Report Number : ICRR0021524

1. Project Data

Operation ID	Operation Name
P155920	Honduras First Fiscal Sustainability DPF
Country	**Practice Area(Lead)**
Honduras	Macroeconomics, Trade and Investment

L/C/TF Number(s)	Closing Date (Original)	Total Financing (USD)
IDA-57500	30-Mar-2017	50,000,000.00
Bank Approval Date	**Closing Date (Actual)**	
15-Dec-2015	30-Mar-2017	

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	50,000,000.00	0.00
Revised Commitment	50,000,000.00	0.00
Actual	50,000,000.00	0.00

Prepared by	Reviewed by	ICR Review Coordinator	Group
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2. Project Objectives and Policy Areas

a. Objectives

The program development objective (PDO) of the First Fiscal Sustainability and Enhanced Competitiveness Development Policy Financing (FSECDPL-1) was to support the government of Honduras in (i) strengthening institutional arrangements to support fiscal sustainability; and (ii) enhancing the regulatory framework to promote competitiveness.

The program was initially conceived as a programmatic series of two DPOs. The second operation did not materialize as the Bank decided to refocus the IDA resources to other critical areas such as scaling up the rural competitiveness project and social protection given their direct impact on helping the poor and vulnerable.

Program objectives, indicators and targets for the two operations remained valid, and achievement of objectives is assessed against them.

b. Pillars/Policy Areas

There were two pillars

Pillar 1: Strengthening institutional arrangements to support fiscal sustainability. This pillar was to be addressed by actions to promote fiscal stability by improving fiscal and financial management; reducing energy subsidies and quasi-fiscal deficits; and improving the targeting and transparency of social spending.

Pillar 2: Enhancing the regulatory framework to promote competitiveness. This pillar was to support improvements in the regulatory framework to foster competition; and improvements in trade facilitation.

c. Comments on Program Cost, Financing, and Dates

Program cost and financing. The commitment under FSECDPL-1 was US$50 million; it was fully disbursed.
Dates. FSECDPL-1 was approved on December 15, 2015 and closed on schedule on March 30, 2017.

3. Relevance of Objectives & Design

a. Relevance of Objectives

The program objectives are relevant to the country situation and to the World Bank Group's Country Partnership Framework (CPF) for the period FY2016-FY20. Honduras has one of the highest poverty rates in the Latin America and Caribbean Region, in part driven by high levels of crime and migration. Poverty is also influenced by institutional factors that affect the country’s economic performance, in particular weaknesses in public sector management and the need to shape fiscally sustainable policies that can enhance competitiveness and accelerate economic growth. The second pillar of the CPF aims at improving conditions for growth, emphasizing the regulatory framework and institutional capacity as one of the four objectives of that pillar. The program objectives are also aligned with government strategy as reflected in the National Plan for 2014-2018, and its longer term 2010-2038 vision. The country’s economic planning documents include implementation of a comprehensive domestic reform program to address macroeconomic imbalances and enhance competitiveness in the enterprise sector. The objectives were well-aligned with the priorities of the international donor community.

Rating
High

b. Relevance of Design

There was a logical causal link between actions supported by the program and expected outcomes, for both the fiscal sustainability and the competitiveness objective. Improved institutions supporting fiscal, financial, and electricity sector management were to promote macroeconomic stability and increase fiscal space in order to maintain safety net programs, while avoiding excessive reductions in capital expenditures. Better targeting of safety net programs was to channel resources to the neediest. Competitiveness was to be enhanced through an improved regulatory framework. The objectives were considered to be achievable, drawing on the experience under a successfully completed IMF program and a previous Development Policy Credit (P151803) that preceded the operation under review and was rated Satisfactory. Nevertheless, both the IMF program and the Policy Credit experienced difficulties with the energy sector. The current operation experienced similar difficulties (Section 4, Sub-objective 1).

While the second DPL, which had been introduced to maintain reform momentum gained under the first DPL, was dropped, six of the nine triggers for that DPL had been met at the time of this Review. The three unmet ones related to improvements in the fiscal sustainability sub-objective and publishing of a poverty map (see Section 4).

The macroeconomic framework during preparation of the FSECDPL-1 was deemed adequate and sustainable over the medium term. Growth was improving, aided by favorable external conditions – improving terms of trade, and US economic recovery; increased remittances were fueling consumption growth; and the current account balance was buoyed by foreign direct investment inflows. The fiscal position was favorably affected by reforms to boost revenues, reduce expenditures, and through improvements in fiscal management. A Stand-By Arrangement with the IMF began in 2014 and a first review was successfully completed in late 2015.

Rating
Substantial

4. Achievement of Objectives (Efficacy)

Objective 1

Objective

Strengthening institutional arrangements to support fiscal sustainability

Rationale

The Objective was to be achieved by strengthening fiscal planning and transparency; management of energy subsidies and quasi-fiscal deficits; better public debt management; more rigorous budget controls; better targeting and transparency of social spending; transparency and accessibility of census and household survey information.

a. Fiscal planning and transparency

In 2015, the government approved, published, and submitted to Congress a medium-term macroeconomic and fiscal framework (MTFF) including projections over a three-year horizon, consistent with its medium-term debt management strategy (prior action). It set up a permanent mechanism to prepare and monitor the MTFF, institutionalizing it as an instrument of fiscal policy. Furthermore, it enacted a fiscal responsibility and transparency law codifying fiscal rules (trigger for FSECDPL-2). The law is based on international best practice.

This enhanced fiscal framework is designed to support better fiscal discipline, as long as the government stays within the boundaries of the MTEF. In 2016 and 2017, actual recurrent expenditures deviated by less than 10 percent from the MTFF specifications of the previous years, thereby meeting the outcome target. The deviation in the case of the central administration was 5.5 percent in 2016 and 9.2 percent in 2017, while that for the non-financial public sector was 2 percent in 2016 and 7.9 percent in 2017. Baseline figures prior to the program are not available, nor are they relevant. The key to improved performance is the extent to which the budget stays within the guidelines, and it has done so.

b. Energy subsidies and quasi-fiscal deficits

The state-owned electricity company, ENEE, absorbed considerable government subsidies each year. In order to improve its financial situation and sustainability, the government's national energy commission approved, published and applied a new energy tariff structure that reduced the electricity subsidy for residential consumers (prior action). The reduction was 9 percent, but still insufficient to ensure full cost recovery. The revision of the tariff structure to consumers followed several other measures not supported by this program but also aimed at achieving a better financial situation for ENEE (reduced technical and non-technical losses, employment restructuring); and they were to be followed by the issuance of a decree to restructure ENEE (the decree was a trigger for FSECDPL-2). That decree has been issued, but it has not yet been implemented. Another trigger for FSECDPL-2 - a new electricity tariff framework to establish a sustainable cost-reflective tariff structure - has not moved forward at all, and is an important means of dealing with volatility in electricity costs which is high in Honduras, being where external factors such as rainfall and international oil prices play an important role.

The outcome indicator for this sub-objective – ENEE's financial deficit was to be reduced by at least 60 percent relative to its level in 2014 – was not met as the deficit had fallen by only some 30 percent by project closing in 2017. Moreover, it is not obvious that even this outcome can be fully attributed to the prior action, since it may also have been influenced by efficiencies such as reduced electricity losses and employment restructuring. Moreover, the financial situation of ENEE started deteriorating again in 2016 and the deterioration seems to have continued into 2018 (ICR, page 19). However, that does not necessarily reflect new inefficiencies in the system, but rather external volatility, and the absence of a sustainable cost-reflective tariff structure to help address such volatility..

c. Public debt management

In order to strengthen the framework for debt management, the government approved and published a medium-term public debt policy (prior action) that set debt ceilings, targets for state-owned enterprises (SOEs), and borrowing guidelines for local governments; as well as a calendar for debt issuance for 2015 and 2016. These measures were expected to enhance control and monitoring of the debt stock by strengthening internal controls over the debt incurred by local governments and SOEs, and to improve internal debt records. In particular, the establishment of clear debt guidelines and procedures was expected to facilitate and encourage the use of competitive auctions for debt purchasing (see outcome indicator below).

Amendments to the organic budget law (trigger for FSECDPL-2) were aimed at mainstreaming the debt policy formulation process by including clear borrowing objectives and establishing procedures for contracting public debt. They have been submitted to Congress but have not yet been approved. However, considering the significant measures already taken to manage public debt, the absence of amendments to procedures for debt policy formulation may be considered a moderate shortcoming.

By closure, 96 percent of public debt issuance used competitive auction mechanisms (2018) compared to a 2014 baseline of 42 percent.

d. Budget controls

To strengthen control of spending levels and their composition, the government introduced a budget module into the financial management system with ceilings consistent with the medium-term macroeconomic and fiscal framework, and a budget law that specifies processes for registering public trust funds in the budget (prior action, and trigger for FSECDPL-2, respectively). This type of budgetary control aimed to provide a comprehensive view of commitments made while avoiding new commitments without enough funding. Another trigger for FSECDPL-2 was the introduction of institutional functional reviews and subsequent approval of staffing strategies based on the functional reviews. The trigger was met.

The outcome indicator relates to improved payroll controls and measures the share of the public sector workforce that is being evaluated by an institutional functional review (60 percent of the workforce had been evaluated by 2018, compared to a baseline of zero in 2014, and a target of 50 percent for 2017).

e. Targeting and transparency of social spending

The government extended coverage of its conditional cash transfer (CCT) program to counter high drop-out rates among poor children in lower secondary education while also adjusting the targeting system to prioritize the most vulnerable municipalities (prior action).

The adjustments to the CCT were made in the wake of earlier reforms (outside the FSECDPL framework) that had already almost doubled the share of extremely poor households receiving cash transfers. Following the program, the CCT coverage of eligible children attending lower secondary school 80 percent of the time increased by some 60 percent over the period 2015-2018, the share of boys being 49 percent, compared to a baseline of 48 percent. The target was a 60 percent increase in children from eligible poor households, including a 49 percent share for boys.

As a trigger for FSECDPL-2, the government introduced electronic CCT payments on a limited basis, contracting with one financial institution to pilot electronic transfers. According to the ICR (page 24) the pilot was successful in terms of client satisfaction surveyed during the pilot. It also pointed to the need to train potential beneficiaries in new systems prior to their introduction.

f. Transparency and accessibility of census and household survey information

To increase public access to statistical information generated by the National Statistics Institute (NSI) and thereby increasing its usefulness in assessing pro-poor fiscal policies, NSI published full documentation and metadata of the 2013 population census, and provided detailed tabulations of census data and a 2015 household survey on the NSI website (prior action). Furthermore, and to address the absence of geographic data on poverty, the government had intended, as a trigger for FSECDPL-2, to prepare an updated poverty map and publish the underlying poverty headcount data by municipality, use the poverty maps in targeting social programs, and publish a quality assessment of the household survey. While the poverty map was developed, and procedures for using it were defined, it was not published as foreseen in the trigger.

In summary: (i) with the implementation of an MTFF consistent with the country's debt management strategy, fiscal discipline was strengthened by aligning spending with income and debt level expectations; (ii) the operation contributed to temporarily improving the financial situation of the state-owned energy company, but not to longer-term financial sustainability, as the company's financial situation again has started to deteriorate; (iii) the introduction of a medium-term public debt policy provides a framework for better control over the public debt stock, but is somewhat weakened by the lack of an organic budget law; (iv) with the introduction of a budget module integrating budget ceilings to control spending levels and the composition of spending, payroll controls can be expected to improve and the financial management system to be strengthened; (v) drawing on prior initiatives to protect the poor in a fiscally neutral manner, the government's CCT program design was modified to extend coverage to children in lower secondary school; and (vi) to further improve the efficiency and effectiveness of pro-poor fiscal policies, public access to relevant statistical information was expanded, and a poverty map developed and shared among government agencies, albeit not yet officially published.

Rating
Substantial

Objective 2

Objective
Enhancing the regulatory framework to promote competitiveness

Rationale
This Objective was to be achieved by changes in the regulatory framework that: (i) foster competition; and (ii) improve trade facilitation.

a. Regulatory framework

In 2015, the government adopted an amended competition law creating a leniency program (exempting cartel members from sanctions in exchange for information on the cartel), and the competition authority issued regulations on the application of the leniency program (both prior actions). With weak competition in the domestic market and the proliferation of cartels in certain sectors, for instance pharmaceuticals and cement, the law aimed to stimulate competition through improved detection and deterrence of anti-competitive practices through leniency applications and tip-offs. The results indicator to evaluate these measures was the number of legal counsels trained to provide advice on a leniency application: From a baseline of zero, there currently are 123 trained legal counsellors, compared to a target of 30. However, the number of legal counsels trained does not necessarily measure enhanced competition. There are no direct indications of the impact of the amended legislation on cartel behavior.

Reducing the costs of starting and running a business was to be addressed by the creation of an electronic platform to facilitate common business tasks (trigger for FSECDPL-2). The government created the platform, which is operational. However, results are, to date, insignificant. There has been a slight reduction in the average number of days needed to start a business from 14 in 2014 to 13 in 2017.

b. Trade facilitation

To address burdensome documentation and customs procedures, the government submitted to Congress a trade facilitation agreement (TFA) with the World Trade Organization that identifies areas where action is needed to facilitate trade (prior action). The Congress ratified the TFA in 2016 (trigger for FSECDPL-2). Commitments under the TFA include the creation of new systems to enhance electronic payments, and electronic processing of sanitary certifications and health certificates for selected agricultural products (trigger for FSECDPL-2). It was implemented in 2018 after the closing of the operation.

Initially, the outcome indicator for this activity was to target the reduction in the number of days to import and export goods as measured by the Doing Business (DB) methodology. Using the DB as an indicator, the ICR estimates that there has been no improvement in the duration of exports and imports a a result of the TFA. However, DB uses the time it takes to export to Germany and import from the US. With the TFA, the methodology has been revised, and progress is now measured against intra-regional trade. Here, there appears to have been significant improvement: the ICR
However, the methodology has been revised and no longer allows for progress to be measured against the Doing Business baseline which used the time it takes to export to Germany and import from the US. The new methodology appears more relevant as it refers to intra-regional trade: here the new procedures appear to have generated significant time savings: the ICR raises the example of trade between Honduras and Guatemala, where the time for goods to cross borders has been reduced from 19 hours to 10 minutes.
In summary, Achievement of objectives was partial. Although the chosen outcome indicator for enhanced competition was achieved, there is no evidence of changed cartel practices; the number of days to start a business was reduced by one day (from an already relatively low baseline); while the effects of trade facilitation are uncertain - there were improvements in intra-regional trade, but that appears not to have been the case in the broader perspective of DB.

Rating
Modest

5. Outcome

Relevance of objectives is rated **high:** the objectives were aligned with the CPF, reflected government policy, and were relevant to the country's development challenges. Relevance of design was **substantial** with a set of prior actions underpinning improved institutional instruments that were likely to help in achieving fiscal sustainability and raise competition. Efficacy for the first Objective is rated **substantial**: three of the six sub-objectives showed moderate shortcomings, but achieved important results, two reached their goals, and one - energy - did not. Efficacy for the second Objective is rated **modest** in the absence of any well-defined outcomes for either the regulatory framework for competition or for trade facilitation.
The second operation was cancelled for reasons that had nothing to do with the series or its objectives. The cancellation may have partially affected the outcome of the operation, and left it incomplete: while six triggers were completed, two were left in abeyance. The first one - a new electricity tariff framework - is key to achieving

a sustainable cost-reflective tariff structure; the second one - amendments to the organic budget law spelling out procedures for contracting public debt - leaves part of the legal and regulatory framework incomplete; the third one concerned issuing the poverty map, which has not yet taken place. The triggers might have been met with the pressure to release the second DPL, or they might have delayed its release and the closing of the series. So far, there has been no forward movement on the two items since closing.
Overall, with the exception of the ENEE, the program had moderate shortcomings, and the outcome is rated **moderately satisfactory**.

a. Outcome Rating

Moderately Satisfactory

6. Rationale for Risk to Development Outcome Rating

The Government is committed to the reform program reflected in its policy declarations, and in the progress made under the FSECDPL-1 despite the elimination of the follow-up DPL. At the same time, there are a number of risks in the internal and external environment: political demands from various stakeholder groups in the wake of presidential elections in late 2017 are putting pressure on maintaining fiscal stability; and a growing deficit in the energy sector may threaten fiscal balance in the non-financial public sector. The country also suffers from chronic, and unpredictable, violence and insecurity. The ICR (page 29) also indicates external factors, notably economic developments in the US and its migrant policy, and Honduras' vulnerability to adverse weather conditions.

a. Risk to Development Outcome Rating

Substantial

7. Assessment of Bank Performance

a. Quality-at-Entry

The design built on earlier development policy operations in Honduras, such as Fiscal Sustainability and Social Protection (P151803), and Fiscal Emergency Recovery (P121220), highlighting the need to be alert to the country's implementation capacity constraints. Contents was shaped by consultations with different levels of government, the private sector, and civil society. The government was engaged since early in the preparation process. The results framework was consistent, albeit with some indicators of only limited usefulness. In assessing overall risk as being substantial, the team provided a balanced risk analysis focused on political, macroeconomic and institutional risks. Still, these were largely avoided through careful risk management, including a frank and open dialogue with the political leadership, close collaboration with the IMF, and technical assistance to ease institutional constraints. The choice of a two-operation series, although ultimately truncated for extraneous reasons, was appropriate with a view to maintaining momentum throughout the reform process.

Quality-at-Entry Rating

Moderately Satisfactory

b. Quality of supervision

Supervision was originally envisaged as a continuing policy dialogue between the Bank and government teams. This did not materialize as expected, since the second DPL was dropped. Some momentum was lost as a result, and instead forward movement was supported under complementary investment projects. They included *Improving Public Sector Performance Project* (P110050), *Power Sector Efficiency Enhancement Project* (P104034), and *Social Protection Project* (P152266), co-financed with the Inter-American Development Bank. This turned out to be sufficient to enable most of the triggers envisaged for FSECDPL-2 to be met.

Quality of Supervision Rating

Moderately Satisfactory

Overall Bank Performance Rating

Moderately Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

Government has consistently been engaged in the reform process. This is reflected in its own policy documents and in the reform momentum that has carried beyond the policy actions introduced under FSECDPL-1 into meeting, partially or completely, most of the triggers for FSECDPL-2. However, the management of fiscal policy has encountered difficulties (in the energy sector, and, as a result of capacity and resource constraints in public agencies). Some of these issues were subject to government control, for instance the failure to pass the organic budget law, not publishing the poverty map, while others, notably the external economic environment, were not.

Government Performance Rating

Moderately Satisfactory

b. Implementing Agency Performance

Not rated

Implementing Agency Performance Rating

Not Rated

Overall Borrower Performance Rating

Moderately Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

The policy and results matrix for the operation provided a logical sequence of prior actions underpinning for policy changes. Key indicators for systematic tracking of outcomes were identified in the results matrix, including specification of baselines and targets where appropriate. While results in most instances were adequate to measure outcomes, in some cases they were limited in their ability to capture progress: for instance, measurement of better public debt management was limited to the use of competitive auctions for debt issuance. Similar, partial indicators were present in some other cases - to measure improved competitiveness, smoother customs procedures, and changes in cartel behavior.

b. M&E Implementation

Monitoring was carried out through a dialogue between Bank teams and the government, mainly its Secretariat of Finance (it also included representatives of the IMF and the Inter-American Development Bank, whose operations were running in parallel). In April 2016, when FSECDPL-2 was dropped, the policy dialogue continued under the auspices of ongoing complementary investment projects, and technical assistance. Fiscal reforms were supervised through regular macro monitoring visits by the country economist. Energy sector reforms were monitored by the energy team during their visits related to a technical assistance and tariff reform.

c. M&E Utilization

The increased access to data through some of the prior actions, notably fiscal accounts data, strengthened the work on fiscal projections in the relevant agencies. Regular monitoring and data collection facilitated oversight of reforms and results. Creation of the MTFF increased use of the fiscal accounts data and enhanced collaboration with government authorities on macro and fiscal projections.

M&E Quality Rating

Modest

10. Other Issues

a. Environmental and Social Effects

No safeguards policies were triggered by the operation, and the ICR does not discuss any possible environmental impact. No negative social effects were identified, and it is possible that some of the measures may help to safeguard pro-poor programs. The latter is likely to have been influenced by stronger fiscal discipline and greater transparency in fiscal management, as well as through better access to data.

b. Fiduciary Compliance

The ICR does not identify any fiduciary issues.

c. Unintended impacts (Positive or Negative)

None indicated

d. Other

None indicated

11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Moderately Satisfactory	Moderately Satisfactory	---
Risk to Development Outcome	Substantial	Substantial	---
Bank Performance	Moderately Satisfactory	Moderately Satisfactory	---
Borrower Performance	Moderately Satisfactory	Moderately Satisfactory	---
Quality of ICR		Substantial	---

Note

When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.

The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

The lessons are drawn from the ICR.
A strong policy dialogue can continue even after a programmatic DPL is truncated. In this case, the dialogue was supported by other vehicles such as technical assistance, ongoing investment projects or knowledge products in areas supported, and by continued donor coordination.

Complex challenges require comprehensive solutions. Isolated sector-level interventions may be undermined by exogenous factors, either in the domestic economy or the external environment. The energy reforms supported by the FSECDPL provided only short-lived results, which were quickly undermined by external (oil price increases) and internal developments (weak governance, political economy aspects). Without tackling the challenges in the energy sector in a comprehensive manner, durable progress turned out to be difficult to achieve.

Coordinated assistance by the principal external partners helps solidify and consolidate reforms. Teams should seek common ground and complementarity on reform with other stakeholders. In Honduras, this allowed complementary TA to be linked into the operation while supporting joint objectives.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR provides a sufficient discussion of the background and rationale of the FSECDPL to allow an assessment of the results and ratings of the operation. While the cancellation of the second operation had nothing to do with the operation as a whole, the ICR could nonetheless have been more informative about the reasons for the cancellation, and how they might have affected implementation of the series. The document was internally consistent, and in accordance with OPSC guidelines.

a. Quality of ICR Rating

Substantial