Statement by Jan Piercy  
Date of Meeting: December 14, 1999

HONDURAS: Country Assistance Strategy

1. We commend Bank staff for the high quality of this Country Assistance Strategy (CAS). In particular, we were pleased with the serious donor coordination and public consultation the document reflects and its candor in discussing current impediments to development.

2. This CAS comes at a difficult time for Honduras. The effort needed to organize relief and reconstruction following Hurricane Mitch has absorbed much of the authorities' energy. Although Honduras has met the quantitative performance criteria of its new ESAF arrangement with the IMF, progress in implementing structural reforms has lagged. The fact that Honduras's investment as a percentage of GDP has been one-third higher than the average for Latin America and the Caribbean while its GDP growth has been lower than the regional average demonstrates the need for structural reform to improve economic efficiency. The prevalence of poverty and the increase in poverty since Hurricane Mitch provide an even more compelling reason for the authorities to renew their focus on and commitment to the structural reform agenda. In observing this, however, I take heed of Zhu Xian's cogent observation in yesterday's Board retreat that, faced with pressing and immediate needs, borrowers can sometimes perceive the Bank as promoting "reform for reform's sake". In this context, I hope that the Bank's rapid response in Honduras to Hurricane Mitch has strengthened the partnership and trust and will now stand us in good stead in the reform dialogue. We are pleased that the overall thrust of the CAS is consistent with the need to consolidate and extend structural reforms, appropriately balancing the need for reconstruction with the need to build a stronger, more equitable economy in line with a poverty reduction strategy underpinned by broad social consensus.

3. Let me now flag our principal concern with the CAS, as there is much I will go on to commend. We seriously question the volume of base case lending proposed for FYs 00 and 01 ($185 million and $127 million, respectively), particularly given that no IDA credits have yet been approved this fiscal year. We recognize that the Government absorbed a larger
amount in FY 99. However, the CAS's proposed base case consists mainly of projects, which may pose implementation challenges that exceed the Government's institutional capacities. In this context, while we appreciate and commend both the Honduran authorities and Bank staff for their efforts to improve Honduras's portfolio performance, we note that Honduras scored only 6.2 on OED's Development Effectiveness Index (DEI). In addition, only one-quarter of the Honduran projects OED reviewed were judged likely to be sustainable or to have substantial institutional impact. These effectiveness indicators are far below regional and global averages.

4. In view of these factors, we do not accept staff's unqualified statement in paragraph 86 that "some weakening in the quality of IDA's portfolio may be inevitable" given the risk that the volume of IDA lending may outstrip the Government's implementation capacity. **Weakening portfolio performance should be a clear trigger to scale back the volume of new lending towards the low case level until meaningful progress has been made to address the institutional capacity problems.** Further, staff's definition in paragraph 73 of what constitutes satisfactory portfolio performance for the purposes of justifying remaining at the base lending case sets too low a bar. Both the proposed percentage of problem projects (not more than 25 percent) and the proposed disbursement ratio (not less than 20 percent) are substantially weaker than current performance. **We request that both of these issues be clarified and changed in the final CAS document.**

5. The quality of the CAS rests in large part on the dialogue with civil society. We would appreciate hearing more from staff about how specifically the thrust of the CAS or its specific lending and non-lending activities changed as a result of these consultations. The CAS's finding that a lack of national consensus to underpin and consolidate reform efforts has been a major impediment to achieving a higher level of sustainable and equitable economic growth is significant. It underscores the need to continue and deepen these consultations as an integral part of the Government's effort to elaborate a participatory, outcome oriented Poverty Reduction Strategy and reach the HIPC decision and completion points. We welcome the Government's request for assistance in structuring an effective framework for civil society consultation.

6. Dialogue with legitimate stakeholders in civil society is just one of several elements of this CAS that build on the IDA Deputies' report and which we found particularly useful. Replicating these in other CASs will help reinforce an encouraging trend towards higher quality CASs. In particular, I would point to the following:

- **Paragraphs 82 and 83 and Annex F, which describe the respective roles of the multilateral lending institutions and bilateral donors and the Bank Group's priorities, give us information critical to assessing selectivity.**

- **In addition to the excellent description in Annex G of the CAS dialogue with civil society, we appreciate the CAS's discussion of gender and Afro-Honduran issues, not just in a stand-alone section, but throughout the CAS.**

- **Governance and accountability are by any standard important issues in Honduras. The CAS provides a candid assessment of the problems. Effectively implemented, the Government's**
six-part strategy to address governance issues will make important improvements. We welcome the Bank's plans to contribute to this strategy by helping the Government implement an integrated financial management system to realize cost savings and achieve greater transparency.

- We are pleased that Bank staff plan to launch a comprehensive Public Expenditure Review (PER) in January as a step in developing the Poverty Reduction Strategy. Ideally, however, a PER should be a building block of the CAS. While recognizing that the PER could not have been initiated in the midst of Hurricane Mitch, we expect its results to feed into the next CAS Progress Report. Similarly, the Deputies' report encourages completion of Country Procurement Assessment Reports (CPARs) and Country Financial Accountability Assessments (CFAAs) as inputs to the CAS process. We understand from staff that other institutions and donors have conducted such assessments. We would appreciate learning how the findings and recommendations of those assessments helped shape the CAS and the Government's six-point strategy. We are likewise interested in how Honduras fared on the four governance criteria of the Bank's Country Policy and Institutional Assessment (CPIA).

- We also welcome the CAS's discussion of environmental issues. Poor environmental practices and inadequate policies clearly exacerbated the damage from Hurricane Mitch. We are pleased to see the CAS work to incorporate these lessons. In particular, we look forward to the Municipal Watershed Management and Rural Development Project envisioned for FY 01. We encourage the focus on vulnerability assessment and on implementation of measures that could mitigate the effects of future hurricanes. Continued close coordination and cooperation among donors is essential to ensure coherence in these efforts.

7. We welcome the CAS's discussion of private sector development. The role of each institution is clearly presented, as are its priorities. We were pleased to see the IFC is able to provide technical assistance for small and medium-sized enterprise (SME) development, as they have an essential role to play in reconstruction in the region. The IFC's technical assistance is an important complement to the Inter-American Investment Corporation's activities in the region. We welcome the discussion of MIGA's work and priorities in Honduras and commend its information service for potential investors.

8. We are, however, disappointed that the CAS did not discuss labor issues. In the IDA-12 replenishment agreement, as approved by the Board of Governors, the IDA Deputies stated, "Where country [labor] practices and policies have a negative impact on the country's development prospects, these issues should be part of the World Bank's dialogue with that country and addressed in the CAS." The Deputies also welcomed IDA's consultations with the International Labor Organization and proposed further collaboration with it on core labor standards. Adherence to core labor standards, together with an equitable system of labor relations, helps create a framework in which issues of economic growth with equity can be resolved.

9. Honduras's labor standards and practices are directly relevant to a number of issues covered in the CAS, including: the expected role for the private sector in the economy, the need
to attract foreign direct investment, the dynamic development around the San Pedro Sula Valley, and the Government's plans for privatizing Hondutel and other infrastructure and for concessioning the airports and new highways. Although we appreciate that labor was represented in CAS Workshops, Annex G provides no information about labor's views. Nor does the CAS itself provide any information regarding how Honduras's labor standards and practices affect its development prospects. Therefore, we request that the final CAS include a box that would flesh out staff's consultations with labor in Honduras and with the ILO and the conclusions drawn from those consultations.

10. Finally, I would like to reiterate the United States' strong support for Honduras as it works to recover from Hurricane Mitch and achieve higher levels of sustainable, equitable growth. The U.S. Administration pledged substantial grant assistance to Honduras in the aftermath of Hurricane Mitch. USAID looks forward to working closely with the Honduran authorities, the World Bank, and other partners. We wish Honduras every success in overcoming the serious challenges that lie ahead.