PROGRAM DOCUMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION
PROPOSED SUPPLEMENTAL FINANCING CREDIT
UNDER THE GLOBAL FOOD CRISIS RESPONSE PROGRAM
IN THE AMOUNT OF SDR 6.2 MILLION
(US$10 MILLION EQUIVALENT)
TO
THE REPUBLIC OF HONDURAS
FOR
THE FIRST PROGRAMMATIC FINANCIAL SECTOR
DEVELOPMENT POLICY CREDIT

July 24, 2008

Poverty Reduction and Economic Management
Central America Country Management Unit
Latin America and Caribbean Region

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CURRENCY EQUIVALENTS
(Exchange Rate Effective as of July 24, 2008)

Currency Unit = Honduras Lempiras
US$1 = 18.8957 Lps.
1 Lps. = 0.0529221 US$

FISCAL YEAR
January 1 – December 31

ABBREVIATION AND ACRONYMS

AHIBA Honduras Banking Association
AIN-C Expansion of the Child Nutrition Program
BANADESA Banco Nacional de Desarrollo, S.A.
BCF Bank Capitalization Fund
BCH Banco Central de Honduras
BT Bono Tecnológico
CFAA Country Financial Accountability Assessment
CNBS National Bank and Insurance Commission
CPAR Country Procurement Assessment Report
FOSEDE Deposit Insurance Fund
FS-DPC Financial Sector Development Policy Credit
FS-TAC Financial Sector Technical Assistance
IDA International Development Association
IDB Inter-American Development Bank
IMF International Monetary Fund
LSF Financial System Law (Ley del Sistema Financiero)
PASAH Programa de Apoyo a la Seguridad Alimentaria de Honduras
PRAF Conditional Cash Transfer Program
PSIA Poverty and Social Impact Analysis
PFM Public Financial Management
SEFIN Ministry of Finance
SENASA National Service of Agricultural and Animal Health
SIAFI Integrated Financial Management System
TSC Tribunal Superior de Cuentas

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# HONDURAS

PROPOSED SUPPLEMENTAL FINANCING CREDIT FOR THE
FIRST PROGRAMMATIC FINANCIAL SECTOR DEVELOPMENT POLICY CREDIT

## CONTENTS

<table>
<thead>
<tr>
<th>I. BACKGROUND</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>II. THE FIRST PROGRAMMATIC FINANCIAL SECTOR DEVELOPMENT POLICY CREDIT</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Financial Sector Reforms since Approval of the FS-DPC</td>
<td>2</td>
</tr>
<tr>
<td>B. Impact of the Reform Process</td>
<td>3</td>
</tr>
<tr>
<td>C. Emerging Challenges</td>
<td>3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>III. THE FOOD PRICE CRISIS</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>IV. THE GOVERNMENT'S RESPONSE</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>V. BANK'S STRATEGY</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>VI. RATIONALE FOR PROPOSED SUPPLEMENTAL FINANCING</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>VII. IMPLEMENTATION ARRANGEMENTS</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Terms of the Supplemental Financing</td>
<td>10</td>
</tr>
<tr>
<td>B. Fiduciary Aspects</td>
<td>10</td>
</tr>
<tr>
<td>C. Disbursement and Auditing</td>
<td>11</td>
</tr>
<tr>
<td>D. Poverty and Social Impact Analysis</td>
<td>11</td>
</tr>
<tr>
<td>E. Environmental Issues</td>
<td>11</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>VIII. BENEFITS AND RISKS</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Benefits</td>
<td>11</td>
</tr>
<tr>
<td>B. Risks</td>
<td>12</td>
</tr>
</tbody>
</table>
I. BACKGROUND

1. Over the past few years, Honduras has enjoyed a period of rapid economic growth. GDP growth, which had averaged 3.6 percent between 2001 and 2003 and a mere 2.3 percent during the 1990s, exceeded 6 percent from 2004 through 2007. Indeed, growth is now at levels not seen since the late 1970s. Moreover, after years of stagnation in poverty indicators, the recent growth episode has been accompanied by a significant reduction in poverty. In fact, the poverty headcount index which in May 2005 was 71 percent declined to 68 percent in May 2007. More dramatically, the extreme poverty headcount index declined from 53.4 percent to 42.9 percent over the same period.

2. While recent economic performance reflects to some extent, the favorable global environment which existed until mid-2007, reforms on several fronts, including the financial sector, are likely to have had a positive contribution. In the particular case of the financial sector, the Bank has been supporting Honduras reform efforts through the Financial Sector Development Policy Credit (FS-DPC) and the Financial Sector Technical Assistance (FS-TAC) credit. These operations have been instrumental to develop institutional capacity in the sector through improvements in the legal and regulatory framework and through domestic capacity building.

3. The progress achieved over the last years in strengthening the financial sector is now being jeopardized by the onset of several major external shocks that are undermining macroeconomic performance and threatening to weaken the quality of the assets in the banking sector. These shocks include the rapid rise in global food prices, which in Honduras are now increasing at an annual rate of 22 percent (May 2008). In addition to their negative impact on poverty, higher food prices are contributing to: i) higher headline inflation (11.2 percent in May 2008 vs. 6.1 percent in May 2007); ii) a deterioration in the current account balance (which has deteriorated from 4.7 percent of GDP in 2006 to 9.5 percent of GDP in 2008); iii) a weakening in the international reserve position (Honduras was expected to accumulate US$253 million in 2008 but this target seems difficult to meet in the current environment); and iv) the emergence of fiscal pressures as the government is responding to the food crisis, and the external financing envisaged in the 2008 macroeconomic program is expected to be below target by US$50 million (due in part to a slower than anticipated implementation of the Petrocaribe agreement).
4. The Government is now seeking donor support to implement its food prices crisis response program while maintaining a sound macroeconomic policy framework and performance, and its progress in financial sector strengthening. The proposed Supplemental is a response to that request.

II. THE FIRST PROGRAMATIC FINANCIAL SECTOR DEVELOPMENT POLICY CREDIT

5. Bank analysis conducted in 2002/3 found two fundamental problems in the financial sector: a) a weak institutional framework for financial sector transactions, regulation and supervision; and b) low bank capitalization. These problems made the financial sector highly vulnerable to both internal and external shocks.

6. The weak institutional framework was the result of a number of systemic flaws, such as poor bank regulation and supervision, the existence of an inappropriate bank resolution framework and antiquated legislation for bankruptcy, payments systems, anti-money laundering, and combating of terrorism financing. Low bank capitalization appeared to be related to a number of negative external shocks such as Hurricane Mitch, which had hit the country in 1998, the subsequent decline in coffee prices, and the increase in oil prices which had doubled between 1999 and 2004.

7. Against this background, the FS-DPC focused on supporting the Government’s program to strengthen the financial sector through reforms aimed at: a) developing a strategy for management of systemic risks; b) strengthening the legal and regulatory framework; c) introducing legislation to prevent money laundering and terrorism financing; d) strengthening supervision and control of systemic risks; and e) strengthening the payment systems. The FS-DPC was complemented with the FS-TAC to support capacity-building at the financial sector regulatory and supervisory entities.

A. Financial Sector Reforms since Approval of the FS-DPC

8. Progress in implementing the reform program supported by the FS-DPC has been satisfactory.

9. At the time of approval of the FS-DPC, Honduras had already implemented a number of key actions, including: a) enactment of a new Financial Sector Law (FSL); b) the National Bank and Insurance Commission (CNBS) had issued rules on consolidated supervision of financial groups, on the corporate governance of financial institutions, and on currency and maturity mismatches; c) the Central Bank Law (BCH Law) and the Deposit Insurance Fund Law had been amended for consistency with the FSL; d) the know-your-customer policy had been implemented in all institutions subject to CNBS supervision and an Inter institutional Committee for the Prevention of Money Laundering had been established; e) CNBS had approved a program to strengthen its capacity for intensive supervision of high risk institutions, had approved programs to reduce related-party loans in institutions exceeding the legal limit and had completed a data base of related parties and established procedures to update it; and f) the BCH Law had been amended to limit its role as lender of last resort and widen its regulatory powers on the
payments system; and a High-Level Payments-System Committee, representing all participants in the payments system, had been established.

10. Subsequently, Honduras implemented a number of additional reforms: a) adoption of an adequate framework to manage systemic financial crisis; b) adoption of norms and procedures for the effective implementation of the new bank resolution framework; c) creation of a bank capitalization fund (BCF) to support bank resolution processes; d) drafting and presentation to Congress of legislation on corporate bankruptcy and corporate reorganization, creditor rights, and corporate governance; e) criminalization of the financing of terrorism; f) continuation with the program to strengthen the intensive supervision of high risk institutions; g) ensuring that the financial institutions subject to programs to reduce related-party loans remained in compliance with such programs; h) maintaining operational the database of related parties; and i) using the newly acquired BCH powers to regulate the payments system.

11. As a result of this progress, on May 16, 2008, the Bank disbursed the second and final tranche of the FS-DPC.

B. Impact of the Reform Process

12. Among other achievements, the new laws have strengthened considerably the lender-of-last resort and bank resolution mechanisms. The authorities successfully used this bank resolution framework to resolve a financial institution in 2006, with contributions from the deposit insurance agency (FOSEDE).

13. Moreover, the quality of bank assets improved, with non-performing loans dropping from 11.3 percent in 2002 to less than 3.9 percent in June 2007, reflecting private sector efforts to strengthen bank balance sheets, combined with the Government’s program to write-off longstanding impaired agricultural loans, and the dilution effect of rapid credit growth. Overall, financial soundness indicators showed a general increase in profitability, efficiency, and solvency levels, with average capital ratios reaching 13.1 percent in June 2007.

C. Emerging Challenges

14. Despite the progress made, the banking system still remains vulnerable to exogenous shocks. According to the Bank’s 2007 Financial Sector Assessment, the banking system will find it difficult to absorb large shocks to credit portfolios. This is relevant in this context because of the negative impact of high food prices on the real income of households, which in turn is bound to negatively affect the performance of the outstanding portfolio of consumer loans (the type of loans showing the largest growth over the past 4 years). Indeed, there is already evidence indicating that the share of non-performing loans, particularly as regards consumption credit, is on the rise with some commercial banks reporting a doubling of non-performing loans. This situation calls for additional efforts to sustain effective prudential supervision and ensure that the institutional framework is ready to adequately deal with potential threats to the banking system.
15. Similarly, as discussed above higher food prices are having a negative impact on macroeconomic stability, a critical element underpinning the FS-DPC. High food prices are contributing to higher inflation, a deterioration in the trade and current account balance, lower international reserves accumulation than envisaged in the government’s macroeconomic program, and the emergence of fiscal pressures.

16. The fiscal pressures are particularly relevant given that the government is urgently seeking to respond to food crisis with a variety of programs that aim to support the income of the neediest and expand domestic food supplies. The external financing considered in the government’s macroeconomic program for 2008 is likely to be below target by US$50 million, which exacerbates these pressures.

III. THE FOOD PRICE CRISIS

17. Global food prices have dramatically increased in recent months. The food price index compiled by the World Bank indicates that global food prices doubled in the 2 years to April 2008. Honduras is not an exception and domestic food price inflation increased from 8.1 percent in May 2007 (year-on-year) to 20.1 percent in May 2008. The price of some basic staples such as rice has increased over the past year by almost 60 percent. More dramatically, the price of beans has increased more than 100 percent over the same period.

18. Like the majority of countries in the region, Honduras is a net food exporter. However, differences in the composition of food imports and exports, and differences in the price inflation of different food items have resulted in a negative terms of trade shock for the country. In fact, the prices of major Honduran food exports, such as coffee, bananas and shrimp have increased, but at a lower rate than major Honduras imports such as cereals which represent 30 percent of Honduras’ imports. Estimates for 2008 indicate that the food balance surplus could decline to 0.2 percent of GDP this year; this would compare with a surplus of 2.7 percent of GDP in 2005.

19. Food prices are a large part of the problem behind the recent rise in inflation. Food accounts for about 1/3 of the Honduran consumer price index basket. This weight is similar to that found in other Central American countries. Not surprisingly, headline inflation has been increasing in parallel to food price inflation: year-on-year inflation rose from 5.6 percent in January 2007 to 11.2 percent in May 2008. Staff calculations indicate that the evolution of food prices over the past 18 months would account for about 40 percent of the observed rise in inflation over the same period.

20. The social problems associated with high food prices affect a large majority of Hondurans. Bank analysis indicates that about 89 percent of the country's population are net food consumers. In rural areas this is slightly lower but net consumers still represent 86 percent of the rural population. In urban areas the share of net consumers is 91 percent.

21. Given that the poor spend a large share of their income in food, food inflation is particularly affecting the neediest. The Poor Person's Price Index (i.e. the effective
inflation faced by the poor) for Honduras showed an increase of 14.1 percent in the twelve months to May 2008 compared to 11.2 percent in the official price index (end-of period). This implies that the decline in the purchasing power of the poor over the past 12 months is likely to have contributed to a higher poverty rate than expected otherwise.

22. The food price crisis has arrived at a time characterized by several other adverse developments such as record high oil prices and the slowdown of the US economy, both of which limit maneuvering space for the government. The US slowdown is particularly important because it not only negatively affects export oriented activities, but also because of the negative impact on remittances which in 2007 represented 20.9 percent of GDP. The situation of high food prices is expected to continue over the short to medium term.

IV. THE GOVERNMENT'S RESPONSE

23. The Government has adopted a two-pronged strategy that to a large extent is consistent with the recommendations issued by the Bank for countries facing a food prices crisis emergency.

24. The strategy combines actions to support the income of the poorest segments of the population, and actions aimed at expanding the supply of agricultural products, particularly staple crops such as beans, corn and rice. Regarding the income of the poor, the government has recently announced an expansion of the existing conditional cash transfer program, the Programa de Asignación Familiar (Family Allowance Program – PRAF), both in terms of number of families being covered and in terms of the amount of the transfers. PRAF currently covers about 148,000 households, and the Government is aiming to increase this number to 200,000. These efforts are being supported by the IDB, which was already supporting PRAF, through a planned new US$20 million operation.

25. On the supply side, the recently passed Ley de Emergencia para Prevenir el Desabastecimiento de Granos Básicos (Emergency Law to prevent the Shortage of Basic Grains), has created a framework through which the Government can address some of the negative impacts of the emerging food crisis. The proposed investments under the new legislation would amount to Lps. 2.5 billion (US$129.5 million) over two years (of which about Lps. 600 million to be executed this year) and include support for: (i) productive infrastructure; (ii) technological inputs to boost historically low productivity in basic grains; (iii) financial instruments to mitigate both credit and agricultural risk; (iv) enhanced grain storage facilities; and (v) food safety.

26. For the small- to medium-scale producers (from 3.5 to 35 ha.) with some market exposure, some US$60.0 million of finance is being made available through the National Bank of Agricultural Development, BANADESA, at favorable terms. In addition, binding purchase agreements would be accepted towards guaranteeing these loans. Moreover, a guarantee fund of US$10.0 million is to be established, and funds of up to US$1.25 million would partially cover the cost of agricultural insurance for these producers. Subsistence producers (less than 3.5 ha.) would benefit from a technological package of improved seeds, fertilizers and technical assistance totaling US$15.0 million.
under a grant program known locally as the *Bono Tecnológico* (BT), which is expected to reach some 250,000 farmers in 2008. The BT is targeted toward enhancing yields in key staple crops, such as red beans, corn and rice, that are of significant relevance in the Honduran diet.

27. At present, only 2.7 percent of cultivable land in Honduras is irrigated, while the potential is nearly 18 percent. The Government, through BANADESA, is aiming at finance the expansion of small-scale irrigation projects with funds totaling US$20.0 million. Similarly, the Government is planning to increase the strategic grain reserve and is planning to fund the purchase and storage of strategic grains with US$9.5 million. Increased allocations to the *Servicio Nacional de Sanidad Agropecuaria* (National Service of Agricultural and Animal Health) –SENASA- (US$1.5 million) would also boost investment in food safety.

28. The Government’s efforts under the Emergency Law are being complemented with the PASAH or *Programa de Apoyo a la Seguridad Alimentaria de Honduras*, (Honduran Food Security Program). This program, which is being supported by the European Community, also focuses on productive activities. PASAH targets municipalities where the poverty rates have an important gender component and tries to reach households headed by women. In 2007 PASAH reached 43 municipalities, and 20 more will be included during 2008.

29. Even though supply-side interventions can be viewed more as medium to long-term responses than as emergency responses to the food crisis, there is also a sense of urgency (understood as a need for action over the coming weeks) on this front. In fact, failure to address now the constraints faced by small and medium producers could negatively affect the outcome of the approaching second planting season in September, which would further contribute to and extend the negative effects of the food crisis.

A. The Government’s Macroeconomic framework

30. The Government is fully aware that its response to the food prices crisis needs to be framed within the context of an adequate macroeconomic framework. The country’s macroeconomic program is currently being supported by an IMF’s Stand-by arrangement, which was approved by the IMF Board on April 7, 2008. The IMF program includes a comprehensive set of fiscal, monetary, and external policy measures to address emerging macroeconomic imbalances.

31. Honduras is seeking to contain second round effects of food prices as the evolution of core inflation suggests that the prices of non-food/non-oil products are also on the rise. The core inflation rate reached 9.3 in May 2008 up from 6.3 percent in May 2007 and has been closely tracking the evolution of headline inflation.

32. In response to higher inflationary pressures, the Central Bank of Honduras has raised the policy interest rate eight times (275 basis points) since August 2007, with the last adjustment taking place on July 1st, 2008. The monetary program is also aiming at reversing the declining trend in international reserves observed during the second half of
2007. Under the Stand-by arrangement the Government was expected to achieve a net reserve accumulation of US$253 million during 2008. But with an estimated negative impact of external price shocks (both food and oil prices) on the external balance of about US$280 million, the target for international reserves accumulation may be difficult to achieve. The IMF is now working with the government in order to adjust the program to this situation.

33. On the fiscal front, the Government is committed to maintaining the deficit under control (an expected 1.5 percent of GDP for the Non-Financial Public Sector in 2008) even though external financing flows are lower than envisaged by the program. The government is addressing this gap through a combination of measures including: i) requesting additional support from the international community, including the World Bank; ii) reprogramming some of the expenditures in order to find fiscal space to finance the spending needs associated to its response to the food prices emergency crisis; and iii) increasing the original amount of domestic financing in the macroeconomic program for 2008.

V. BANK’S STRATEGY

34. The Bank is supporting Honduras response to the food crisis through a variety of instruments. To start with, the Bank is keeping an open dialogue with Honduras stressing the need to maintain macroeconomic stability and avoid interventions that, while potentially appealing over the short run, are likely to have unsustainable costs over the long run. The proposed supplemental operation will contribute to this dialogue.

35. In addition to the proposed Supplemental, the Bank has also a number of operations in its existing portfolio that are supportive of the Government’s strategy for expanding the supply of agricultural products in the short and medium term. The recently approved Rural Competitiveness project will contribute to increase the competitiveness of the rural sector. The project has been designed to deploy market-oriented, demand-driven mechanisms to assist rural producers to establish partnerships with commercial actors. These linkages will also contribute to stimulating rural investment opportunities, and bringing farmers close to markets as a medium-term measure to increase rural producer incomes and thereby purchasing powers to ensure sufficient access to food.

36. The Rural Competitiveness project will also assist rural producer organizations to devise the right mix of technical inputs that can boost historically low productivity and generate the gains needed to offset the rising costs of fertilizers and transportation.

37. The Bank is also supporting an expansion of agricultural production through the non-lending technical assistance Price Risk Management of Agricultural Commodities in Honduras project. This project is co-financed by the IDB and the World Bank, and executed by the Honduran Banking Association (AHIBA). The project aims at reducing risks for banks and non-bank financial intermediaries in the agricultural sector. These efforts on the agricultural front are being complemented with the recently approved Second Road Rehabilitation and Improvement Project which seeks to rehabilitate and improve secondary roads in the same target communities as the other Bank operations.
38. Similarly, the Bank is assisting in improving the design of one of the domestic programs in the Government’s strategy, the above mentioned Bono Tecnológico. As a first step, the Bank is completing a Poverty and Social Impact Analysis (PSIA) of the program (expected to be completed in September 2008), the results of which will be used to improve the targeting mechanisms. The Bank will work with the authorities to improve the plan’s procurement and financial management practices of the Bono.

39. The Bank is well positioned to attend to requests along several other fronts.

- First, the Bank could step up its support to the neediest. Child malnutrition concerns could be addressed through the ongoing Nutrition and Social Protection Project which supports both the expansion of the child nutrition program (AIN-C) to 1,000 new communities targeting 85,000 children under age 5, and provides assistance to the Red Solidaria social safety net strategy, which is targeted to the 100 poorest municipalities with coordinated investments including the PRAF conditional cash transfer program.

- Second, the Bank could also assist the Government by evaluating the possible environmental aspects of its increased investments in and expenditures for irrigation infrastructure, expanded private sector production, and distribution of fertilizers to small-scale producers.

- Finally, the Bank is also ready to assist the Government with an impact assessment of the overall response to the food crisis.

VI. RATIONALE FOR PROPOSED SUPPLEMENTAL FINANCING

40. The proposed SDR 6.2 million (US$10 million equivalent) credit, funded from IDA 15 replenishment, would support the Government’s commitment to maintain macroeconomic stability and persevere in the FS-DPC’s development objectives while implementing its food crisis response program.

41. As discussed above, Honduras is committed to a reform program aimed at strengthening the financial sector so as to ensure that it contributes to long-term growth and poverty reduction. The authorities have expressed their intention to continue the implementation of the financial sector reform program and more specifically their intention to strengthen supervisory activities, keeping updated the database of related parties, and further strengthening banking resolution including through fully capitalizing the recently created bank capitalization fund.

42. This commitment is particularly important because of the new challenges that the food crisis is creating for the financial sector, as higher food prices negatively affect the portfolio of consumer loans and the country’s macroeconomic stability. In particular, strong supervisory activities and a well capitalized bank capitalization fund are crucial.
stabilizing factors for the financial system, because they signal to the market that the authorities would be able to respond to banks in difficulties and avoid a systemic crisis.

43. Maintaining an appropriate macroeconomic framework is an integral part of the Government’s strategy to keep a strong financial sector. The country’s macroeconomic program is being supported by a Stand-by arrangement with the IMF. Unfortunately, the government is facing unanticipated fiscal pressures arising from additional spending needs resulting from the food crisis and lower than anticipated external financing. The proposed Supplemental Financing would help relieve part of the fiscal pressure.

44. The proposed Supplemental Financing meets Bank requirements for supplemental financing under OP 8.60 as follows:

(i) The program is being implemented in compliance with provisions of Financing Agreement. The FS-DPC was approved in February 2005. The first tranche of SDR 8.1 million was disbursed on March 2, 2006. The second and final tranche of SDR 8.1 million was disbursed on May 16, 2008, following fulfillment of all agreed conditions. The government continues to implement the reform program supported by FS-DPC satisfactorily.

(ii) The Recipient is unable to obtain sufficient funds from other lenders on reasonable terms or in a coordinated manner. Addressing the multiple needs emerging from the food crisis is placing unexpected demands on the government’s fiscal resources at a time when external financing flows are lower than anticipated in the government’s program. The Supplemental Financing, together with resources from other development partners, such as the IDB, will help close the financing needs associated with the crisis.

(iii) The time available is too short to process a further freestanding Bank credit. Although the Bank is preparing a Development Policy Credit focusing on the quality of public services, some of the anticipated prior actions have not yet been taken. Hence, waiting for this DPC would delay the urgently needed financial support. Preparing an investment loan would also be ineffective in timely resource delivery. In contrast, use of a Supplemental Financing option can enable the Bank to deliver program support in a timely manner to help the government continue implementing both its reform program in the financial sector and its strategy to address the food crisis.

(iv) The Recipient is committed to the program and the implementing agencies have demonstrated competence in carrying it out. The government has shown its commitment to the program as demonstrated by the fulfillment of all the conditions for disbursement of the second tranche on May 16, 2008, and its continued satisfactory implementation of the program.
VII. IMPLEMENTATION ARRANGEMENTS

A. Terms of the Supplemental Financing

45. Besides the usual legal opinion required under the General Conditions for IDA Credits, there are no other requirements to this proposed Supplemental Financing. However, there will be an overall requirement that: (i) the Government continues to maintain a satisfactory macroeconomic framework consistent with the objectives of the Program, as was required under the original operation; (ii) no action is taken or policy adopted to reverse any action or policy under the Program in a manner that would adversely affect the objectives of the Program; and (iii) no action is taken or policy is adopted to reverse any of the actions taken under the original credit.

46. The closing date for the Supplemental Financing is May 30, 2009.

B. Fiduciary Aspects

47. The CFAA (2003) and CPAR (2004) identified a number of strengths and weaknesses of Honduras' financial management and procurement systems. Subsequently, a Public Financial Management Performance Report, completed in 2006, highlighted the progress made in implementing public financial management (PFM) reforms since 2004. These reforms provide adequate comfort to proceed with this operation.

48. Important advances to date include (i) the passage of a comprehensive Financial Management Law and its regulations, (ii) improved budget classification and formats, (iii) technical upgrades to the government’s integrated financial management system, SIAFI, that increased its programmatic functionality and expanded the system's coverage across the central government, (iv) improved and functioning treasury operations, (v) the production of the first government financial report prepared by the Tribunal Superior de Cuentas (TSC) together with the promulgation of new regulations for external audits by the TSC, (vi) new internal audit standards and regulations and (vii) the presentation of a multi-annual budget to Congress with overall fiscal and poverty reducing targets.

49. In spite of the notable achievements mentioned above, challenges still remain. The modernization of the Finance Ministry, SEFIN, is progressing well and it will be important for the government to identify a small cadre of highly qualified personnel, who can assume the responsibility to operate, sustain and maintain the central public financial management systems of the government. It will also be important to consolidate the advances made in PFM, especially those in budget execution and treasury management, eliminating exceptions to the single treasury account system, assuring consistency in the use of SIAFI and consolidating the consistency of rule of law regarding Public resources regulatory framework.

50. Going forward, there are some additional key areas of focus which would require technical assistance, as the Government continues to build a modern, reliable and transparent public financial management system. Improvements in these areas are aimed at strengthening governance and anti-corruption, and improving the public perception of
the control of corruption. They include: support to the Implementation of the Transparency Law; support to Professionalization of Civil Service; and strengthening of country PFM systems: SIAFI, Honducompras-SEPA, and consolidation of the Government use of Results-based Management system.

C. Disbursement and Auditing

51. The IMF Safeguard Assessment Report conducted in 2004, found that the Central Bank of Honduras is strengthening its safeguard framework and addressing its weaknesses in financial reporting and independent oversight. In its review of the IMF report and other available information including the review of external audit reports of the Central Bank, nothing came to the attention of the Bank that would indicate that the control environment into which the loan proceeds will flow is other than adequate, and there would not be a requirement for additional fiduciary measures (i.e. dedicated account and audit).

52. The Bank would make the single tranche loan disbursement to an account designated by the Government that forms part of the country's official foreign exchange reserves at the Central Bank of Honduras. After the deposit of the Supplemental FS-DPC proceeds, the Central Bank of Honduras would immediately credit the disbursed amount to the Ministry of Finance Treasury Single Account, thus becoming available to finance budgeted expenditures. Within a week of this operation, the Ministry will accordingly provide the Bank with a written confirmation that funds have been received, and the Bank's supervision for this operation will review such transaction.

D. Poverty and Social Impact Analysis

53. The policies and measures supported by this operation are expected to have positive poverty and social consequences. By providing fiscal space, the Supplemental Financing operation will allow the Government to continue responding to the food price crisis.

E. Environmental Issues

54. Policies supported by this Supplemental Financing are not expected to have any significant effect on the environment.

VIII. BENEFITS AND RISKS

A. Benefits

55. The supplemental financing will be an important source of budget financing for the Government, providing fiscal space to continue responding to the food price crisis, while helping to maintain the macroeconomic stability that led the IMF Board to approve a Stand-by arrangement on April 7, 2008. Timely program support will also assist Government efforts to strengthen the financial sector in a period characterized by exogenous shocks that could potentially weaken some banks.
B. Risks

56. Institutional risks to program implementation are posed by weaknesses in government financial management and weak audit functions. These risks are mitigated by efforts in the areas of public financial management and auditing that the Bank is supporting through the Development Policy Credit under preparation.