I. Project Context

Country Context

Honduras is a lower middle income country with per capita gross national income of US$1,800. It is Central America’s second most populated country, with 7.5 million people, and the second largest in size. About half of the population is rural, and 80 percent of these people live in hilly areas, practicing subsistence agriculture. Honduras’s social indicators are among the worst in the Latin America and Caribbean region but are comparable to other lower middle income countries in other regions.

Honduras remains one of the poorest and most unequal countries in Latin America. The country was severely affected by the economic crisis. As a result of the economic contraction in 2009, poverty in Honduras may have risen by more than 150,000 people between 2009 and 2010. Consumption-based figures for 2009 indicate that 44.5 percent of the population lived in poverty and 20.1 percent lived in extreme poverty. According to official figures, the Gini coefficient that measures inequality in income distribution for 2007 stood at 0.57. These figures are among the highest in Latin America.

Crime and violence have become a major development challenge. Deteriorating citizen security is undermining Honduras’s growth potential and investment climate, its social and human development progress, and its prospects for improving governance. The annual economic costs of crime and violence have been estimated at near 10 percent of Honduras’s GDP (nearly US$900 million). Not surprisingly, citizens perceive violent crime as one of the major threats to their welfare, and the failure to curb this epidemic continues to undermine the legitimacy of government and the rule of law.

II. Sectoral and Institutional Context
State capture and weak accountability pose significant challenges for development in Honduras. According to the 2009 Institutional Governance Review (IGR) (Report No. 53517-HN), clientelistic practices and vested interests have a strong direct (or indirect) influence over the political and economic system in the country. Similarly, limited transparency and information around decision-making weaken the country’s institutional framework.

Efforts to improve governance were made during the past years, but policy discussion lacks focus on performance. The IGR notes that, in general, policy discussion has focused on designing further reforms rather than on enforcing already approved initiatives. Although Honduras put forth several efforts in recent years aimed at improving its governance conditions, spaces created for dialog are still limited and progress towards building consensus among different sectors has been unfruitful. Some advances that were made in key reform areas, e.g., the approval and implementation of the Law on Transparency and Access to Information; the initial implementation of a Results-based Management System, and the expansion and improvement of the integrated public financial management system. However these were affected by the political crisis and compounded further by an environment of political and institutional conflict, insecurity, and deterioration of trust in public institutions.

Public trust in institutions is low. The political crisis that resulted from the ousting of former President Zelaya, further polarized the country and reaffirmed the low levels of trust in public institutions. According to Latinobarometro, the Government in Honduras is perceived as #very weak# with only 32 percent of citizens considering that the Government is the most powerful actor in the public arena. Similarly, citizens’ perception that the country is headed in the right direction reaches only 10 percent, the lowest in the region. Furthermore, according to Transparency International’s Corruption Perception Index for 2010, Honduras ranks 134th among 178 countries, ranking fourth in Latin America and first in Central America.

The current administration shows commitment to a continued governance reform agenda. Since taking office, the Lobo administration, has acknowledged the need to strengthen the country accountability framework, specifically of policy makers towards citizens and taxpayers. The Administration has developed a Transparency and Anticorruption Plan for 2011-2014 (Plan de Transparencia y Lucha Contra la Corrupci, 2011-2014), which includes the design and implementation of a National Policy and System of Integrity. This Plan establishes a set of priority activities to foster accountability and transparency in public sector activities linking them to the objectives of the Plan Naci, especially in key areas such as procurement and management of financial resources. The Anticorruption Plan provides a set of activities for different Sector Cabinets (Gabinetes Sectoriales) to address major governance constraints.

Although these efforts represent important first steps towards strengthening governance in the country, challenges remain. These include consolidating reforms in areas such as public financial management, procurement, human resources management and building capacity to monitor and evaluate top policy priorities.

Honduras public financial management platform has major weaknesses. Although financial management system (Sistema Integrado de Administraci de Finanzas, SIAFI) was introduced in 2004, its technological infrastructure is outdated and contributes to the inefficient use of the system. SIAFI initial implementation was focused on central government entities and the introduction of a Single Treasury Account, substantially improving the management of public resources. However, some initially designed modules (such as travel management and revolving funds) were never implemented; and others were only done so partially (including the human resources and administration of goods).

Expert assessments consistently agree that the conceptual model of the system is sound and that SIAFI fulfills all the basic functionalities that international best-practice recommends. However, shortcomings of the IT system and some of SIAFI functionalities are complicating its proper use and its planned expansion. A technological upgrade and the development of new functionalities are needed in order to allow substantially larger number of users to access the system simultaneously, reduce access costs (i.e. through the Internet), ensure adequate security levels, and enable linkages with other information systems such as the national procurement platform Hondocompras and the national debt management system.

However, current shortcomings of SIAFI are leading to forms of non-transparent financing. Shortcomings of the system include the tracking of expenditures and obligations which the Government has entered into, which in turn have led to a high level of arrears. Underlying issues include inadequate commitment controls and budgeting for contracts, as well as lack of information.

Insufficient capacity of the institutions in charge of public procurement hinders advances in the improvement of the country’s procurement system. The institutional framework of the Oficina Nacional de Contrataciones y Adquisiciones del Estado (ONCAE), the procurement regulator, lacks the decision-making strength and authority, and the current procurement platform Hondocompras is not conditioned to act as a transactional platform.

Building capacity to formulate, and monitor and evaluate public sector programs and policies is a top Government priority. The institutional framework of the entities responsible for the oversight of public sector programs and policies is outdated and the capacity of said institutions limited. This hinders the capacity of the Government to evaluate if the programs and policies being implemented are achieving the results they are intended to.

Human resources management (HRM) continues to be one of the weakest areas in public administration. Regional studies have defined the civil service in Honduras as a clientelistic-based bureaucracy characterized by low autonomy and capacity. It is highly politicized and based on patronage with appointments made following clientelism rather than technical competence. In addition, its cost relative to GDP is higher than in comparable countries. Honduran wage bill as a percentage of GDP has increased substantially between 2008 and 2010, mainly driven by pay increases to teachers, lack of effective controls for payroll management, and the creation of new positions. This has resulted in the diversion of resources from investments needed in social sectors and other priority areas.

Since 2010, the Government has taken important initial measures to contain the education sector wage bill through stronger control over personnel expenditures. However, these efforts need to be extended across the administration. The Government has implemented a payroll audit for teachers and, based on its findings, is currently working to correct inaccurate payments. In addition, after cleaning-up the database the Government would strengthen controls over the payroll by processing salaries for teachers exclusively through SIAFI. Further legislation was approved establishing the procedures for the inclusion of new teachers, the processing of the payroll through shared controls between the Ministries of Education and Finance, and explicitly preventing teachers from receiving duplicated allowances, among other control measures.
III. Project Development Objectives
The objective of the Project is to strengthen the management of public finances and to establish a more efficient, effective and transparent public procurement system through: (i) upgrading the public financial management system; (ii) upgrading the e-procurement platform; (iii) enhancing the internal control systems over personnel expenditures; and (iv) building capacity of the Central Administration.

IV. Project Description
Component Name
- Component 2. Strengthening the Public Procurement System
- Component 3. Improving Public Sector Human Resource Management
- Component 4. Strengthening Governments Capacity to achieve results by improving its monitoring and evaluation system
- Component 5. Project Coordination and Transition Strategy

V. Financing (in USD Million)

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VI. Implementation
The responsibilities of the project implementation would be divided among a project coordination unit and executing agencies. The coordination unit would be responsible for overall project coordination, the fiduciary and safeguards aspects, including all procurement processes, and the executing agencies would implement activities under the components and be in charge of all related technical aspects. The coordination unit would be the Unidad de Administraci de Proyectos # UAP-SEFIN within SEFIN. There would be three executing agencies: (i) the Unidad de Modernizaci # UDEM within SEFIN in charge of Component 1 and Subcomponent 3.1, (ii) Oficina Nacional de Contrataciones y Adquisiciones del Estado - ONCAE within SEFIN in charge of Component 2, and (iii) the Unidad de Apoyo Tcnico Presidencial - UATP within the Secretary of the Presidency for a Subcomponent 3.2 (for professionalization efforts outside SEFIN), Component 4 and Subcomponent 5.2. The inter-institutional arrangements and responsibilities between the Government agencies would be agreed upon in a Memorandum of Understanding (MoU) between SEFIN and the Secretary of the Presidency. Table 1 below summarizes the responsibilities of the units involved. See Annex 3 for more detailed information on the implementation arrangements.

VII. Safeguard Policies (including public consultation)

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