POVERTY REDUCTION AND LOCAL DEVELOPMENT PROGRAM

(HO-0161)

EXECUTIVE SUMMARY

Borrower: Republic of Honduras

Guarantor: Government of Honduras

Executing agency: Honduran Social Investment Fund (FHIS)

Amount and source:

(in thousands of U.S. dollars)

	Phase I	**Phase II**	**Total**
IDB: (FSO)	25,000	35,000	60,000
Local counterpart :	2,800	3,900	6,700
Total:	27,800	38,900	66,700

Financial terms and conditions:

Amortization period:	40 years
Grace period:	10 years
Commitment period:	2 years
Disbursement period:	2.5 years
Interest rate:	1% first 10 years and 2% thereafter
Inspection and supervision:	1% of the loan amount
Credit fee:	0.5% per annum on undisbursed balances

Objectives: This program is in line with the Poverty Reduction Strategy (PRS), its general objective being to help improve the living conditions of the poor by providing greater access to basic social services with community participation. The program's specific objectives are: **Phase I** (i) to carry out the projects selected in the 1998 municipal social investment plans (PISMs), awaiting financing due to the backlog caused by Hurricane Mitch; (ii) to support FHIS participation in the PRS as a poverty reduction instrument, increasing its effectiveness and enhancing management capacity; and **Phase II:** (iii) to implement new intervention approaches devised from lessons learned with pilot programs executed in Phase I (paragraph 2.1).

Description: In line with the Honduran poverty reduction strategy (PRS), the program will help sustain the pace of social investment by increasing access by the poor to basic social services, while fostering community empowerment and a sense of ownership of service delivery. It is conceived as a multiphase operation using the new "multiphase lending" facility that affords flexibility by virtue of its medium-range view, transcending any one government's term in office. The program supports the transformation of the FHIS as an effective instrument for the PRS. In Phase I, financing will be provided for backlogged basic infrastructure projects and pilot programs. Phase II will use designs that proved successful in the pilot programs and apply lessons learned in Phase I. It will also act as an incentive for execution and timely evaluation of pilot programs conducted in the first phase. The move to Phase II is subject to attainment of targets denoted by specific process, outcome, and impact indicators that will signal whether the progress made is in line with the PRS's medium-term objectives. Phase I is scheduled to take 24 months and Phase II, 36 months.

With respect to allocation of program funds, the 1998 poverty map will be used for Phase I of the operation. In order to target it even more closely and give priority to municipalities with the largest numbers of poor people, the allocation formula has been improved to give greater weight to poverty and less to size of population.

Phase I of the program (US$25.8 million) will finance:

1. **Social infrastructure investment commitments** (US$24.2 million): comprises backlogged infrastructure projects with organization and financial specifications regarding maintenance of the works (paragraph 2.8).

2. **Pilot programs to strengthen local communities** (US$900,000): experiment in participatory planning, operational delegation of the project cycle, and maintenance (paragraph 2.13).

3. **Institutional strengthening of the FHIS** (US$400,000): financing of a Technical Support Unit and technical-administrative strengthening activities (paragraph 2.34).

4. **Evaluation of Phase I** (US$300,000): consists of an evaluation by an independent firm acceptable to the Bank, as a requirement for qualifying for Phase II financing (paragraph 2.38).

Phase II (US$35.9 million) will finance extension of the practices shown to be successful in the evaluation of the pilot programs in the previous phase, incorporating them into the priority projects in the new Municipal Social Investment Plans (PISMs). Phase II will be compatible with the PRS design and implementing arrangement (paragraph 2.39).

This document requests the Board of Executive Directors' approval of the program concept, the proposed multiphase mechanism, and a loan for Phase I. Management would recommend approval of Phase II of the program to the Board in a memorandum containing an evaluation of qualitative and quantitative aspects of what is accomplished vis-à-vis the project backlog and the pilot program outcomes. It will also include a revised cost table and procurement plan.

The Bank's country and sector strategy: In line with the PRS, the Bank's strategy for Honduras is geared to poverty reduction. To that end, the Bank will support initiatives aimed at enhancing the equity, efficiency, and reach of public programs. The objectives and activities proposed in this operation, as well as those of other programs being prepared and executed, are also concordant with the PRS. They include: (i) the sector program (HO-0185), dealing with compliance with policy and expenditure measures; (ii) the rural economy reactivation program (HO-0144); (iii) the urban poverty program now in preparation (HO-0184); (iv) the family allowance program (PRAF) (1026/SF-HO); and (v) the Honduran Social Investment Fund (FHIS 3) program (1028/SF-HO). These programs constitute an integrated package of measures to reduce and alleviate poverty. The operation described here is supported by the program for efficiency and transparency in government procurement (1059/SF-HO), which will supervise and strengthen the FHIS procurement system (paragraph 1.21).

Environmental and social review: The FHIS project cycle requires an environmental assessment of projects. Standard projects (education and health) are audited to ensure that the criteria specified in the prototypes are built in and/or satisfied. In all other projects, an environmental diagnostic assessment and/or environmental impact assessments are carried out, depending on the case. The project also provides for systematic incorporation of FHIS requirements with regard to gender equity and respect for the particular needs of ethnic minorities (paragraph 2.15). Also planned are training and initiatives to heighten awareness of these issues among the personnel of the FHIS, municipalities and beneficiary communities (paragraph 4.8).

Benefits: This program is expected to lower costs by increasing the efficiency, effectiveness and useful life of works. In the specific case of investment in human capital, there are expected to be improvements in productivity and direct positive impacts on income, as well as indirect effects on the generation of national wealth. In addition, the adjustment to the resource allocation formula, favoring poorer municipalities, will help raise the return on social investment. It is also hoped that operational delegation of the project cycle (DOPC) will help strengthen municipal capabilities (paragraph 4.14).

Risks: The FHIS menu may be restrictive for some communities, with certain basic social needs considered priorities for them being left unmet. To allay this risk, a negative menu will be tried out during Phase I. In Phase II, which will draw on experience acquired in Phase I, the menu will be adjusted accordingly. There is also a risk that the DOPC process might not progress at the desired pace because of the need to develop new procedures and fine-tune working methods. To minimize this risk the program will introduce DOPC gradually, starting with a pilot scheme of manageable proportions (paragraph 4.19).

Special contractual conditions: The first disbursement will be subject to the following being presented to the Bank's satisfaction:

(i) the revised FHIS Operations Manual (paragraph 2.8), including operational guidelines for execution of the pilot initiatives (paragraph 2.14); (ii) the agreement signed by the FHIS and the Ministry of Finance for the transfer of: (a) maintenance incentives (paragraph 2.24) and (b) the program funds (paragraph 3.41); (iii) the agreement that the FHIS has presented to the Ministry of Natural Resources and the Environment (SERNA) for its signature, that includes the creation—where they do not exist—of new municipal environmental units in the DOPC pilot municipalities (paragraph 2.33); (iv) the final selection of municipalities for the pilot initiatives (paragraph 2.13); (v) the agreement that the FHIS presented to the Association of Honduran Municipalities (AMHON) for signature, whereby AMHON undertakes to support participation of the chosen municipalities in the pilot projects (paragraph 3.27); and (vi) the model of the agreement to be signed by each municipality participating in the various pilot projects under the program, on the terms agreed upon with the Bank (paragraph 2.14).

Poverty-targeting and social sector classification: This operation qualifies as a poverty targeted investment given that it supports the activities of a social investment fund (automatic sector classification) (paragraph 4.19). Moreover, because it involves the social sector, the operation qualifies as a social equity enhancing project as described in the indicative targets for the Bank's activities set out in the Eighth Replenishment report (document AB-1704).

Exceptions to Bank policy: None.

Procurement: Procurements under the program will conform to Bank policy. International competitive bidding will be required for construction contracts worth over US$1,500,000, US$250,000 for related goods and services, and US$200,000 for consulting services

Procurement of goods, construction work, and services for which FHIS is responsible and which fall below the above thresholds will be governed by the FHIS Procurement Operations Manual (paragraph 3.37).

Procurement method	Construction	Goods	Consulting services
International competitive bidding	1,500,000 or more	250,000 or more	Over 200,000
Local competitive bidding	75,000 to 1,499,000	75,000 to 149,999	75,000 to 200,000
Limited bidding	37,000 to 74.,999	37,000 to 74,999	37,000 to 74,999
Short list of providers	Under 37,000	Under 37,000	Under 37,000

Procurement of goods, works, and services for which the municipalities are responsible will be governed by Honduran legislation provided that it does not contravene the Bank's basic principles.