



1. Project Data:		Date Posted : 10/02/2002	
PROJ ID: P007387		Appraisal	Actual
Project Name: Hn Pub Sec Mod Sac	Project Costs (US\$M)	238	277.9
Country: Honduras	Loan/Credit (US\$M)	83	122.9
Sector(s): Board: PS - Central government administration (67%), Telecommunications (12%), Aviation (12%), Power (9%)	Cofinancing (US\$M)	155	155
L/C Number: C2816			
	Board Approval (FY)		96
Partners involved : IDB	Closing Date	12/31/1998	11/30/2001
Prepared by :	Reviewed by :	Group Manager :	Group:
Laurie Effron	John H. Johnson	Rene I. Vandendries	OEDCR

2. Project Objectives and Components

a. Objectives
This adjustment loan was in support of the Government's Public Sector Modernization Program (PSMP), whose main objectives were to: (i) improve public services through greater private sector participation; (ii) curtail expenditures by restructuring public institutions and employment; and (iii) improve public management to enhance efficiency, transparency, and accountability.

b. Components
The credit supported: **(i) private sector participation** : improved legal and regulatory framework and establishment of the regulatory agency for **telecommunications** and for basic telephone services, ensuring that the enterprises established by Hondutel, the public telecommunications enterprise, are managed and controlled by private investors; for **civil aviation** , establishing the legal framework and entering into concession contracts for management and operation of airports with international traffic; and for **electric power** , publicly commit to implement a new tariff structure; approve strategy for geographical rationalization of power distribution; and award at least one contract for private sector participation in electric power distribution, covering at least 35 percent of consumers. **(ii) administrative reform to curtail expenditures** : establish legal framework for administrative restructuring and implement institutional restructuring plans; rationalize employment and salary structures; efforts were to be focused on health, education, communications and infrastructure, natural resources, and economics and finance secretariats; and **(iii) reform of public management** : agree on and implement action plans for public sector human resource management and for improving financial management and investment programming .

c. Comments on Project Cost, Financing and Dates
The credit included, in addition to the credit amount of US\$ 55 million equivalent, reflows from IDA repayments, originally estimated at US\$28 million equivalent; by the end of the credit period, however, the reflows totalled about \$68 million. The loan closed after four extensions about three years later than expected .

3. Achievement of Relevant Objectives:
The operation was partially successful in **increasing private sector participation** in public services. In **telecommunications** , an appropriate legal framework was established, covering private participation, establishment of a regulatory agency, and privatization of HONDUTEL . The regulatory entity was established and has been functioning effectively since early 1996 (before the credit was approved). The privatization of HONDUTEL was not accomplished, however (para. 5). In **civil aviation** , private sector participation exceeded objectives, and the four international airports are under private management through a 20 year contract; passenger growth has been high and at one of the airports, cargo growth has been particularly strong . In the **electricity sector** , a more comprehensive strategy for privatization was adopted, beyond that envisioned under the credit (which focused on distribution), but actual accomplishments fall short of the credit's objectives (para. 5). A new tariff structure was put in place, and the Government has adjusted tariffs in 1997 and 2000. Nevertheless, certain principles of a revised tariff structure have yet to be met (para 5). Two studies were carried out as planned to separate the country into

geographical regions, which may facilitate future private sector participation in the sector .

In administrative reform , objectives were partially achieved . The legal framework was established and restructuring was carried out in the main secretariats; more than 20 percent of permanent positions were eliminated or frozen, well above the 10 percent reduction that was a condition under the credit; some services were transferred to the private sector (particularly the Secretariat of Education and the Secretariat of Communications, Public Works, and Transportation); and progress was made in deconcentrating many functions to departmental offices . The size of the civil service is similar to other Central American countries . The salary wage has continued to increase however (see para. 5 below).

In public management, objectives were partially achieved . A human resource management system and a modern financial administrative system are now in place . In human resources, all 25,000 posts in the central administration have been classified and an appropriate salary structure associated with each post . A human resource data base is operational and a number of problems, such as absenteeism, multiple employments, and excessive administrative posts have been identified . It remains to correct these problems (para. 5 below). In financial resource management, an integrated information system that encompasses budget, treasury, accounting and public credit is functioning, providing real time information, improved accuracy, and increased transparency on financial transactions in the central administration . Further development of the system will involve expanding it to all Secretariats and development of performance indicators for use of the budget .

4. Significant Outcomes/Impacts:

Although unable to meet the Fund's ESAF targets for macroeconomic performance in 1996 and 1997, the Government did meet or exceed renegotiated targets thereafter (1998-2001), controlling inflation, reducing the fiscal deficit, and reaching over 5% GDP growth. This performance was remarkable for 1998 given the devastation of Hurricane Mitch late that year. In subsequent years, relatively sound macroeconomic management has continued, although growth has been negatively affected by soft commodity prices, high oil prices, and a slowed U .S. economy .

In public services, although private sector participation was not as great as expected in either the telecommunications or electricity sectors, telecommunication service has improved, with more private agents offering non-basic services, and the coverage and quality of services considerably expanded . The tariff structure has been modified; HONDUTEL is not a drain on public funds (it is not clear from the President's Report or the ICR whether it was a drain on government funds before tariffs were changed) . In the electricity sector, since 1996, there has been an improvement in coverage of households receiving electricity; lower average prices paid to generators due to more competition from private providers, and a decrease in distribution losses .

The administrative reforms underway are far-reaching and may lead to a more streamlined and efficient public service, although recent salary increases in the health and education sectors are undermining the progress achieved in containing expenditures through rationalizing employment .

Progress was made in establishing both a human resources management system and a financial resources management system, although challenges remain (para. 5).

5. Significant Shortcomings (including non-compliance with safeguard policies):

Telecommunications : HONDUTEL has not been privatized, although it has been brought to the point of sale; only one bid was received, and it was below the Government's base price; telecommunications services remain in public hands. **Electricity** : The legal framework has not been agreed by Congress (passage of the law was a condition of first tranche release and was waived); the Framework Law for the Electricity Sector has been under discussion since late 1999; support for privatization of the public electricity company has weakened . In spite of the new tariff structure and price increases, the structure remains convoluted, average rates are low relative to other countries, and most of the subsidies for electricity go to the non-poor. In spite of improvements, coverage and quality of telephone and electricity services in Honduras remain well below the service levels in other countries in the Region .

Administrative reform : In spite of the reduction in the number of civil servants, the wage bill has continued to increase, mainly due to the increased salaries of teachers and health workers, and reached 10 percent of GDP in 2001 compared to 8.2 percent at the beginning of the reforms . Thus the main objective of the administrative reform, to reduce expenditures, was not achieved, and fiscal sustainability is still an important issue .

In public management , the more difficult task remains that of correcting the problems identified through the creation of the human resources data base (absenteeism, multiple employments, gaps between official and actual functions, and skewed allocation of administrative posts relative to operational posts), which will involve unpopular measures; the ICR considered that the Civil Service Directorate is not up to this challenge .

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Unsatisfactory	The ambitious objectives of this credit were only partially met. The program was

			to have taken three years, but six years after its approval, in only one of the three service sectors targeted has there been successful privatization. The second major objective, to curtail administrative expenditures, has not been met. Although employment has been cut back at the central level, a higher portion of GDP was spent on salaries in 2001 than before the credit. Finally, a start has been made in improving public management, but on the human resources side, the challenges that have now been identified and quantified have not yet been tackled and the agency charged with carrying out the changes is not, according to the ICR, up to the task.
Institutional Dev .:	Substantial	Substantial	
Sustainability :	Likely	Likely	
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Unsatisfactory	Although the Borrower made considerable efforts to fulfill ambitious conditionality, it failed to privatize state owned enterprises in two of the three sectors targeted; undermined the objective of curtailing administrative expenditures by increasing wages for education and health workers; and has not yet addressed the human resource management challenges identified under the credit. Exogenous factors, in particular Hurricane Mitch, also made it more difficult for the Government to focus on the overall reform program .
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with '*' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

Thorough and sound sector work preceding the design of the adjustment credit proved very useful for formulating an appropriate reform agenda; the loan was accompanied by a well designed technical assistance credit to help implement the reforms. This combined package of instruments was a good design for adjustment lending .

Close collaboration among other international financial institutions, in this case the IMF and IDB, was useful for providing a consistent approach to reforms .

More modest adjustment credits/loans that focus more narrowly on priority sectors or a set of priority reforms in a specific area would be less complex to implement and might have a greater chance of success . It would permit a greater concentration by both Borrower and the Bank on a smaller number of reforms .

Optimal sequencing for privatization may vary by country : in Honduras, congressional approval for the broad legal framework prior to privatization may not have been the most effective way to proceed .

In small countries, the size of the market may impede privatization; economic regional integration may hold promise for improving the attractiveness of the markets for private investors .

8. Assessment Recommended? Yes No

9. Comments on Quality of ICR:

The overall quality is satisfactory, with candid comments about the complexity and some of the shortcomings of the operation and with useful boxes presenting background and helpful insights . OED agrees with most of the judgments, with the exception of outcome, as noted above . The report would be better if it had a more careful presentation, however. For example, the project data presented at the beginning of the report are not accurate : the original effectiveness date should have been within three months of Board approval, which would have been mid-1996, and not April 1997 as is shown. The original closing date, as noted on page 23, was December 31, 1998, not the actual date of November 2001. The original credit amount included an IDA reflow of \$28 million equivalent, and not \$67 million, as stated. The Box on macroeconomic performance is a useful addition to the discussion of

specific objectives and conditionalities under the credit, but readers would benefit from figures showing expected key indicators (growth; inflation; fiscal deficit) as shown in the President's Report, or targets under the ESAF for 1996-98; there is only a mention of the fact that Honduras could not meet ESAF targets and, in 1997, renegotiated new ones, which they met or exceeded. There are a few inconsistencies, such as in the proportion of power generated by the private sector. (The ICR states on page 15 that, since 1994, new power generation from IPP has been slow to develop, and implies that only 10% of installed capacity is in the hands of IPP, while on page 16, it notes that about 50% of power generation is provided by the private sector.) There is no information on whether the IDB disbursed its \$155 million loan, and if so, the timing, and there is no mention of whether comments on the ICR were solicited from the cofinancier IDB, as is suggested should be done in the ICR guidelines .