application. ▪ Reactivate the one-stop-window for investment. ▪ Consolidate trade liberalization and insertion in international markets <ul style="list-style-type: none"> - Achieve benefits similar to those of the Free Trade Association. - Investment promotion and protection agreements - Progress in the integration mechanism ▪ Increase private participation in the delivery of public services. <ul style="list-style-type: none"> - Conclude Hondutel tender - Award cellular band "B" concession - Concession of previously defined port services. - Privatization of electric power transmission and distribution. - Conclude tender for the concession of the main airports. 	Ministry of Industry and Commerce (M.I.C)
MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISE		
Support micro, medium, and small production units, especially through financial and technical assistance and access to markets.	<ul style="list-style-type: none"> ▪ US\$xx expansion of loan portfolio in support of micro, medium-sized, and small enterprises ▪ Establishment of at least 20 mutual guarantee associations ▪ Start-up of at least 10 small enterprise "incubators" ▪ Create production alternatives for artisans and street vendors <ul style="list-style-type: none"> - Crafts fairs - Peripheral markets. 	FONAPROVI M.I.C M.I.C M.I.C
BASES FOR SUSTAINABILITY		
MACROECONOMIC STABILITY AND DEBT SUSTAINABILITY		
Maintain and strengthen public saving	<ul style="list-style-type: none"> ▪ Net domestic financing for the nonfinancial public sector should be zero in 2000 ▪ Shift expenditure priorities toward social objectives and reconstruction of basic infrastructure ▪ Maintain central government current revenue at around 18% of GDP ▪ Strengthen enforcement of sanctions contained in the Tax Code ▪ Submit to Congress a bill defining more precisely revenues and costs for income tax purposes ▪ 	M.F.
Enhance efficiency and control of government expenditure	<ul style="list-style-type: none"> ▪ Restrict the central government wage bill ▪ Establish a plan of action for a uniform wage policy for central government employees ▪ Implement the second stage of the wage scale restructuring - extensive audit of posts and drafting of details profiles for each job in the civil service ▪ Implement tariff adjustments based on marginal cost pricing. ▪ Increase the progressivity of the electricity subsidy 	

MATRIX OF MEASURES OF THE POVERTY REDUCTION STRATEGY

Sector/Objectives	Measures/Goals	Institution Responsible
	<ul style="list-style-type: none"> ▪ Review targeting of urban transport subsidy in Tegucigalpa 	
<p>Social security and pensions</p> <p>Enhance the efficiency of monetary instruments within the framework of stability and growth.</p> <p>A more open economy, through further liberalization and simplification of red tape.</p> <p>Maintain an adequate level of administration and management of the external debt</p>	<ul style="list-style-type: none"> ▪ Adopt a plan of action to create separate accounting for the Pension and health schemes of the Honduran Social Security Institute(IHSS) ▪ Adopt and implement an IHSS restructuring plan ▪ Form a working group on the government's payment of its debt to the IHSS ▪ Form a working group to start analyzing possible reforms of the pension system ▪ Take steps to increase efficiency in the public sector pension's system, including INJUPEMP and INPREMA ▪ Reduce inflation to single digits <ul style="list-style-type: none"> -Arrange more flexible management of CAM auctions in order to achieve appropriate interest rate levels -Reduce compulsory investment requirements for the banking sector -Maintain net international reserves of the Central Bank equivalent to four months of imports ▪ Abolish all export taxes ▪ Proceed with tariff reduction under the Central American Common Market Agreement ▪ All new foreign loans to require prior approval of a committee formed by the BCH and Ministry of Finance ▪ No contracting or guaranteeing of debt on nonconcessionary terms ▪ No new accumulation of arrears ▪ Negotiation and prompt signing of all bilateral agreements in order to implement the Paris Club agreement of April 1999 and prepare for the HIPC decision point. ▪ Work closely with the World Bank, IMF, and IDB on updated evaluation of the sustainability of the external debt 	<p>IHSS</p> <p>IHSS – Ministry of the Presidency (M.P.) M.F.-IHSS Executive and social cabinets. CNBS</p> <p>Central bank (BCH), M.F. M.F.</p> <p>M.F.,BCH</p>
Achieve a modern public administration in terms of structure and operationally.	<ul style="list-style-type: none"> ▪ Achieve substantial progress in the modernization and structural reform of the State <ul style="list-style-type: none"> - Finish implementing the SIAFI system. - Submit the Law of Administrative Simplification to Congress - Request enactment of the Framework Law for the Water and Sanitation Sector - Request enactment of the Framework Law for the Electricity Sector - Adopt a plan of action to create separate on an accounting basis the IHSS's pension and health fund - Request enactment of the law to regulate private pension funds - Simplify permits and the regulatory arrangements governing different productive services ▪ Strengthening of the Judiciary System <ul style="list-style-type: none"> - Implementation of a career system in the judiciary - Implementation of the new Code of Criminal Procedures and of the Criminal Code - Establishment of a specific quota of number of courts per inhabitant 	<p>M.F., IHSS, M.H.</p> <p>Supreme Court of Justice</p>
Further progress in decentralization and deconcentration , with community participation.	<ul style="list-style-type: none"> ▪ Step up the transfer of public projects and services to municipalities through decentralization programs and delegation of functions in education, health, water supply, sewerage facilities, social investment, and natural resources <ul style="list-style-type: none"> - Strengthen the PROHECO and AECOS programs - Convert xx health areas into decentralized entities - Transfer to municipalities of xx water and sewerage services - Ensure xx municipal investment plans for project prioritization and approval 	<p>Executive,</p> <p>M.P, Ministry of External Relations (M.R), M.H., M.E., FHIS</p>
	<ul style="list-style-type: none"> - Decentralize the functions of the Honduran Fund for Social Investment (FHIS) - Reactivate and strengthen the executive committee on decentralization of the state - Establish cooperation programs between the Central Government and the Mayors' Offices in order to strengthen management and technical capacities 	

MATRIX OF MEASURES OF THE POVERTY REDUCTION STRATEGY

Sector/Objectives	Measures/Goals	Institution Responsible
<i>MODERNIZATION OF THE STATE, INSTITUTION-BUILDING, AND DECENTRALIZATION</i>		
	<ul style="list-style-type: none"> ▪ Implement the participation mechanisms established in the Municipalities Law <ul style="list-style-type: none"> - No. of Municipal Development Councils - No. of Open Council Meetings - No. of Regional Consensus-building for a ▪ Inclusion of communities and community associations in the identification, prioritization, and execution of local projects ▪ Training of the population in decision making processes, distribution of funds, and management of services 	Executive branch, Municipalities AHMON
<i>STRENGTHENING OF GOVERNANCE</i>		
<p><i>Consolidate good governance in the country and strengthen democratic participation processes.</i></p> <p><i>Increase transparency and minimize the scope for corruption in order to reduce investment risk and enhance the potential for growth.</i></p>	<ul style="list-style-type: none"> ▪ Establish and publish a broad strategy to improve governance <ul style="list-style-type: none"> - Strengthen capacities in the Office of the Comptroller General of the Republic and Administrative Probity - Adapt the role of the Armed Forces to those of a more democratic state - Consolidate and modernize the electoral system by amending the legal frameworks ▪ Guarantee a legal system effectively establishing property rights <ul style="list-style-type: none"> - Modernize the registry office - Complete the national land register ▪ Strengthen NGOs' and developmental organizations' structures and their role as promoters of citizen participation <ul style="list-style-type: none"> - Enactment of the law regulating NGOs and developmental organizations ▪ Continue introducing accountability mechanisms regarding the use of funds <ul style="list-style-type: none"> - Strengthen the Office of the Comptroller General (CGR) - Establish an efficiency and transparency program - Request Congress to create the National Statistics Institute ▪ Prompt and transparent procurement procedures in accordance with law <ul style="list-style-type: none"> - Enactment of the new law on public sector procurement - Drafting of procedure manuals for the CGR 	<p>M.P., Comptroller general (CGR), Department of Administrative Probity</p> <p>CGR, M.F., BCH, M.I.C.</p> <p>CGR M.F.</p>
<i>ENVIRONMENTAL SUSTAINABILITY</i>		
<p><i>Improve sustainable management of natural resources by diminishing ecological vulnerability and protecting the environment. Coordinate with local governments, civil society, and central government.</i></p>	<ul style="list-style-type: none"> ▪ Develop environmental education programs <ul style="list-style-type: none"> - Amend school curricula ▪ Improve waste water management, initially targeting the most vulnerable areas <ul style="list-style-type: none"> - Establish a Waste Water Management Program ▪ Improve management and demarcation of protected areas <ul style="list-style-type: none"> - Perform gap analysis - Delimitation and legalization of protected areas ▪ Protect the Middle American Corridor in coordination with other countries in the region, by implementing the agreement with the World Bank ▪ Strengthen and decentralize environmental protection, conservation, and sustainable forestry programs. ▪ Enact and promote enforcement of the Land Planning Law ▪ Appropriate assessments of the impact of economic and social policies on the environment <ul style="list-style-type: none"> - Apply fast track procedures for environmental impact assessment and certification - Undertake studies to identify threats to the environment and to the sustainable use of natural resources - Inclusion of environmental costs in the national accounts ▪ Drafting and implementation of a management program for selected catchment areas 	<p>Ministry of Natural Resources (M.N.), M.E, M.A. and AFE- COHDEFOR.</p> <p>AFE-COHDEFOR</p> <p>AFE-COHDEFOR M.N. M.N., BCH</p> <p>M.N., M.A.</p>

MATRIX OF MEASURES OF THE POVERTY REDUCTION STRATEGY

Sector/Objectives	Measures/Goals	Institution Responsible
	<ul style="list-style-type: none"> ▪ Request Congress to harmonize legal instruments dealing with the environment, specially the Environment Law, the Forestry Law, the Land Planning Law, the Water Law and others 	M.N.
<i>RISK MANAGEMENT AND DISASTER PREPAREDNESS</i>		
<i>Reduce the country's vulnerability to natural disasters through effective risk management.</i>	<ul style="list-style-type: none"> ▪ Introduce risk management education programs <ul style="list-style-type: none"> - Train CODEM and CODEL members ▪ Develop intersectoral programs to educate and train human resources in risk management <ul style="list-style-type: none"> - Standardized risk information system - Plan of action coordinated with all bodies involved in risk management or disaster prevention ▪ Request Congress to enact the National Law on Emergencies ▪ Aim to have the private sector and municipal corporations to include a specific item in their budgets for risk management. 	COPECO COPECO COPECO Mayoralties, Private Sector

NOTE: The matrix and the document as a whole are preliminary. For this reason, the measures and goals have not been suitably quantified, and the dates by when they should be met are subject to revision and more detailed description. Some measures are included that stretch beyond the current government's term, as the idea is to reflect the long-term horizon of the strategy as well as the (also preliminary) frame of reference of the PRGF.

ANNEX B

DEMOCRATIC PARTICIPATION IN THE PREPARATION OF THE POVERTY REDUCTION STRATEGY IN HONDURAS

I. BACKGROUND

Since 1981, Honduras has pursued a vigorous process of democratic transition, characterized by the consolidation of the rule of law and democratic participation. The present administration has strengthened and furthered this process of democratic reintegration, which has been marked by two characteristics of the utmost importance: **i)** the redefinition of civilian-military relations, which has led to greater prominence and relevance of civil society vis-a-vis military authority; and **ii)** support for civil society forums, resulting in growing democratic participation.

Some important aspects that give evidence of progress in this field are the decentralization of public functions, the fight against corruption and related measures to increase transparency, the strengthening of the administration of justice, and measures to prevent discrimination on the grounds of sex, ethnicity or social differences.

As part of an innovative process of participation and decentralization at the municipal level, the first Open Town Council Meetings were held simultaneously throughout the country on September 26, 1998. These meetings involved 17,000 councils and were supported by the leadership of the 298 Mayors of the Association of Municipalities of Honduras (AMHON). This process has made Honduras a pioneer in large-scale social participation programs and has involved the development of facilitating methodologies and linkages at the national level which have encouraged and are continuing to inspire micro-planning efforts with civil society. Over 6,486 meetings have been held throughout the country, with an attendance of 646,000 people to do the work of identifying needs and prioritizing projects in their own communities, in order to initiate implementation of the Municipal Development Plan.

Another participatory experience is the Honduran Community Education Project (PROHECO) which is seeking to improve the quality and coverage of pre-school and basic education in the poorest rural communities that have no schools. The project constitutes a decentralized method of providing educational services, with community participation in decision-making concerning the education of their children through Community Education Associations (AECOS). The AECOS are made up of parents on a governing board elected in a general meeting of the members of the community. The government contracted the services of the AECOS to provide educational services to their own communities through direct transfers of funds, and it provides them with administrative legal support so that as legal entities they can administer the resources allocated. The supervisory function is exercised by the Ministry of Education, PROHECO, the District Director, the Finance Ministry through the rendering of accounts of the Ministry of Education and the Comptroller General of the Republic. At present there are 643 AECOS operating in 13 departments, and 3,829 parents have been trained.

II. PROCESS OF PARTICIPATION AND CONSULTATION IN THE PREPARATION AND IMPLEMENTATION OF THE MASTER PLAN FOR NATIONAL RECONSTRUCTION AND TRANSFORMATION (PMRTN)

After Hurricane Mitch, the government of Honduras prepared the PMRTN¹ through a broad process of analysis, discussion and consultation with the most representative sectors of Honduran civil society, in order to obtain important contributions to the definition of the such a plan. Noteworthy progress was made in increasing the participation of civil society in this consultative process, which found its fullest expression in the National Convergence Forum (Foro Nacional de Convergencia - FONAC) and in other forums, NGOs and social organizations. The contribution of these groups extended to active participation in the three meetings of the Consultative Group held in Washington, December 10-11,1998; in Stockholm, May 25-28, 1999; and most recently in Tegucigalpa, February 7-8, 2000.

The government of Honduras in its original statement presented in Stockholm expressed its firm support for the social audit initiatives developed in civil society as a complement to the public mechanisms for project auditing and monitoring. In addition, it seeks to raise public awareness of the various sectors in order to promote a culture of transparency. It is therefore promoting the process of involving organized civil society in the management, care, and use of public resources and initiating a process of raising the awareness of organized representative bodies, municipalities, associations, secondary education institutions and organizations for the protection of human and other rights.

To this end, the government of Honduras, with the support of international cooperation, decided to implement a series of measures and actions aimed at establishing the control of all relief, rehabilitation and reconstruction actions. An Inspectorate of Projects was set up for this purpose and a Program for Transparency in Government Procurement and Contracting, and progress to date points to their prompt implementation. This approach reflects the political will of the government to achieve efficient and effective administrative management of both national funds and those coming from the international community. This program responds to the Second Principle of the Stockholm Declaration, which aims to reconstruct and transform Central America on the basis of an integrated approach of transparency and good governance.

Continuing with this line of work, a Support and Supervision Commission was set up by Executive Decree 052-99 and is made up of three honorable members of civil society, who have the task of ensuring that there is no corruption in the contracting and performance of reconstruction work. It also issues reports on work contracted under the Emergency Decree, through the Ministry of Public Works, Transport, and Housing (M.P.W) and the Honduran Social Investment Fund (FHIS).

In addition, there is a social audit project headed by the Human Rights Commissioner, who in March 1999 presented his preliminary report on the management of international aid received following Hurricane Mitch. The Commissioner is also responsible for the continuation of this project, which enables civil society to exercise its right to obtain information and to petition. Accordingly, the Commissioner is promoting a social audit program which is intended, among other things, to promote the benefits of the social audit and familiarize the public and institutions

¹ The Master Plan for National Reconstruction and Transformation (PMRTN) is aimed at economic revival and job creation through the recovery and development of productive sectors and infrastructures and the consolidation and possible extension of macroeconomic reforms. It is intended to fight poverty and promote comprehensive human development through actions that reduce extreme poverty and improve the quality and coverage of basic social services. It also aims to reduce vulnerability through the sustainable management of natural resources and the environment, and an appropriate system for the prevention and mitigation of disasters, as well as the promotion of democratic participation and social equality in the various aspects of national life.

with the technical aspects and organization of social audit teams, as well as the procedures for lodging complaints or claims and the dissemination of results.

The government has also encouraged local government participation in the process of reconstruction, above all in community projects, so that they can adapt them to their specific needs. To this end, the existing participation mechanisms have been strengthened through the FHIS, which has reoriented its investments with a new targeting methodology using an index of poverty--and a participatory process that includes Mayors' Offices, the Municipal Development Council (CODEM), community leaders, and community assemblies, which participate in applications for and the prioritization of projects. Once the prioritized list of municipal projects to be financed by the FHIS is drawn up, the community representatives democratically elect social audit boards, made up of a member and two alternates, who are responsible for monitoring and supporting performance of the work. Community representatives who will form the organization responsible for continuation of the work are also elected.

For the implementation of the PMRTN, the government established a policy of broad participation by organized civil society in implementation, monitoring, and evaluation through a policy of co-participation and coordination with NGOs in the implementation of the different programs and projects, acting as co-managers or direct managers. Mention should be made of the extensive participation of over 185 NGOs in housing projects, access roads, training, infrastructure, primary health care, child care, support for ethnic groups and for farming and community organizations, with a budget of more than L 1,074.8 million in 1999-2000 for the 18 departments of the country.

III. CREATION OF NATIONAL CIVIL SOCIETY CONVERGENCE AGENCIES

Under the present government, civil society in Honduras has acquired growing importance through its organized capacity to help solve its own problems through unions and private development organizations. In this context, convergence areas have been created and laws have been passed, as in the case of the National Forum of Convergence (FONAC).

The FONAC is made up of authorized representatives of civil society, appointed through the 46 central organizations that participate in the General Assembly, representing 205 base organizations, or some 90% of all the organizations of civil society. In addition, the FONAC is working to increase the participation of civil society and is open to the incorporation of other organizations and representative bodies.

As part of its diverse contributions to the process of national reconstruction and transformation, including the strengthening of the participation of civil society, the FONAC is involved in a process of national and departmental consultation on a National Education System. This process has been endorsed by the President of the Republic, and is being supported by the Ministry of Education at all levels and by all the education boards and colleges of the country. To this end, the Education Commission of the FONAC has designed a methodology and guidelines for consultation at the municipal and departmental levels.

Moreover, to ensure greater commitment and the broadest possible participation of civil society in the monitoring and evaluation of the PMRTN and give the process the necessary transparency, the Executive Decree of August 23, 1999 created the Commission for the Participation of Civil Society in National Reconstruction and Transformation. Every week, the Special Reconstruction Cabinet meets with this Commission, discussing, among other things, the criteria used in the prioritization of projects and the progress made and obstacles

encountered in the implementation of these projects. This Commission is an ad-hoc body made up of:

- The Executive Secretary of the FONAC;
- The Chairman of the Association of Municipalities of Honduras (AMHON);
- Two representatives of private enterprise;
- Two representatives of other civil society organizations; and
- A citizen appointed by the President of the Republic.

It should be pointed out that some of the other functions of the Commission are to be familiar with and make recommendations concerning the prioritized projects in the pipeline; analyze alternative modalities; propose and support the implementation of procedures to ensure the maximum participation of the citizens and the country's productive forces in the formulation, assessment, implementation, and monitoring of national reconstruction and transformation projects and actions.

IV. CURRENT STATUS OF PARTICIPATION IN THE POVERTY REDUCTION STRATEGY (PRSP)

Discussion of the subject of poverty in Honduras is not new. The government has implemented a series of activities in this area involving public sector institutions, civil society, and donors, as a pivotal element of the PMRTN. In fact, one of the explicit objectives of the PMRTN was to formulate a Strategy to Combat Poverty, which was reconfirmed in the Meetings of the Consultative Group in Stockholm and Tegucigalpa as a country commitment. For preparation of the PRSP, the government implemented a series of actions involving both public sector institutions and civil society, which are worth highlighting:

1. At the Government level

a) Meetings with the World Bank and IMF Mission

In the first week of December 1999, the government welcomed the first World Bank/IMF technical mission, marking the start of the work of preparing the PRSP. This first meeting was attended by the Secretary of State and was held in the Office of the Presidency. In the meeting, the mission presented the general outline of the PRSP in Honduras and its relation to the country's request for eligibility to the HIPC (Heavily Indebted Poor Countries) initiative.

At this meeting, it was also agreed that the government of Honduras will prepare the text of the document and define the necessary technical support and framework for consultation with civil society. The mission also expressed its willingness to provide technical support for preparation of the document and undertook to present the final outline to be used for that purpose. For its part, the government of Honduras stated that it was working on a document on the Social Cost of Basic Services and another on Social Diagnostic Assessment, which will be used in the preparation of the PRSP.

The mission requested the Government to prepare by February 25, 2000 a preliminary strategy including the government's commitment to reducing poverty, with a timetable, details of the process of consultation with civil society, projections of key indicators, and a matrix of policy priorities.

The government agreed to prepare the requested preliminary document, but stated that although specific objectives can be set for 2000 and 2001, the objectives from 2002 on will only be indicative as a new government will be involved. The government also expressed the need for ad hoc international technical support for preparation of the PRSP and consultation with civil society, to supplement the national technical efforts.

b) Meetings of the Social Cabinet to familiarize with and discuss the PRSP

Progress in developing the PRSP has included various meetings with members of the Social Cabinet and the inter-institutional group of national experts, who will be working in the different areas covered by the document.

In the process of examining and managing the conceptual interpretation of poverty in Honduras, the Social Cabinet analyzed and discussed the various methodologies and points of view on the PRSP in Honduras. In particular, a working meeting was held on January 18, 2000, in which Ministers and experts examined and analyzed the following subjects:

- a. Combating poverty: methodological concepts, diagnostic assessment and strategy;
- b. Approaches to poverty reduction and indicators;
- c. Reflections on some experiences in tackling poverty; and
- d. Social diagnostic assessment in Honduras.

The Social Cabinet then convened and fully participated in two workshops with civil society: **i)** the first was held on January 26, 2000; in it, the plan for drafting the PRSP document was discussed and a report was given on the work schedule and deadlines agreed with cooperating organizations; **ii)** the second was held on February 16, 2000 to explain the basic conceptual aspects of the PRSP diagnostic assessment.

2. Consultative meetings with civil society and other entities

The government considers it essential that the country assume ownership of the PRSP through a participatory process led by the government, unhampered by rigid guidelines. Broad consultation with Honduran society is based on the idea that the strategy must not be conceived and implemented from outside, on bases inconsistent with our situation. This process is seen by the government as a fresh opportunity to demonstrate the open approach it has taken since the start of its administration and which has been reinforced in the context of national reconstruction and transformation.

Brief description of the meetings with civil society in the context of the PRSP:

- a) The first meeting with civil society took place on January 26, 2000. There were 250 participants, the great majority of whom represented trade unions, confederations of workers, farmers, ethnic groups, cooperatives, women's organizations, NGOs, private enterprise, political parties, etc. Also taking part were representatives of the public sector (centralized and decentralized), the National Congress and the Supreme Court of Justice.

The proceedings included the following:

- Two lecture-type presentations:
 - One on the proposed outline of the Poverty Reduction Strategy, by the Minister of the Presidency; and
 - The other on the relationship between external debt relief and the PRSP, by the Minister of Finance.
- Five working groups were set up, each addressing a specific sector or area. Participants were free to join any of these working groups. Each group defined the criteria for organization and discussion of the outline document previously distributed to all participants.
- The work method of the groups was to discuss the outline presented by the Minister of the Presidency and then make specific contributions and/or recommendations to improve it. Each group appointed a coordinator and a rapporteur and was assisted by experts from UNAT and the Social Cabinet.
- A plenary session followed, in which each rapporteur presented the group's observations, conclusions, and specific contributions to improve the outline of the Strategy. Time was allotted after the plenary session for questions and clarifications on the outline of the PRSP.
- The assigned experts collected the written contributions of each of the rapporteurs, for consideration as inputs in preparing the Poverty Reduction Strategy. Next, the contributions of each working group were consolidated and

SECTORS PARTICIPATING IN THE FIRST MEETING

For civil society

- FONAC (all federations, confederations, unions and organizations represented)
- INTERFOROS (ASONOG, FOSDEH, FOPRIDEH, CARITAS, FONAMIH, Standing Committee for Reconstruction, Youth Network, COIPRODEN, COSIBAH)
- NGOs (COIPRODEN, UNISA, ASEPADE, CEDOH)
- Citizen's Forum
- Women's Organizations ("Visitación Padilla" Committee of Women for Peace, Council for the Comprehensive Development of Women, AHDEJUMUR, University Women's Collective, CEM, Forum of Women for Central American Integration, UNCA, FEHMUC, AHMUC, CODIMCA, ANAMUCH)
- Private enterprise (Chambers of Commerce, Federal Chambers)
- Municipal NGOs (AMHON, FUNDEMUN)
- Churches (Catholic; International Christian Center, Confraternidad Evangélica)
- Life Foundation
- COVELO Foundation
- Cristo del Picacho Foundation
- Political Parties (National, Liberal, PDCH, PINU, UD)
- University Professional Associations and Unions
- Universities (public and private)
- Ricardo Ernesto Maduro Andreu Foundation for Education (FEREMA)
- Human Rights Groups (CODEH, COFADEH)
- Rural Organizations (UNC, COCOCH)
- Ethnic Groups (National Lenca Indian Organization, Confederation of Indigenous Peoples of Honduras - COMPAH)
- Media
- Miners' Association

For the government

- Social Cabinet
- M.F. – Ministry of Finance
- BCH – Central Bank of Honduras
- INHFA - Honduran Institute of the Family
- PRAF – Family Allowances Program
- INAM - National Institute for Women
- M.P.W – Ministry of Public Works, Transportation, and Housing
- FHIS - Honduras Social Investment Fund
- IHSS – Honduran Social Security Institute
- INPREMA – Teachers Retirement Institute
- INJUPEMP - Public Employees Retirement Institute
- M.A. –Ministry of Agriculture and Livestock
- M.N. –Ministry of Natural Resources
- COPECO – Standing Contingency Coordination Committee
- COHDEFOR – Honduran Forest Development Corporation
- FONAPROVI - National Production and Housing Fund
- National Commissioner for Human Rights

incorporated in this preliminary version of the PRSP.

- b) A second meeting was held on February 16, 2000 to examine a number of the conceptual and fundamental aspects serving as the basis for formulation of the first part of the Strategy, related to the Diagnostic Assessment.

The proceedings included the following:

- Presentations were given on four subjects:
 - Conceptual aspects that are part of the Strategy and that make it possible to elucidate a broad, comprehensive approach, which can effectively lead us toward poverty reduction.
 - Relevant aspects of a social diagnostic study in Honduras. This study provides us with estimates of the level of poverty, based on the poverty-line methodology; as well as statistical information on the behavior of key indicators related to incomes by occupation, labor market and education, broken down into urban and rural areas and vulnerable groups such as women, children and young people.
 - The principal findings of a study on social expenditure on basic services carried out by a group of Honduran consultants. This study is related to the commitments of the Copenhagen Social Development Summit of 1994 and the framework of the 20/20 initiative, which sets universal objectives for primary health care and education programs with the capacity to overcome extreme poverty in the medium term.
 - Reflections on the contribution of civil society to the success of the strategy, in each of its phases.
 - Participating in this event were 132 representatives of organizations of the various sectors of civil society: private enterprise, trade unions, political parties, NGOs, convergence forums, ethnic groups, rural and women's organizations, the media, and others. Representing the government were the Ministers of the Social Cabinet and several members of the Government Cabinet, deputy ministers and the experts of the inter-institutional group.
- c) Another event of great significance in this connection was without a doubt the meeting of the Consultative Group of Organizations Cooperating for Honduras, held in Tegucigalpa February 7-8, 2000. A cordial invitation was extended to a large number of organizations representing civil society to join with the government in its presentation before the international community on the progress made toward achieving the goals of the Master Plan for National Reconstruction and Transformation and how the financial cooperation received to date is being used.
- d) Also, with the view to raising the awareness of the State authorities, on March 8, 2000 the Minister of the Presidency and ESA Consultants addressed the National Congress on the principal points of the PRSP Preliminary Diagnostic Assessment. The content of the presentation was:
- Poverty in Honduras, its extent and profile; including definitions of poverty, its measurement, distribution and who are the most vulnerable.
 - Poverty in Honduras, its explanation and origin; including an analysis of economic growth and inequality in income distribution.

The meeting was attended by groups representing the political parties, whose chairman expressed their concern with the subject and their willingness to support preparation of the PRSP.

- e) In addition, the UNAT sponsored a series of technical meetings to exchange views with cooperating organizations—essentially, the World Bank, the IDB, the CABI and USAID—for the purpose of delving more deeply into each topic covered in the PRSP.
- f) It should be noted that the government has guaranteed that the process of consultation will continue at the national level and to the extent possible at the regional and departmental levels, with a view to harmonizing the conceptual framework and the basic indicators that will be used to reconcile macrodata with regional data. Operational and technical authorities will also be set up to ensure that the PRSP document and its pipeline of viable projects for implementation of the strategy are available as soon as possible. This will involve continually increasing the representation of all sectors and considering appropriate proposals from representative associations to improve the document.

V. PROPOSAL TO INCREASE PARTICIPATION IN THE FORMULATION AND IMPLEMENTATION OF THE PRSP IN HONDURAS

The government hopes that the country's long tradition of informal civic organizations and leaders will enable the latter to take a leading role in anti-poverty programs and projects. The success of the Strategy requires sustained economic growth with equity, which can be achieved through macroeconomic stability, appropriate structural reforms, and efficient implementation of specific social development programs and productive activities with a social impact. This will involve energizing the social sectors through policy measures, programs, and projects to both relieve and reduce poverty.

The government believes that organizations and the institutions that represent them should make specific proposals for policies, programs, and projects, indicating the actual costs and ensuring that they are consistent with the government's macroeconomic program and the priority projects of the PMRTN. It has been demonstrated that most social projects work better when their implementation and operation depend not only on State support, but also on the participation of the organized beneficiary community².

Preparation of the PRSP is viewed as a participatory and consultative process in which all sectors and actors have access to and use the same information, as well as share the same view and clear understanding of the action plan to be implemented. Its purpose is to get people involved and help them internalize both the process and the actions it entails, so that they can truly participate in the implementation of the proposal. The government will direct the process through the Social Cabinet, which will facilitate participation in coordination with the Executive Secretary of the FONAC and the Commission for the Participation of Civil Society.

² An evaluation of FHIS projects found that consultation with the beneficiaries before implementing a project increased by 13 percent the probability of their contributing to the project and by 7 percent their use of the facilities built: see Quentin T. Wodon et al; Poverty and Policy in Latin America and the Caribbean (Washington, D.C.: World Bank, January 2000), pp. 94-95.

1. Operational aspects to be considered

- a) The methodology of “participation in the consultation process” will involve the organized sectors involved in the definition of the PRSP. The mechanism for participation in the consultation was defined at the central government level, with the cooperating international agencies and each of the coordinating agencies. Mechanisms have also been established for coordination and liaison between the government, private enterprise, and civil society.
- b) The participating sectors and organizations are: **i)** for government, the three branches of government (Executive, National Congress, Supreme Court of Justice) and the municipalities; **ii)** for private enterprise, a broad representative spectrum including the COHEP (Honduran Private Enterprise Council), chambers of commerce and industry, and small and micro-enterprises; **iii)** for civil society, the FONAC, which brings together the authorized representatives of civil society appointed by the various social, union, and political organizations comprising 205 base organizations³; and the Committee for the Participation of Civil Society, created as an ad-hoc body to support the Special Cabinet for National Reconstruction in the implementation of the PMRTN, representing INTERFOROS (FORO CARITAS, ASONOG, FOSDEH, FOPRIDEH, FONAMINH, Standing Committee for Reconstruction, Youth Network, COIPRODEN, COSIBAH) and Citizen Forum.
- c) It is important that the participants be organizations with a social will and commitment, interested in working to support and/or implement the PRSP, and able to take action and motivate people as well as establish good contacts with the grass roots to promote the PRSP.
- d) The levels of consultation have been defined by the government in coordination with the Committee for the Participation of Civil Society, and a track record has already been established with the PMRTN. The strategy is to work at the national and regional levels, starting with the basic PRSP document, which is to be supplemented with inputs.
- e) Commitments by sectors will enable people directly related to the population benefiting from projects to offer support and become involved in implementation. Once the PRSP proposal and the respective action plan with its measures and short-, medium- and long-term goals have been finalized and its financing determined, mechanisms will be set up for continual monitoring and operational coordination between the government, private enterprise, and civil society.

2. Consultation Meetings Between Civil Society, Government Authorities, and Cooperating Organizations

a) Analysis of the diagnostic assessment of the preliminary report (national consultation)

In accordance with the proposed work schedule agreed with the World Bank and IMF, on February 25, 2000, the Minister of the Presidency presented the PRSP Preliminary Diagnostic Assessment and on February 28 received comments. Once incorporated in the document, preparations will be made for the next consultation meeting with civil society held Monday, March 20, 2000, to present and discuss the contents of the Preliminary Diagnostic

³ All of the legally registered political parties are represented in the FONAC; nevertheless for its political importance it is to be recommended that their representativeness should be increased.

Assessment. To that end, the government sent out copies of the document to acquaint each participant with it in advance, thus encouraging constructive contributions at said meeting.

The methodology and participating sectors will be the same as in the meetings of January 26 and February 16, 2000, in which the outline of the PRSP and the methodological advances were discussed.

On February 28, 2000, the government convened a joint meeting with the Cooperating Group of 8 and the Inter-institutional Technical Group to review progress and learn how the cooperating organizations view the PRSP and how they can contribute to its success.

b) Presentation of the overall approach, general guidelines, and objectives of the PRSP (national consultation)

The next step planned is to present a more detailed proposal to civil society, including the short- and long-term approach and objectives of the PRSP, as well as projections of key indicators to 2010. Once again, the document will be distributed in advance and discussed with the participation of the largest possible number of sectors. After the consultation, and making optimal use of the contributions of civil society and of experts from national and international institutions, the measures necessary for the achievement of the objectives and goals will be formulated, and the programs, projects, and necessary financing will be defined.

c) Presentation of the preliminary document to civil society (national and regional consultation)

A broader process of consultation and discussion of the document containing the preliminary diagnostic assessment is programmed for the March 20-31, 2000 period. This process will be characterized by a series of meetings involving the government, specialists and experts, and, in the case of civil society, the consultation will be at two levels: **i)** national, in which the most representative sectors of civil society will participate, in the same way as in the earlier stages of the process; and **ii)** regional, in which consultation meetings will be held in a number of large cities, attended by mayors, governors, and representatives of councils, chambers of commerce, Lions Clubs, union organizations, regional bodies, NGOs, and community organizations. This consultation will take place in the cities of Tegucigalpa, La Ceiba, San Pedro Sula, Copan, Juticalpa, and Choluteca. After the regional consultation process, and once the preliminary document has been revised and the inputs from civil society incorporated, the document will be submitted to the cooperating organizations on May 31, 2000.

Schedule of meetings for participation in the consultation to discuss the PRSP

1. With Civil Society

No.	Activity	Date	Comments
1	<p>Presentation of the outline of the PRSP and its relationship to external debt relief.</p> <p>Prepare a matrix with comments from the five working groups on each topic.</p>	1/26/00	<ul style="list-style-type: none"> The comments and recommendations of the five working groups used as inputs for preparation of the PRSP. Submission of the outline
2	<p>Conceptual and fundamental aspects for formulation of the PRSP:</p> <ul style="list-style-type: none"> Aspects included in the Strategy Social Diagnostic Study in Honduras Main findings of the Study on Social Expenditure on Basic Services. Comments on the contribution of civil society to the success of the strategy, in each of its phases 	2/16/00	<ul style="list-style-type: none"> Comments and recommendations from civil society. Submission of documents for each presentation
3	Presentation of the PRSP Preliminary Diagnostic Assessment in Tegucigalpa	3/20/00	<ul style="list-style-type: none"> Advance submission of the Diagnostic Assessment document. Comments on the draft
4	Presentation of the PRSP Preliminary Diagnostic Assessment in La Ceiba.	3/22/00	Submission of the document for discussion on the day of the event.
5	Presentation of the PRSP Preliminary Diagnostic Assessment in San Pedro Sula.	3/23/00	Submission of the document for discussion on the day of the event.
6	Presentation of the PRSP Preliminary Diagnostic Assessment in Copan.	3/24/00	Submission of the document for discussion on the day of the event.
7	Presentation of the PRSP Preliminary Diagnostic Assessment in Juticalpa.	3/29/00	Submission of the document for discussion on the day of the event.
8	Presentation of the PRSP Preliminary Diagnostic Assessment in Choluteca.	3/31/00	Submission of the document for discussion on the day of the event.
9	Presentation of the main components of the PRSP	To be decided	Overall approach, general guidelines, and objectives
10	Presentation of the main components of the PRSP	To be decided	Measures, goals, and follow-up and monitoring system

2. At the government level

No.	Activity	Date	Comments
1	Meeting with the Social Cabinet to explain agreements with the IMF/World Bank mission and present the guidelines for the PRSP	1/13/00	Each Minister member of the Social Cabinet, appointed an expert to make up the national team.
2	Meeting convened by the Social Cabinet to analyze and discuss methodologies and points of view on the	1/18/00	Participation of Ministers and experts involved in the

	<p>PRSP in Honduras:</p> <ul style="list-style-type: none"> • Combating poverty: concepts methodology, diagnostic assessment, and strategy. • Approaches to the reduction of the poverty and appropriate indicators. • Comments on some experiences in combating poverty. • Social diagnostic assessment in Honduras. 		<p>process of understanding and managing the conceptualization of poverty in Honduras.</p>
3	<p>Working meeting with the inter-institutional technical group to plan the consultation meeting with the Cooperating Group of 8</p>	2/28/00	<p>Attended by representatives of the IHSS, M.A., BCH, M.P.W., INA, M.H., M.E., STSS, M.N., INFA, FHIS, PRAF and UNAT</p>
4	<p>Presentation of the main components of the PRSP Preliminary Diagnostic Assessment to the National Congress. Content of the presentation:</p> <ul style="list-style-type: none"> • Poverty in Honduras, its extent and profile. • Poverty in Honduras, its explanation and origin. 	3/8/00	<ul style="list-style-type: none"> • The presentation was made by the ESA Consulting firm. • Attended by all the groups of the parties represented.
5	<p>Various working meetings with the Social Cabinet and the Inter-institutional Technical Group to continue the preparation of the PRSP.</p>	Various dates	

3. International cooperation organizations

No.	Activity	Date	Comments
1	<p>Various working meetings with the first IMF/World Bank technical mission to begin the work of defining the PRSP.</p>	11/29/99 to 12/3/99	<ul style="list-style-type: none"> • Attended by the Secretary of State from the Office of the President and other Cabinet ministers. • The mission presented the guidelines of the PRSP and its relationship to the country's application for inclusion in the HIPC Initiative.
2	<p>Various working meetings with the IMF/World Bank technical mission for the revision and submission of the PRSP Preliminary Diagnostic Assessment</p>	2/17-24/00	<p>Version submitted to the Ministers (2/21/00) and subsequently to Humberto López, mission representative, for comments.</p>
3	<p>Meeting with the Cooperating Group of 8 to report on the progress of the PRSP</p>	2/29/00	<p>Attended by representatives of the bilateral and multilateral cooperation agencies.</p>
4	<p>Various working meetings with the missions of the cooperating organizations to continue the preparation of the PRSP.</p>	Various dates	

ANNEX C

METHODOLOGY FOR MEASURING POVERTY

The methodology used to update poverty indicators is that developed by the Social Policy, Population, Gender, and Employment Project (HON/94/PO2) of the Ministry of Planning, Coordination, and Budget (SECPLAN), in 1994.⁴

Some of the main features of this methodology are:

1. The source of information used is the Multipurpose Household Survey conducted by the General Directorate of Statistics and Census at six-month intervals, usually in March and September. The March survey was used for each year except 1994, when only one survey was conducted (in October).
2. The methodology referred to establishes poverty and extreme poverty lines based on the quantification of a basic urban and rural food basket. For income, the household surveys initially took into account only what was received from remunerated employment. From 1994 onwards, so as to adjust and consolidate the methodology for estimating poverty levels, the income definition used was broadened to include the value of other household income, such as income from leases, rents, pensions, and remittances, as well as self-consumption by producers, based on the findings of the living standards module carried out in 1993. In addition, the adjustment factors corresponding to previous years were applied, thereby ensuring that the data were consistent for the decade as a whole.
3. The extreme poverty line corresponds to the estimate of the monthly value of the basic food basket, using weighted prices provided by the Central Bank of Honduras (BCH), which are available only for urban areas. The (per capita) extreme poverty line values are as follows:

<u>Years</u>	<u>COST BB</u> <u>(L/month)</u>		<u>Years</u>	<u>COST BB</u> <u>(L/month)</u>	
	URBAN	RURAL		URBAN	RURAL
1991	166.8	113.1	1995	310.8	203.4
1992	167.4	121.2	1996	372.0	273.3
1993	170.1	150.9	1997	465.0	342.0
1994	252.6	186.0	1998*	577.8	427.8

*Preliminary.

4. Starting in 1994 the urban poverty line (see below) is derived by multiplying the extreme poverty line by 1.70, assuming that 59 percent of urban income is spent on food.
5. Assuming that in rural areas 75 percent of income is spent on food, the rural poverty line is obtained by multiplying the extreme poverty line by 1.33.⁵
6. The technical steps taken for the adjustments made by SECPLAN in 1994, were as follows:⁶

⁴ 'La pobreza en Honduras: Conceptualización, Enfoque Metodológico, Causalidad y Características, Sugerencias de Política' [Poverty in Honduras: Concepts, Methodological Approach, Causality and Characteristics, Policy Suggestions].

⁵ The adjustment factor used by SECPLAN was 1.60. However, it was felt that that figure overestimates the value of nonfood basic needs and that 1.33 was more realistic.

- Calculation of values by deciles, for income from principal occupation (they are different for each year).
- Application of the adjustment coefficients for each decile, according to the weight of expenditure on food in total household income. The aim of this calculation was to approximate income to more realistic values, which entailed knowing for each decile the size of the gap between income from principal occupation and other incomes. It is to be noted that those adjustments are distinguished according to geographical area, although the values for each decile are uniform for the country as a whole.
- Application of the following Engel coefficients:
 - Tegucigalpa 1.70
 - San Pedro Sula 1.72
 - Other urban areas 1.60
 - Total rural areas 1.60⁷
- It should also be taken into account that, in calculating these coefficients, the first three income distribution deciles were eliminated. It is to be noted that the high income concentration index in the last decile of the distribution means that the desired coefficient is not the one including the last two deciles.
- The above coefficients imply that for Tegucigalpa and San Pedro Sula, approximately 59 percent of income should reasonably be earmarked for food, whereas in the rest of the country, the percentage is as high as 63 percent.
- This is a very relevant aspect because, in the previous estimates, these percentages were different (50 percent and 75 percent, respectively). A revision was proposed in light of the new module indices and because incomes were also adjusted on the basis of the module.

VI. LIMITATIONS

- There may be a bias in the income level used, to the extent that the value quantified underestimates or fails to consider the totality of other sources of income (subsidies, for instance).
- Urban prices are used to estimate the cost of the rural basic basket, because BCH has no data on rural prices. Given that rural prices for many foods are lower than urban prices, and a considerable quantity of food is produced by the same people who consume it, the use of urban prices tends to overvalue the cost of the basic food basket and ultimately to overestimate the incidence of poverty in rural areas.

⁶ La pobreza en Honduras [Poverty in Honduras], pp. 27-28

⁷ As mentioned above, a coefficient of 1.33 is considered more realistic.

- The composition of the basic basket corresponds to average energy needs of 2,200 calories per person [per day], as defined by SECPLAN on the basis of the 1987 food consumption survey (the only instrument available) and the benchmark international requirements basket. However, given that energy needs are lower in children, an average of 2,200 calories per person may overestimate the number of calories required per family. Furthermore, considering that rural families tend to have more children than urban families, the bias is greater for rural areas

ANNEX D

MONITORING AND EVALUATION OF THE STRATEGY

A key element of the Poverty Reduction Strategy is a follow-up, monitoring, and evaluation system, which makes it possible to determine progress with respect to the strategy's principal indicators as well as identify the likely causes of delays or deviations in its implementation. Moreover, the principal point of departure is that the Strategy is a dynamic process that is continually adjusted based on the changing nature of the various components of poverty.

The follow-up, monitoring, and evaluation system includes an institutional framework, mechanisms and its own objectives.⁸ One of the key elements of the system is adequate monitoring of the strategy's basic indicators, which is to be achieved by strengthening the existing mechanisms for generating periodic information and by implementing other mechanisms as necessary.

A. NATIONALLY REPRESENTATIVE SURVEYS AND CENSUSES

There are three principal sources of information on poverty that are representative of Honduras as a whole.

1. The Multipurpose Household Survey (EHPM).

This is a labor force survey conducted every six months by the General Directorate of Statistics and Census (DGEC), with financial support from USAID. The framework of the survey sample consists of 7,200 households, stratified in 4 geographic regions (1) Tegucigalpa; (2) San Pedro Sula; (3) Other urban areas; and (4) Rural areas.

Although there has been some concern regarding the quality of the data, the survey is currently the only base available for monitoring poverty over time. The sample includes a table or rotating panel, but this information has not been utilized correctly, and work is needed to reconstruct the panel by linking the various surveys. A valuable characteristic of the EHPM is that it provides comparable data at many points in time, given that it has been conducted twice a year almost every year. However, the survey has significant limitations for measuring poverty.

Even should measures be taken to improve the quality of the data collected by the EHPM, it would still be impractical for it to include a detailed spending module. This is a fundamental element to be considered, as it is well known that spending provides a better picture of poverty and well-being than that provided by income, owing in part to the cushioning strategies households use to adapt to drastic changes in income. In other words, the variation in poverty identified by the survey in urban areas may be greater than actual changes in well-being. Another aspect is possibly exaggerated measures of income inequality in the EHPM resulting from the survey's inability to measure income over a sufficiently extended period of time. Finally, like other labor force surveys, the EHPM generally does not accurately capture the earnings of the self-employed.

⁸ To be developed in a more refined version of the PRSP

2. The **National Survey of Household Income and Spending** was conducted by the Central Bank of Honduras (BCH) in conjunction with the DGEC between February 1998 and March 1999, with support from USAID.

The sample consists of 4,000 households distributed equally throughout the same four regions (Tegucigalpa, San Pedro Sula, Other Urban Areas, and Rural Areas). This survey has information on income, spending, housing, education, health and employment. In general terms, the survey could provide a consistent basis for measuring poverty using spending rather than income as the indicator of well-being. The survey can also help to estimate poverty lines with more precision, especially the nonfood component of these poverty lines.

As part of the HIPC initiative, it would be advisable to allocate funds to conduct an Income and Spending Survey at least every two years. If this is done, it is essential that the equipment used be transferred to the DGEC, despite the fact that it currently lacks sufficient means to accomplish its mission.

Currently under consideration is a draft law submitted last December to the National Congress on the creation of the National Statistics Institute. The proposed Institute would replace the current DGEC, assuming its functions and establishing rules for producing statistics in the country, which would be very helpful in monitoring poverty. The World Bank and other donors can help to provide assistance to the Institute through the MECOVI program.

3. **Data on nonmonetary indicators of poverty available in the latest national population census from 1988.**

This information was used extensively, for example in the Q Book (1994), to measure access to basic infrastructure services and the so-called *Unsatisfied Basic Needs (UBN)*. A new census will be conducted in 2000 with technical and financial support from the United Nations Development Program (UNDP). In this regard, it will be important for the census to include questions on indigenous or ethnic affiliation and thus obtain information on living standards of these population subgroups.

4. **Surveys Conducted by Specialized Government Agencies**

- a) In 1999 The Family Allowance Program (PRAF), with financing from the Inter-American Development Bank (IDB) and technical assistance from the International Food Policy Research Institute (IFPRI), implemented a survey representative of one half of the country's cities using indicators of malnutrition. Malnutrition is measured by the Ministry of Education through an annual census of the nutritional status of children in the first year of primary school (*Weight and Height Census*). The PRAF survey has a spending module as well as information on education and health. It can also be used to evaluate hurricane Mitch's impact on households. The analysis of this report benefited greatly from collaboration between the PRAF, the IFPRI and the World Bank.
- b) In addition, in 1998 the Honduran Social Investment Fund (FHIS), with financing from the World Bank, conducted a survey in its areas of operation. Although surveys of this type cannot provide the same services as nationally representative surveys on income and spending, they are essential for evaluating and targeting the government's programs.

Effective and reliable monitoring of Honduras's progress toward attaining the goals proposed in the Poverty Reduction Strategy will require access to broad-based and timely household surveys. More generally, the country needs greater statistical capabilities for policy design and analysis purposes.

In this regard, it would be very helpful to conduct the new income and spending survey on a regular basis (at least every two years). This should be done by a strengthened Statistics Institute. Currently, the DGEC is weak and the few statistics it produces are not broadly used, in part because there is no budget for disseminating them. The DGEC is underfinanced and poorly equipped in terms of staff, partly because salary levels are not sufficient to attract highly qualified technical personnel. The DGEC also suffers from a poor physical infrastructure, in terms of both its building and its computer equipment. Even more importantly, the DGEC lacks institutional autonomy.

Despite the above, in the interim while the National Statistical Institute is starting up its operations, the country would benefit from participation in the MECOVI (ISLC) Program (*Improving the Surveys of Living Conditions in Latin America and the Caribbean*) jointly coordinated by ECLAC, the Inter-American Development Bank (IDB), and the World Bank. This program provides financing and training to improve data collection, dissemination, and analysis of household surveys.

Participation in the MECOVI program would offer an excellent channel to support activities that would include an improved estimate of poverty and improvements in national household surveys, which are key sources of data for measuring poverty. However, to achieve a sustainable impact, a medium- to long-term program will be required to remedy weaknesses in institutional capabilities in Honduras. Not all of these activities fall under the general financing guidelines of the ISLC. Thus, it will probably be necessary to formulate separate projects; tasks that could be assumed by the National Statistics Institute, responsible for gathering and maintaining the data produced by the different sources available in the country (not just the surveys and censuses, but also the information produced by the various governmental agencies).

BASE PROJECTIONS FOR THE SOCIAL SECTORS¹
(data in percent)

	1999 ²	2003	2005	2010	2015
Health sector					
<i>Infant mortality (< 1) (per 1,000)</i>	34	30	28	24	21
<i>Child mortality (< 5) (per 1,000)</i>	46	41	39	33	29
<i>Life expectancy (years)</i>	68	69	70	72	74
Vaccination	92	94	95	96	97
Education sector					
<i>Illiteracy</i>	29	26	24	21	19
<i>Net enrolment ratio, primary</i>	88	90	91	93	96
<i>Net enrolment ratio, secondary</i>	23	26	28	33	38
<i>Net enrolment ratio, tertiary</i>	12	15	16	21	27
Basic services					
<i>Access to water</i>	81	88	92	99	99
Poverty lines (national)					
<i>Poverty</i>	66	62	60	56	52
<i>Extreme poverty</i>	49	45	37	37	32

¹ Base projections for the establishment of targets. Subject to revision, and modifiable thereafter.

² The 1999 data are estimates based on the most recent observations.

Monitoring and Evaluating the PRSP

The legal and institutional framework used in the PMRTN will be salvaged and taken advantage of for the PRSP. The Government of the Republic will continue to implement the integrated mechanisms of transparency and governance by way of the implementation of monitoring and evaluation instruments which could strengthen the social auditing methods, so that civil society can witness an adequate implementation of the Strategy and to guarantee an efficient management of the domestic and external resources.

ANNEX E. Macroeconomic Scenario, 1997-2002

	1997	1998	Prel. 1999	Projections		
				2000	2001	2002
(Annual percentage changes, unless otherwise indicated)						
National income and prices						
GDP at constant prices	5.1	2.9	-1.9	5.0	5.5	5.5
GDP deflator	22.5	11.0	11.1	9.3	9.2	8.6
Consumer prices (end of period) 1/ (period average) 1/	12.8	15.6	10.9	10.0	9.0	7.0
	20.2	13.7	11.6	10.5	9.4	7.9
Exchange rate (depreciation -) 2/						
Nominal rate	-2.6	-6.5	-5.1	...	...	...
Real effective rate	15.0	5.4	7.5	...	...	...
Money and credit						
Net domestic assets	11.5	17.3	-5.2	21.5	19.0	14.6
Public sector credit (net)	276.9	132.3	90.0	14.5	1.1	11.7
Private sector credit	47.1	36.7	19.2	21.7	17.8	15.6
Broad money	43.3	23.4	20.6	15.3	14.9	14.3
Average lending rate (in percent)	32.1	30.6	29.5	...	...	...
Average deposit rate (in percent)	15.3	15.3	15.0	...	...	...
(In percent of GDP)						
Consolidated nonfinancial public sector						
Revenue and grants	30.4	30.2	32.0	32.4	31.4	29.0
Noninterest expenditure	28.1	26.9	30.9	35.2	33.3	30.2
Primary balance	2.2	3.3	1.1	-2.9	-1.9	-1.2
Interest payments	4.2	3.5	1.8	1.2	1.2	1.4
Overall balance	-2.0	-0.2	-0.7	-4.0	-3.1	-2.6
External financing	2.9	1.3	10.9	5.3	3.4	4.1
Domestic financing	-0.9	-1.1	-10.2	-1.3	-0.3	-1.5
Combined public sector balance (after grants) 3/	-3.6	-0.3	-0.7	-4.1	-3.2	-2.7
Combined public sector balance (before grants) 2/	-3.6	-0.6	-2.3	-6.5	-4.3	-2.8
Public sector savings 4/	5.5	6.6	5.5	5.6	5.8	6.2
Central government domestic debt	7.2	5.7	4.4	3.2	2.5	2.0
Savings and investment						
Fixed capital formation	23.8	25.5	23.9	28.7	27.3	27.5
Gross national savings	19.9	24.7	18.2	19.7	20.6	21.7
(In millions of US\$, unless otherwise indicated)						
Balance of payments						
Gross international reserves	548	770	1,209	1,248	1,383	1,489
(in months of imports) 5/	2.4	3.0	4.2	4.0	4.0	3.8
Change in net international reserves (increase -)	-280	-168	-342	0	-100	-125
External current account balance (percent of GDP) (excluding official transfers)	-3.9	-0.8	-5.7	-9.0	-6.7	-5.8
	-6.8	-5.8	-11.0	-11.7	-9.9	-8.5
Exports, f.o.b. (annual percent change)	8.2	8.0	-22.2	17.2	19.4	14.9
Imports, c.i.f. (annual percent change)	15.9	14.7	11.2	10.3	8.9	12.6
External debt (percent of GDP)	77.5	73.8	80.5	79.9	75.7	72.0
Debt-service ratio (in percent of exports of goods and services before debt relief)	26.7	20.6	22.9	17.2	14.6	10.9

Sources: Central Bank of Honduras; Ministry of Finance; and Fund staff estimates.

1/ Using 1978 expenditure weights. The new CPI index will be updated in May 2000.

2/ Change in the annual average rate.

3/ Includes operational losses of the central bank.

4/ In 1998-2000 excludes HONDUTEL savings, estimated at 1.5 percent of GDP a year.

5/ Refers to the following year's imports of goods and services.