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Report Number : ICRR0020677

1. Project Data

Operation ID P151803	**Operation Name** HN Fiscal Sustainability DPC	
Country Honduras	**Practice Area(Lead)** Macro Economics & Fiscal Management	
L/C/TF Number(s) IDA-55770	**Closing Date (Original)** 01-Mar-2016	**Total Financing (USD)** 55,000,000.00
Bank Approval Date 09-Dec-2014	**Closing Date (Actual)** 01-Mar-2016	

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	55,000,000.00	0.00
Revised Commitment	55,000,000.00	0.00
Actual	55,000,000.00	0.00

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

a. Objectives

According to the Program Document (pp. v, 12), the Program Development Objective (PDO) of the Development Policy Credit (DPC) was to support the Government of Honduras' effort to promote fiscal sustainability and enhance social protection programs. Specifically, the operation aimed to: (i) strengthen fiscal and financial management; (ii) strengthen the management of the power sector; and (iii) improve the targeting of social protection programs. The Financing Agreement did not provide a statement of program objectives.

b. Were the program objectives/key associated outcome targets revised during implementation of the series?

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c. Pillars/Policy Areas

There were three policy pillars, aligned with the three objectives.

1. Strengthening fiscal and financial management. A large public sector wage bill, an opaque and inefficient government purchase system, and inadequate public debt management were the key challenges in Honduras’s fiscal sustainability efforts. The DPC supported actions to increase fiscal space through (i) tightening controls over payroll expenses, (ii) improving the efficiency of public procurement, and (iii) strengthening public debt management.

2. Strengthening the management of the power sector. Inefficiencies in the power sector cost the Government a significant amount of budgetary resources as it had to provide regular capital transfers to keep ENEE, the State-Owned Electricity Company, running to ensure a constant power supply. The DPC supported policy reforms in the power sector to improve the financial sustainability and transparency of ENEE and to reduce the fiscal cost of the power sector.

3. Improving the efficiency of social protection programs. Amid stubbornly high levels of poverty and declining overall real social public spending, Honduras rapidly expanded its non-contributory social protection and labor programs, although these programs suffered from inadequate coverage and a weak focus on the extreme poor. The DPC supported institutional reforms to improve the targeting and management of social programs.

d. Comments on Program Cost, Financing, and Dates

The single-tranche credit of US$55 million was appraised on October 29, 2014, approved by the World Bank Group’s Board on December 9, 2014, and fully disbursed upon credit effectiveness on December 22, 2014. The operation closed on schedule on March 1, 2016.

3. Relevance of Objectives & Design

a. Relevance of Objectives

The DPC objectives were highly relevant to the country context and the government’s strategies. It was fully aligned with the government's fiscal consolidation program. Chronic fiscal instability was a key development challenge in Honduras, putting public investment and social spending at risk, discouraging private investment, and intensifying poverty. To break from this growth and poverty reduction constraint, the new administration that took office in January 2014 formulated the “Plan for a Better Life 2014-18” with four high level objectives. The DPC objectives were linked to two of these high-level objectives: reducing inequality and improving social protection, and enhancing transparency and modernization of the State. The new administration made fiscal consolidation a priority (along with citizen security, economic growth, and the fight against organized crime), and pursued a comprehensive fiscal reform in which key measures included tax reforms, spending (wage bill and procurement) controls, a medium-term public debt strategy, a new law for the power sector, and a Single Registry of Participant for social programs.

At appraisal, the DPC objectives were consistent with the Country Partnership Strategy Progress Report for FY2012-2015, specifically Results Areas 2.1 (pension, energy utility, and public sector wage bill discipline) and 2.4 (consolidated and strengthened social protection system) under Strategic Objective 2 (Expanding Opportunities through Reducing Vulnerabilities), and Results Area 3.1 (improved public financial management, procurement, and results monitoring and evaluation capacity) under Strategic Objective 3 (Enhancing Good Governance). At program closure, the DPC objectives continue to be consistent with the Country Partnership Framework for FY2016-2020, especially Objective 1 (expand coverage of social programs) under Pillar 1 (Fostering Inclusion) and Objective 2 (improve reliability of key infrastructure) under Pillar 2 (Bolstering Conditions for Growth). On the other hand, the CPF does not define any objectives directly related to strengthening fiscal management even though it is recognized as a key government priority for stimulating growth and promoting competitiveness.

Rating

High

b. Relevance of Design

The design of the DPC was straightforward, with a clear causal chain linking the prior actions supported under DPC and the expected outcomes. While all the outcomes were broadly defined, the indicators narrowed down the scope of the results sought. The Program Document explained in detail the rationale for the actions supported and how they would contribute to the objectives. The three policy areas complemented one another: better fiscal and financial management was important for safeguarding social spending; greater power sector efficiency would remove a big threat to fiscal balance; and more effective social programs helped to cushion the potential negative impact of fiscal discipline in the short run.

At the time of appraisal, the macroeconomic situation of Honduras was deemed to be sufficiently stable to proceed with a development policy operation. Following a period of significant turbulence - low growth, a record high current account deficit, and a fiscal deficit which deteriorated from 2.8 in 2011 to 7.6 percent of GDP in 2013, the Honduran Congress in December 2013 approved a comprehensive fiscal reform to reduce the deficit, strengthen public finance, and create a new social program to reduce extreme poverty. Thanks to these and other reforms, Honduras' macroeconomic outlook improved. By the time of DPC appraisal in late 2014, the risk of public external debt distress was considered moderate with the debt to GDP ratio projected to peak in 2017, and the financial sector remained sound. An IMF Standby Arrangement was put in place for the period 2014-2017.The stabilizing macroeconomic framework allowed the World Bank to engage through the DPC, notwithstanding considerable downside risks.

Rating
Substantial

4. Achievement of Objectives (Efficacy)

Objective 1

Objective
Strengthening fiscal and financial management

Rationale
The DPC would contribute to this objective by supporting actions in three specific areas. Overall, the government's fiscal stability efforts have been successful. The ICR reports that between 2013-15, the budget deficit dropped by 6 percentage points of GDP (to 1.1 percent), of which around 5 percentage points came from spending cuts and 1 percentage point from improved tax collection. In April 2016 (after DPC closure), the Fiscal Responsibility Law was enacted to further institutionalize fiscal discipline.

Tightening controls over payroll expenses. Based on a successful payroll control reform in the education sector, which accounted for 50 percent of the government payroll, the government designed a strategy to expand the reform to other public institutions. Implementation of the reform involved three steps: (i) creating a staff registry; (ii) conducting payroll audits; and (iii) implementing a functional review of target institutions. The DPC supported the first step. The Prior Actions included the creation of a Public Administration Reform Commission, operationalization of the Public Employee Control and Register System (SIREP) for personnel from five priority agencies, and publication of a summary of the database of the registry on the website of the Secretariat of Finance. The expected outcome was that by 2015, 80 percent of public sector staff in the Executive Branch was included in the SIREP. The ICR reports that this target was exceeded as 100 percent of public employees in the Executive Brunch had been registered in SIREP as of December 31, 2015. Data on savings from this measure is not available, but overall spending on wages and salaries declined from 14.2 to 11.4 percent of GDP during 2013-2016. Since May 2016, the SIREP is also cross-referenced with monthly payment data from the Integrated Financial Management System (SIAFI) and the Integrated Human Resources System to validate benefit payments and control against ghost workers.

Improving the efficiency of public procurement. In 2014, the government (i) adopted an e-Procurement Law, which allowed three procurement methods (framework agreements, shared purchases, and inverse auctions) using electronic catalogue through the country's procurement platform *Honducompras*, (ii) published its regulations in the Official Gazette, and (iii) signed a Shared Services Agreement for the provision of IT support in the administration of the *Honducompras* (Prior Actions). A pilot program of framework agreements in 2013 yielded savings of $1.3 million for the government. The DPC supported an expansion of the program to all SIAFI institutions and more products. It was expected that this would generate savings of $2.0 million. The ICR reports that this target was exceeded as the annual savings totaled $2.6 million in 2015. Moreover, enhanced interconnection between SIAFI and *Honducompras* facilitated ex-ante control of public procurement commitment, and shared information services between the Modernization Unit of the Secretariat of Finance (SEFIN) and the procurement regulator (ONCAE), thereby eliminating duplicated functions. These measures also allowed ONCAE to focus on strategic policy issues by reducing its operational tasks.

Strengthening public debt management. In 2014, the government adopted a medium-term debt strategy (MTDS) as an important step toward developing a comprehensive debt management framework. The adoption, publication, and submission of the MTDS to Congress was the Prior Action for this component. The ICR reports that there has been annual MTDS issued and made publicly available, thus meeting the results target. The ICR further reports that the risk profile of Honduras' public debt has improved, with yields of domestic bonds falling from 10 percent in August 2013 to 6.5 percent in June 2015 and the government having exchanged short-term maturity bonds with a new bond carrying longer maturities.

Rating
High

Objective 2

Objective
Strengthening the management of the power sector

Rationale
In 2014, the government adopted a new Electricity Law to improve power sector governance, expand private sector participation, and restructure ENEE. The government implemented the prior actions which included reducing the direct electricity subsidy threshold, institutional reforms to separate ENEE's generation, transmission and distribution functions, and implementing a national Integrated Commercial Management System in ENEE. The ICR reports that the combined effect of increased electricity tariffs, reduced and better targeted electricity subsidies, reduced ENEE wage bills, and a significant decline in oil prices (by over 60 percent in 2013-15), resulted in a sharp reduction in ENEE deficit from 1.8 percent of GDP in 2013 to 0.05 percent in 2015, surpassing the target of 1.5 percent by a large margin.

However, the ICR notes that institutional reforms in the power sector, especially regarding the de facto separation of generation, transmission and distribution, have lagged and require further capacity building. To improve ENEE's management practices and transparency, it was expected that ENEE would prepare and publish externally-audited financial statements in 2015. The ICR reports that although financial statements have been generated through an Integrated Management System that was put in place under World Bank's Power Sector Efficiency Enhancement Project (P104034), and audited by external auditors with assistance from the IDB since 2014, they have not been published. Also, the power sector remains highly vulnerable to a resurgence in international oil prices.

Rating
Modest

Objective 3

Objective

Improving the efficiency of social protection programs

Rationale

In 2014, the government launched the *Vida Mejor* strategy to create an umbrella framework for social policies, targeting the extreme poor. Implementation of that strategy involved institutional reforms including the creation of the Secretariat of Social Inclusion and Development (SEDIS) with overall responsibilities for social policies, services, and programs. To improve targeting and reduce duplication of beneficiaries, a new targeting formula for social programs was approved and a Single Registry of Participants was mandated for use (Prior Actions). The ICR reports that these measures improved the coverage of the extreme poor population under at least one social assistance programs, including the flagship conditional cash transfer program, *Bono Vida Mejor*. The coverage targets for extreme poor (75 percent), extreme poor women (52 percent), and extreme poor indigenous and afro-descendants (20 percent) were all met by the end of 2015.

Moreover, the Single Registry of Participants captured 100 percent of the beneficiaries of all social programs by December 2015. This represented significant progress from the baseline of 22 percent in 2013 and more than doubled the target of 45 percent.

Rating

High

5. Outcome

Both the PDO and the specific objectives were highly relevant to the country context, and aligned with the government's and the World Bank Group's strategies. Program design was conservative, but substantially relevant for achieving the stated objectives. Efficacy was high in two of the three program areas (fiscal and financial management, social programs), where the government successfully delivered the expected outcomes supported under the DPC. In the third area (energy), important progress was also made, albeit slower than expected and more support is needed to carry out the complex institutional reforms.

a. Outcome Rating

Satisfactory

6. Rationale for Risk to Development Outcome Rating

In contrast to the trend from the previous two decades, Honduras has successfully maintained macroeconomic stability and fiscal discipline since 2014. Strong commitment to the DPC program has led to achievement of the objectives and continuous implementation of the reform measures. The World Bank continued to support the fiscal stability agenda after closure of the DPC (e.g. programmatic DPF series).

Despite the broadly positive macroeconomic outlook, however, the ICR notes substantial risks to development outcome, including political risks in an election year (November 2017), potential external and domestic economic uncertainties, and institutional capacity constraints. While these risks pose a real threat to the reform momentum and fiscal performance, the risk of reversal is reduced by the modesty of the measures supported. Many of the outcomes targeted institutional improvement (e.g., including more public employees and social program beneficiaries in the relevant registries, expanding the electronic catalogue for public procurement, updating the MTDS, utilizing improved targeting formula for social programs), which has a reasonable chance to be sustained. The most significant risk to the outcomes achieved is with the energy sector, where capacity constraint is significant, reform progress has been partial, and all the identified risks, if materialized, can quickly reverse the results achieved.

a. Risk to Development Outcome Rating

Substantial

7. Assessment of Bank Performance

a. Quality-at-Entry

Design of the operation benefited from analytical work prepared specifically on the policy areas (policy notes presented to the government in January 2014) and other relevant materials (e.g. a study on the balance of payments, a public expenditure review, and an assessment of social spending for Central American countries). Program design reflected lessons from previous DPCs and IMF programs in Honduras, including the need for prudence in the scope and depth of measures supported, for consolidation of positive outcomes from the government's actions before proceeding to deeper reforms, and for coordination with other external partners, especially the IMF and the IDB. There was good synergy between the DPC and an IMF Stand-By Arrangement for 2014-2017 and an IDB budget support operation in the power sector, both approved in December 2014. There were broad consultations with stakeholders under Honduras' Open Government Action Plan and as part of the preparation for a new Country Partnership Framework. The risk assessment was candid and described appropriate mitigation measures by the government, the World Bank, and other partners. The implementation and M&E arrangement were adequate, with the Secretariat of Finance (SEFIN) given the main implementation responsibility, in coordination with ENEE and SEDIS. There was continuity and complementarity between the DPC and other World Bank lending and technical assistance in public financial management, power sector reform, and social protection.

The design of the DPC was conservative. In several areas, the expected results represented intermediate outputs (e.g. updating strategy, including staff/beneficiaries in relevant registries) toward the desired outcomes rather than the outcomes themselves, and many targets were modest. However, given Honduras' poor track record in maintaining fiscal discipline and the disappointing outcomes of previous World Bank projects in public finance, energy, and social sectors in the country, it was judicious for the DPC to maintain a limited scope.

Quality-at-Entry Rating

Satisfactory

b. Quality of supervision

Being a single-tranche DPC, there was no ISR filed in the operation portal. The ICR indicates that program supervision during the 15-month implementation period focused not just on this operation, but program implementation more broadly, and the preparation of the follow-up DPF series (approved in December 2015) to provide continued support on fiscal sustainability (and competitiveness). Parallel support from the partners and continuous analytical and technical assistance also helped to maintain a dialogue with the government and to ensure effective supervision of reform implementation.

Quality of Supervision Rating

Satisfactory

Overall Bank Performance Rating

Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

The government demonstrated strong ownership of the reform program and remained committed throughout the implementation period and beyond. The ICR reports that the government carried out broad consultation on the proposed reforms and that the Secretariat of Finance worked closely with ENEE and the Secretariat of Social Inclusion and Development (SEDIS) to coordinate and monitor implementation of the agreed actions. Capacity constraints within ENEE, the national energy company, combined with inherent complexity of energy sector reforms, were a key reason behind the slower than expected progress in that area.

Government Performance Rating

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b. Implementing Agency Performance

The government implemented the program through SEFIN. No separate assessment is made of implementing agency performance.

Implementing Agency Performance Rating

Not Rated

Overall Borrower Performance Rating

Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

M&E design was clear and largely appropriate. The Program Document presented a plausible results chain in each policy area. The outcomes were directly linked to the Prior Actions, and the results indicators were measurable, with time-bound baselines and targets. The strength of M&E design could have been improved with more precisely defined outcomes and indicators that measured outcomes achieved (e.g., savings from registering public sector staff) rather than intermediate outputs delivered (e.g., share of staff registered). As the main counterpart, the Secretariat of Finance had the responsibility for monitoring program implementation.

b. M&E Implementation

Most indicators relied on publicly available data. Results were also monitored through the large number of parallel World Bank investment and technical assistance projects and partner programs, as well as during preparation of follow-up DPF operations.

c. M&E Utilization

The ICR reports that the DPC promoted and supported the use of M&E arrangements and systems. Regular monitoring and data collection were also credited for facilitating discussions with the government on reform implementation.

M&E Quality Rating

Substantial

10. Other Issues

a. Environmental and Social Effects

The DPC was not expected to have significant environmental effects (Program Document, p. 28); the ICR does not address the issue.

Annex 3 of the Program Document provided a detailed analysis of the poverty and social impact of the DPC.

It was expected that the DPC would have an overall positive impact on the poor and vulnerable. The ICR confirms this expectation. While acknowledging that counterfactuals are difficult to prove, it argues that the creation of fiscal space supported under the DPC would help protect spending on social programs. Moreover, the DPC's third policy area directly addressed the targeting of social protection programs to improve their focus on the extreme poor.

b. Fiduciary Compliance

The Program Document noted improvement in public financial management in Honduras, but assessed the fiduciary risk as substantial on account of the ONCAE's reduced capacity while the executive branch was being restructured (p. 28). The ICR reports that this risk did not materialize.

c. Unintended impacts (Positive or Negative)

NA

d. Other

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11. Ratings

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

IEG concurs with the four lesson distilled on the success of the DPC,including the importance of dedicated technical assistance for reforms in a difficult environment, government commitment and timing of engagement, coordination with development partners, and complementarity of World Bank instruments.

In addition, the DPC underscores the importance of setting realistic objectives. The World Bank supported a broad reform agenda in Honduras. However, the country had a poor track record in maintaining fiscal discipline. Several recently evaluated World Bank investment projects in the DPC policy areas was also unsuccessful - the Power Sector Efficiency Enhancement (P104034) was rated *moderately unsatisfactory* and the Improving Public Sector Performance (P110050) was rated *unsatisfactory.* In this context, the scope of the DPC was appropriately modest even though the ICR states that the DPC "tackled an ambitious set of reforms". Such realism appear to have been a key factor in the program’s success in achieving the expected outcomes.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR is clear, concise, and covers all areas of the DPC in sufficient detail. The ICR could have reflected on the contrasts between the outcomes of the DPC and those of the complementary investment projects, and how each has contributed to the policy and institutional strengthening agenda supported by the other.

a. Quality of ICR Rating
Substantial