

**HONDURAS:**

**PUBLIC EXPENDITURE ASSESSMENT AND  
STRATEGY FOR AN ENHANCED  
AGRICULTURAL AND FORESTRY  
SECTOR**

**Prepared for the World Bank/ARD, in collaboration with RUTA**

**By**

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## ABBREVIATIONS AND ACRONYMS

|                     |  |
|---------------------|--|
| <b>AFE-COHDEFOR</b> | <b>Agencia Forestal Estatal (State Forestry Agency)</b>  |
| <b>BANHPROVI</b>    | <b>Banco Honduran para la Produccion y la Vivienda (Production and Housing Bank)</b>   |
| <b>CAFTA</b>        | <b>Central American Free Trade Agreement</b>   |
| <b>CFI</b>          | <b>Conservation and Forestry Institute</b>   |
| <b>CODA</b>         | <b>Consejo de Desarrollo Agroalimentario (Counsel of Agricultural Development)</b>   |
| <b>DICTA</b>        | <b>Direccion de Tecnogia Agrícola (Directon of Agricultural Technology)</b>  |
| <b>DR-CAFTA</b>     | <b>Dominican Republic and Central American Free Trade Agreement</b>  |
| <b>ERP</b>          | <b>Estrategia para la Reduccion de la Pobreza (Poverty Reduction Strategy)</b>   |
| <b>FHISS</b>        | <b>Fondo Hondureño de Inversión Social</b>   |
| <b>GoH</b>          | <b>Government of Honduras</b>  |
| <b>MOA</b>          | <b>Ministry of Agriculture</b>   |
| <b>MOU</b>          | <b>Memorando of Understanding</b>  |
| <b>MTEF</b>         | <b>Médium Term Expenditure Framework</b>   |
| <b>NACC</b>         | <b>Nacional Anti-Corruption Commission</b>   |
| <b>PAARS</b>        | <b>Proyecto de Administración de Areas Rurales (Rural Administration)</b>  |
| <b>PBA</b>          | <b>Program-Based Approach</b>  |
| <b>PBPR</b>         | <b>Proyecto de Bosque y Productividad Rural (Forestry and Rural Productivity Project)</b>                                    |
| <b>PESA</b>         | <b>Política de Estado del Sector Agroalimentario (Government's Long Term Agricultural Sector Policy) (2004-2021)</b>         |
| <b>PER</b>          | <b>Public Expenditure Review</b>   |
| <b>PRS</b>          | <b>Poverty Reduction Strategy</b>  |
| <b>SEFIN</b>        | <b>Secretaria de Finanza (Ministry of Finance)</b>   |
| <b>SERNA</b>        | <b>Secretaria de Recursos Naturales y Ambiente</b>   |
| <b>SIAFI</b>        | <b>Sistema Financiera Integrated (Integrated Financial System)</b>   |
| <b>SOP</b>          | <b>peracio peracional Plan (2006-2010)</b>   |
| <b>SWAp</b>         | <b>Sector Wide Approach</b>  |
| <b>TC</b>           | <b>Transparency Commissions</b>  |
| <b>UNAT</b>         | <b>Unidad de Apoyo Tecnico de la Secretaria del Despacho Presidencial (Technical Unit of the Ministry of the Presidency)</b> |
| <b>UPEG</b>         | <b>Unidad de Planeacion, Evaluación Y Gestión (Planning &amp; Evaluation Unit) (from MOA)</b>                                |
| <b>WB</b>           | <b>World Bank</b>  |

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## EXECUTIVE SUMMARY

### Background and Introduction

- i. This study for Honduras comprises one of the six country case studies of the World Bank's ARD/DFID partnership in public expenditure analysis for the agricultural and rural sector.
- ii. In Honduras, there is an important macro-level and sectoral context which warrants some urgency on the part of the Government of Honduras, with the active support of the international donors, to help ensure its agricultural and forestry sector public expenditures be improved in its efficiency and equity features, and gradually, increased in accordance with improved performance.<sup>2</sup> Past public expenditures have had limited impacts on productivity and poverty reduction and Honduras still shows an erratic agricultural growth pattern, well below its potential. Agricultural expenditures are still affected by serious macro-fiscal constraints and there are recognized patterns of under- and mis-investment in the agricultural sector. This pattern also is observed in other sectors. This historical pattern contrasts with stated Government intentions to transform the agricultural sector into becoming a more rapidly growing, equitable, and competitive sector which can take maximize the potential benefits of the CAFTA and other policy reforms. The recent and on-going efforts and results are not compatible with achieving these ambitious and laudable intentions, unless major efforts are stepped up on various fronts, as outlined in this report.
- iii. This sector study has two principal objectives to address key aspects of this compelling context:
  - Carry out in a participatory and analytical manner a sectoral public expenditure assessment for Honduras' agricultural and forestry sector, as an input toward enhancing its efficiency, efficacy and equity, and to improve the prospects of achieving the priority sectoral outcomes outlined in its Strategic Operational Plan (SOP, 2006-2010), and in its recently updated strategy which further operationalizes the SOP, with a commodity chain focus.
  - Provide options and recommendations to help strengthen the processes, mechanisms and capacities of and between the Government institutions of the agricultural and forestry sector to improve the effectiveness and impacts of sectoral public expenditures.

### Conceptual Framework

- iv. This study adopts a conceptual framework which seeks to generate and validate empirically some hypothesis regarding the effectiveness of public expenditures in the agricultural and forestry sector in Honduras. For this, the study team develops a general model for Latin American countries, with special attention to Honduras. A key conceptual aspect of this study is to distinguish between three types (or orientations) of public expenditures: public goods; private goods; and goods oriented to reduce poverty and enhance equity. With this classification framework, the study team hypothesizes that each orientation has differential impacts on the growth and equity, and this provides a possible roadmap to recommend a strategic re-orientation of public expenditures in a context of scarce public resources.

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<sup>2</sup> It should be noted that in Honduras there is institutional fragmentation of the overall agricultural, forestry and natural resource management sector, such that they are treated by Government as three separate "sectors", with weak coordination arrangements. This report refers to the agricultural and forestry sector, as one overall sector, given the importance of forestry resources and inter-related linkages with the same rural and agricultural-based households. From an operational and public expenditure point of view, it is important to promote stronger coordination arrangements to help generate sustainable rural growth and poverty reduction through public private partnerships--- a central theme in this report.

v. The study also analyzes diverse characteristics of sectoral expenditures, such as macro and sectoral ministry-level performance (especially involving MOA and SERNA), the relative weight in the total Government expenditures vis-à-vis weights in the sectoral value-added, implementation capacity, composition of expenditures between capital and recurrent expenditures, extent of dependency in donor funding

vi. The study also considers some qualitative aspects, which involve internal (within and between Government agencies) which also explain a large part of the obstacles to generate greater impacts of public expenditures in Honduras' growth and poverty reduction. Problems in execution, dispersion, and inflexibility of expenditures play a key role in the analysis, especially the weak processes to mobilize funds within a medium term expenditure framework. Accordingly, the study combines a quantitative and qualitative methodology, giving special attention to relevant institutional issues, together with a comparative assessment of other countries. It builds on relevant findings from the WDR 2008, which focuses on many of the same themes addressed in this country report.

## **KEY FINDINGS, CONCLUSIONS AND RECOMMENDATIONS**

vii. The conclusions of this report need to be placed within a broader context by considering the implications of recent national and global assessments on public expenditures which helped guide relevant conclusions and value-added recommendations for Honduras' agricultural and forestry sector. Some of the main features and implications of these recent national and global assessments are outlined in this report (e.g., the realities of the severe fiscal constraints facing the country, the need to focus on increased efficiencies, rather than seeking significant increases of public expenditures, the urgent need to strengthen the expenditure management systems and capacities). There are many aspects of the Honduras case study, including the methodological approaches and tools used in this country case study, which may also be used for the analysis and policy design work in other developing countries which are facing similar challenges as Honduras.

### Key Sectoral Constraints, Strategy Thrusts, and Emerging Debate

viii. The study's assessment of the public expenditures for the agricultural and forestry sector, in addition to considering the above national and global reviews, also is placed in the context of addressing cumulative sectoral structural problems inherited from past Government administrations, and in line with the Government's sectoral strategies for the long-term (PESA, 2004-2021), medium term (SOP, 2006 – 2010), and the on-going exercise to update and operational its short-to-medium agricultural and forestry strategy (2008 – 2012), which has a commodity chain focus. This report summarizes the more important sectoral constraints and corresponding strategies which provide a framework for prioritizing sectoral public expenditures. The current main thrust of the Government's updated sectoral strategy focuses on enhancing the operational content and modalities of 4 main strategic themes (food security; productive transformation; competitiveness; and institutional development). These are being linked to the development of differential commodity chain operational strategies, driven by local and international market demand forces, and an expanded role of the private sector.

ix. These strategy thrusts are generally sound, although there is still some debate on the appropriate role of the state to be more consistent with Honduras' stated policies and good international practice (as outlined in the WDR 2008), and with the most effective means to helping to realize Honduras' agricultural and forestry potential. There is some risk that the Government effectively may choose (or push) what to produce ("winners"), rather than enabling producers to make these commodity and enterprise choices, in accordance with market forces. The GoH/MOA-driven updated strategy potentially aims to provide a framework for guiding and prioritizing its sectoral expenditures to address the above mentioned constraints and to help tap substantial unrealized

potential in the sector by diverse stakeholders. The extent to which the operational sectoral strategy takes a programmatic and market-driven commodity chain approach is still under discussion and emerging, with strong political pressures for the Government to generate, and possibly, direct tangible production results in the short-term (especially in the remaining two years of the current administration). There is evidence that recent public expenditure patterns are increasing the amount of transfer payments, including inputs subsidies, as private goods, in response to these short-term pressures to show production results. This is a major issue in the need to ensure that the composition of sectoral expenditures is more consistent with efficient use of public resources, which will affect the Government's ability to meet its own sectoral outcomes. Improving the composition and associated efficiencies of expenditures will also help stimulate expanded private sector investments, in line with the Government's sound emphasis on competitiveness strategies, for achieving more sustainable and equitable growth patterns.

### Key Findings, Conclusions and Implications of the Historical Analysis of Sectoral Public Expenditures

x. The study's historical quantitative analysis of Honduras' sectoral public expenditures was used to better inform and underpin the report's assessment of expenditure trends (level, composition, and quality), criteria and future priorities, and enhanced processes for attaining better governance and sustainable impacts. Some of the main conclusions include:

- a) Honduras has a low orientation index of agricultural expenditure compared to other similar countries --- a low level and share of sectoral expenditure allocations (less than 5% for most years) vis-à-vis the economic importance of agriculture and associated activities (about 40% of GDP), especially considering the cumulative under-investment in addressing various structural constraints and tapping its vast agricultural potential;
- b) Honduras has exhibited relatively low efficiency levels in the execution of its sectoral expenditures, averaging about 60% since the year 2000 ----- and measured as sectoral expenditures as a percentage of the expenditure levels approved by the National Congress. The expenditure rate has increased in 2007 (to about 90%), and it appears that some of the underlying causes of the low expenditure rates of the past are being currently addressed by MOA and other sectoral agencies.
- c) There is a mixed assessment on the composition and quality of sectoral expenditures, as reflected by various indicators: there are under-investments/allocations for public good type of expenditure activities (especially agricultural research and development, phytosanitary services, property rights and land access, key rural infrastructure, forestry regulations; and protected areas). Since 2002 there are increasing trends toward private good expenditures, including: input subsidies (through the "bono nologico"), while there being relatively low producer and consumer price subsidies; there is a relatively high ratio of recurrent to capital sectoral expenditures (about 70:30 ratio), especially if one considers a proper classification of donor-funded expenditures, which in actuality cover portions of recurrent expenditures.
- d) There are about 142 projects in the agricultural and forestry sector (as of 2007), for a total cost of about US\$475 M, an average total expenditure level of about \$50-80 M per year. There is a recent downward trend in expenditure levels, due to a weak pipeline of programs and projects under implementation and preparation.
- e) There has been a relatively high dependency on external donor funding, with about 50-70% (varying by period) of the sectoral expenditures funded by external donors (on a grant and loan basis). The projects tend to be implemented and managed in a fragmented manner, with many of them relying on project management units, especially those which are donor funded, which are not well integrated with the stated strategic programs and services. There is potential scope for retrofitting many of these on-going projects to better support the Government's updated sectoral strategies and targets (e.g., especially regarding the recent competitiveness program

and the commodity chain approach). There is also substantial scope for introducing appropriate harmonization and alignment actions which can enhance the effectiveness, sustainable impact and reduce the transaction costs of sectoral external assistance. With many of these donor-funded projects coming to a close (by 2010), and there is a fiscal challenge for Government to assume a growing share of sectoral expenditures, while at least maintaining the expenditure levels, with increased efficiency (including its composition and decreased transfer payment/input subsidies).

xi. The quantitative analysis explored the potential and limitations of using public expenditure in the agricultural and forestry sector of Honduras to generate sustainable impacts on growth, efficiency and poverty reduction. The study team used panel data compiled by FAO in a comparative study of public spending for 18 countries in the LAC region (1985-2001), to assess the effectiveness of this type of public expenditure. A general model was estimated for the whole dataset of countries and situated Honduras in a comparative ranking, looking at its relative performance in terms of efficiency and equity impacts.

xii. A stochastic production frontier model was derived to assess the impacts of public expenditure on sector growth and efficiency, and a fixed-effect model to estimate impacts on rural poverty. The analysis shows that there is consistent evidence that only the expenditure in public-good-type of investments promote growth and reduce poverty, whereas expenditure in private-good-types are clearly detrimental both to growth and poverty. Finally, there are ambiguous results for the equity-enhancing type of expenditure, with apparently negative effects on growth, positive effects on efficiency and neutral effects in terms of poverty reduction.

xiii. Looking at these results, a recent worrisome trend in Honduras is the increase in private-good type of expenditures, which increased from 20% in 2001-2003 to more than 40% of sector expenditure in 2004-2006. It appears that the allocations for 2008 are increasing this trend, partly driven by MOA's focus on meeting various production targets, rather than focusing on public goods and services which can help generate a multiplier effect of expanded private sector investments. If these type of private good allocations continue to be increased, this would not be the best strategy to promote competitiveness and to reduce rural poverty for this low-middle income country. These are major policy objectives of the Government, so greater consistency is needed in its sectoral expenditures. Given Honduras' pressing macro-fiscal constraints, these historical results would suggest finding more productive ways to leverage scarce public resources.

#### Emerging Framework and Challenges for Enhanced Sectoral Public Expenditures

xiv. The study, including an updating exercise in February 2008, was carried out in close collaboration with the UPEG team of the MOA. With the support of this sectoral PER study, including an important sectoral expenditure planning workshop held in May 2007, the MOA/UPEG team, especially more recently, is endeavoring to promote and coordinate the development of an enhanced and operational framework and governance processes for sectoral expenditures. In mid-2007, the MOA/UPEG team formulated an initial sectoral MTEF (2007-2010), which was used to help guide and formulate the 2008 sectoral budget. The scope of this sectoral MTEF is still limited to the institutions which are under the administrative jurisdiction of the MOA, and which exclude the vital forestry sector agencies and expenditures. The recent passage of the Forestry Law (2007) is leading to a further segmentation of institutional responsibilities, with the vital forestry sector considered as a separate "sector", from the point of view of government administration and expenditures. It is estimated that the Forestry Law will require an additional expenditure of about US\$25 M, to fulfill its new functions. Given fiscal constraints, the new Conservation and Forestry Development Institute (CFI) will need to prioritize its requirements. More recently, the UPEG team is making efforts to formulate a sectoral MTEF (2008-2012), including forestry and other associated Ministries/agencies

which are important to attain sectoral strategies and outcomes, and to use various coordination mechanisms to ensure coherence expenditure priorities (e.g., effective use of national and regional Councils for Agricultural Development/CODAs, strengthening the sectoral roundtable consultation processes, possibly activating a Agricultural and forestry sub-Cabinet, to gain the active support of the President and “core” Ministries such as Finance and the President’s Office).

xv. MOA’s recent updating of the sectoral strategy has identified sound operational criteria for setting expenditure priorities for on-going and proposed sectoral investments, is endeavoring to develop a MTEF which reflects an increasing shift toward a programmatic approach (according to key programs and services, which it has identified), an increasing share of public goods and services in the expenditure composition, and to introduce enhanced participatory and transparent processes and mechanisms for promoting better governance and results for the sector. The key elements of these proposed improvements, and operational methodologies for their appropriate application, are presented in this report, and which are being considered by the Government. At the same time, there are still strong pressures in Government to increase public transfers and input subsidies, while also recognizing the need to improve the targeting and delivery mechanisms, and “exit” strategy to ensure adoption of improved technologies by smallholders will be sustained. These proposed improvements are at an early stage of discussion, and hence there is still an absence of a broad-based consensus on the above improvements by the diverse sectoral ministries, and also strong pressures and vested interests to continue the inclusion of separate and fragmented projects in the expenditure plans.

xvi. Many of these good expenditure practices suggested in this report can be potentially exhibited through the Government’s recent (late 2007) launching of a “Partnership Competitiveness Program” proposal. Currently, it is comprised of three separate but coordinated competitive projects, which focus on promoting complementary public and private sector investments to attain key sectoral goals and targets, with a focus on promoting private sector-driven priority commodity chains. This major program offers some innovative avenues for enhancing both broad-based growth and poverty impacts on smallholders, as well as tapping the potential benefits of implementing the Central American Free Trade Agreement. The content and modalities of this competitiveness program, including the public expenditure composition and modalities for cost sharing, are in the early stages of being developed and launched. Through this program, there are promising steps being taken by MOA leadership to address many of the previous weaknesses in the agricultural and forestry expenditure portfolio, as indicated above, including: taking a programmatic approach to addressing and implementing a competitiveness strategy, adopting coordination mechanisms to enhance harmonization and alignment of the external assistance, implementation modalities, and achievement of common goals. It will be important for MOA to demonstrate its leadership in promoting this programmatic approach for these separate competitiveness projects.

xvii. Hence, an overall conclusion of this study is that Honduras is at a cross-road in formulating, adopting and effectively implementing sound expenditure strategies and programs for the agricultural and forestry sector, which can generate sustainable impacts, if properly managed and facilitated. The decisions and actions taken by its Management over the next 1-2 years will determine which pathway it will take, especially in enhancing the composition and quality of sectoral expenditures. These decisions can also positively influence the momentum and continuity of improvements with the next Government administration, beginning in 2010. A key lesson observed in Honduras is the relatively high transitional costs with changes in Government Administration, so continuity of policy and strategies will be facilitated by a sound sectoral medium term expenditure plan.

xviii. Table 4.1 outlines the summary of the main messages and recommendations arising from this assessment, and which build on good international practices (as reflected in the WDR 2008). The recommendations comprise elements of an action plan which are suggested for consideration by the officials of the MOA, who currently are undertaking the challenge of promoting the transformation of

the agricultural and forestry sector. The action plan is intended to enhance the quality aspects in terms of institutionalizing the promotion of increased efficiency, equity, and sustainable impacts of public expenditures for Honduras' agricultural and forestry sector. The action plan is intended to be updated and adjusted by the Honduran officials, based on implementation experience and learning-by-doing. Finally, it is hoped that the suggested recommendations, many of which focus on enhanced expenditure processes and governance, may also stimulate useful ideas and actions in other countries which are facing and addressing similar challenges.

## I) INTRODUCTION AND BACKGROUND

### A) Introduction

1.1 Given growing evidence and concerns about the role and effectiveness of public expenditures in stimulating sustained growth rates and poverty reduction, in 2006 the World Bank/Agriculture and Rural Development (ARD) and DFID formed a partnership to carry out a global public expenditure analysis for the agricultural sector. It included six country case studies to assess key principles, methodologies and lessons in order to promote improved analysis for sectoral public expenditures to enhance their poverty impacts and technical capacities for such analysis.<sup>3</sup> Honduras is one of the country case studies. The timing of this work also coincides with the opportunity of addressing related expenditure issues and messages highlighted in the WDR 2008, taking them to the country level. The WDR 2008 indicates that developing countries with dynamic agricultural and rural economies (sustained rapid growth, competitive, equitable) demonstrate a good mix, interaction, and coherence of sound policies, institutional arrangements and roles, and sectoral public expenditures.

1.2 The analytical work and report preparation for the Honduras case study was carried out during the period of January – May, 2007.<sup>4</sup> This report provides a synthesis of this earlier expanded report (prepared in Spanish), as well as reflecting an updated assessment based on a recent visit to Honduras.<sup>5</sup> It has been prepared in a manner where this report can serve as a useful document to ARD practitioners in Honduras and other developing countries.

1.3 Some of the contextual issues which underpin the urgent need by the Government of Honduras, with the active support of donors, to address sectoral public expenditures issues in Honduras include the following:

- There are relatively low and erratic agricultural growth rates, and continued widespread rural poverty in Honduras, which the GoH has highlighted as a high priority in addressing more frontally in its national and sectoral<sup>6</sup> development plans and targets
- There is a recently completed Public Expenditure Review (PER) for Honduras<sup>7</sup>, with a focus on the macroeconomic aspects, carried out by the World Bank. It was generally well received by the Government, which intends to adopt many of the recommendations. They also have important implications for enhanced expenditure management in the agricultural and forestry sector. The sectoral PER for Honduras was carried out in parallel to the WB PER, and has endeavored to integrate and adapt relevant recommendations to the agricultural and forestry sector, especially involving improved expenditure management.

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<sup>3</sup> The ARD/DFID Partnership for the public expenditure work is comprised of 3 modules: a synthesis of existing studies (completed); 6 country case studies (in process --- Ethiopia, Honduras, Laos, Nepal, Nigeria and Uganda); and next steps/dissemination of lessons, tools, capacity building.

<sup>4</sup> For the full version in Spanish, see: Honduras: Estrategia para Mayor Eficiencia y Equidad del Gasto Publico en el Sector Agroalimentario (Mayo, 2007), prepared by a team led by R. Anson, and included E. Zegarra, J. Suazo, Jose Hernandez, on behalf of RUTA (and funded by DFID).

<sup>5</sup> The visit by the main author (R. Anson) was carried out in early February, 2008, as part of on-going technical assistance being provided by RUTA (Rural Unit for Technical Assistance) to the Ministry of Agriculture's on-going efforts to update and further operationalize their agricultural and forestry strategy and expenditure program, with a focus on commodity chains.

<sup>6</sup> The agricultural and forestry sectoral plan refers to the "Plan Operativo del Sector Agroalimentario (2006-2010)", Ministry of Agriculture (August, 2006).

<sup>7</sup> See Honduras Public Expenditure Review (World Bank, November, 2007).

- GOH has a functioning Integrated Financial System (called “SIAFI”), which is a key financial monitoring tool used by the Ministry of Finance, and which has contributed to important improvements and transparency in macro-level public expenditure financial management.
- There is a monitoring and evaluation system in the infant stages of development for MOA. Most of the monitoring of expenditures is carried out in an ad-hoc manner, with limited value. There are very few analytical studies which have been able to assess past sectoral expenditures. For those few evaluation studies which have been prepared, they have been carried out by donor agencies to fulfill their own internal requirements. These reports do not appear to be readily available and used (by Government or donors).
- The Ministry of Agriculture’s (MOA) Strategic Operational Plan for the Agricultural and Forestry Sector (2006-2010) (August 2006) showed a large financing gap. While GoH has made some progress in closing this financing gap, this situation highlights the need to develop and reach a consensus on sound and transparent criteria which will help prioritize sectoral expenditures.
- There is an expressed strong demand at the technical level of the agencies in the agricultural and forestry sector to strengthen and integrate the planning and budgetary processes, with the aim of better attaining the agricultural and forestry sector’s strategic outcomes and targets. There is a need for MOA to move toward a program-based approach in its planning and budgetary systems in order to generate more sustainable impacts.
- There appears to be a general consensus among persons familiar with Honduras’ agricultural and forestry sector that there is both underinvestment and mis-investment in the sector, for the historical period reviewed and where data was available (up to 2001 for the analytical model and 2006 for Honduras public expenditure).

## **B) Objectives and Approach**

1.4 This sector expenditure study has two principal objectives:

- Carry out a sectoral public expenditure review for Honduras’ agricultural and forestry sector, as an input for enhancing its efficiency, efficacy and equity, and to improve the prospects of achieving the priority sectoral outcomes outlined in its Strategic Operational Plan (SOP, 2006-2010)
- Provide options and recommendations to help strengthen the processes, mechanisms and capacities of and between the Government institutions of the agricultural and forestry sector to improve the effectiveness and impacts of sectoral public expenditures.<sup>8</sup>

1.5 The study focuses on addressing 3 key questions with regards to the agricultural and forestry sector:

- What have been the results and impacts of past sectoral public expenditures on the agricultural and forestry sector and broader development variables?
- What should be the sectoral public expenditure priorities? And based on which criteria?
- How to improve governance aspects of sectoral public expenditures?

1.6 The study has pursued the following approach and methodology:

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<sup>8</sup> It is noted that the study team’s participatory approach to involving actively GoH counterparts from various Ministries/agencies, including the workshop held on May 5 and 6, 2007, demonstrated the keen interest of Government officials to enhance their technical capacities, if the opportunity is provided.

- Quantitative and qualitative, based on available information, and incorporating good practices adjusted to the Honduras context and requirements
- Participatory, in order to promote sustainability in the analysis and a better management of public expenditures in the agricultural and forestry sector.

### Conceptual Framework

1.7 This study adopts a conceptual framework which seeks to generate and validate empirically some hypothesis regarding the effectiveness of public expenditures in the agricultural sectors of the Latin American countries, with special attention on Honduras. A key conceptual aspect of this study is to distinguish between three types (or orientations) of public expenditures: public goods; private goods; in goods which promote poverty reduction and enhance equity. With this classification framework, each orientation has differential impacts on the growth and equity, and this provides a possible roadmap to recommend a strategic re-orientation of public expenditures in a context of scarce public resources.

1.8 The study also analyzes diverse characteristics of sectoral expenditures, such as macro and sectoral ministry-level performance (especially involving MOA and SERNA), the relative weight in the total Government expenditures vis-à-vis weights in the sectoral value-added, implementation capacity, composition of expenditures between capital and recurrent expenditures, extent of dependency in donor funding

1.9 The study also considers some qualitative aspects, which involve management and coordination requirements within and between Government agencies, and which also explain a large part of the obstacles to generate greater impacts of public expenditures in Honduras' growth and poverty reduction. Problems in execution, dispersion, and inflexibility of expenditures play a key role in the analysis, especially the weak processes to mobilize funds within a medium term expenditure framework. Accordingly, the study combines a quantitative and qualitative methodology, giving special attention to relevant institutional issues, together with a comparative assessment of other countries.

### C) Key Background Information

#### Macro-economic Context

1.10 Key Country Information: Honduras is a low-middle income country, with a per capita income of US\$1,190 and a rapidly growing population (about 2.8% p.a.) which totals 7.2 million (2005). Honduras is one of most open countries of Latin America, where the exports of its goods and services comprise about 40% of its GDP. At the same time, historically Honduras is one of the countries with the lowest economic growth rates. To some extent, this explains why Honduras has made relatively little progress in reducing extensive poverty. Honduras continues to be one of the poorest countries in Latin America, based on various key socio-economic indicators (e.g., it has one of the worst indicators on the quality of education and child nutrition). About 51% of the population is "poor", and 24% are extremely poor. The majority of the poor lives in rural areas, and relies primarily on agriculture. About 60% of the population live in rural areas, and comprise about 60% of the poor, and about 65% of the extreme poor of Honduras. Based on available data, including household survey data, these poverty indicators have not changed much since 1997.

1.11 Some of the main conclusions of the recent World Bank PER includes the following points, which are pertinent for this study:

- Macroeconomic performance since 2004 generally has been “favorable”, but also highlights concerns to sustain and improve these trends;
- There are a number of key policy areas and trends which raise concern, and need to be addressed more frontally, including: a decrease in public revenues; an increase in the operating losses of public enterprises; increases in public sector salaries (especially of teachers); increases in subsidies (especially regarding energy). These trends are contributing to significant fiscal pressures, thereby making it difficult to attain a sustainable fiscal balance. All of this has important and potentially adverse implications for the agricultural and forestry sector.
- There are two key issues which affect the economy and well-being of Hondurans namely: relatively low economic growth rates; and the continued persistence of poverty, which has not decreased much, notwithstanding the significant increases in expenditures to reduce poverty over the past five years (as part of the Government’s Poverty Reduction Strategy Program/PRSP).

1.12 These macro-economic, especially fiscal, trends have two important implications for this sectoral expenditure study: (1) there is a genuine constraint in achieving significant increases in sectoral public expenditures over the next 3-5 years; (2) it is very important that Government (central and local) strengthen their systems and capacities to establish and manage a public expenditure which is efficient and equitable for all key sectors, especially those which impact rural poverty.

#### Synthesis of Sector & Public Expenditure Constraints, Features and Trends

1.13 The Government’s Strategic Operational Plan for the Agricultural and Forestry Sector (2006) (SOPA) was formulated to address the following key sectoral constraints:

- Deficient sectoral policies and strategies
- Low, erratic and highly inequitable growth in agricultural value-added
- Diversification of agricultural production, with its promising commodities (vegetables, tilapia) are in their infant stages
- There is a high degree of fragmentation and low degree of formalizing agrarian property rights, together with extensive underutilization of agricultural land
- There is a high concentration of poverty in rural areas (60% of the total poverty), accompanied by food insecurity
- Rural asset ownership is highly inequitable
- The production structure is limited, non-competitive and low-value added (with a focus on grains)
- There is a high degree of institutional weaknesses, including deficient coordination at the agency and field level, together with deficient services to farmers

1.14 One of the main characteristics of public expenditures in the agricultural and forestry sector of Honduras refers to its growing instability and volatility. At the institutional and project levels, there are contrasting periods of increases in expenditure with periods of significant decreases. Although in general terms, the per capita sectoral expenditures is low relative to other countries in Central America, this characteristic is affecting the Government’s institutional capacity to support effectively the allocation of public funds and the sustainability of programs and projects in the medium to long terms.

1.15. The study team observed that there is a general consensus among persons knowledgeable of Honduras’ agricultural and forestry sector that there are numerous factors which explain these characteristics and trends. They also highlight the need for coherent and coordinated

appropriate responses. GoH/Ministry of Finance has a budgetary and investment policy at the macroeconomic level, but it is not disseminated and well understood by the other Ministries, local government and private sector. The study team observed that the investment priorities are: (a) not coherent or consistent with the Government's main policies for the sector; (b) not consistent with the priorities of many of the target groups in various regions of the country (which is reinforced by the general lack of explicit territorial criteria for helping to allocate expenditures); (c) not making a clear distinction between public and private goods which enable a growing share toward public goods; (d) the criteria for setting institutional and sectoral targets are relatively arbitrary, which do not result in the proper allocations; there is an alignment problem in the allocation of expenditures with existing programs and services in the MOA and SERNA (which serve as sectoral coordinating entities).

### Government's Sectoral Strategies, Targets and Institutional Architecture

1.16 As background to formulating a sectoral expenditure framework, this section summarizes the current Government's sectoral strategies and targets. The current administration defined three sector policy objectives: (a) achieving productive transformation; (b) achieving significantly enhanced food security; and (c) frontal fight against poverty. The MOA, in its Strategic Operational Plan (SOP) for the Agricultural and forestry Sector (2006-2010) takes on similar objectives and defines a strategic action plan to achieve the objectives and corresponding targets, together with a complementary institutional reform strategy, consistent with its stated programs and services, and a program-based approach (PBA). In the short to medium terms, MOA is taking a sub-program-based approach, based on focusing on 4 strategic subsectors.

1.17 The Government's sector objective is to promote and consolidate a modern agricultural and forestry sector, diversified, efficient, competitive and environmentally sustainable, and which promote vertical and horizontal integration and value-chains, which will be key elements in poverty reduction and enhanced food security. To achieve these goals, there is a need to attain a production structure and level which are consistent with its comparative advantages, and internal demand for food and primary goods, which promote jobs with dignity, a significant increase in the incomes of the rural population and contributes to enhance external trade balance.

1.18 The sectoral objectives of the SOP include (and also give a clear indication of the sectoral expenditure priorities):

- Value-added agricultural growth with greater equity of at least 4% p.a. during the period 2006-2010
- Reduction in extreme poverty for the rural population which corresponds to two percentage points per year
- Generation of productive employment of about 50,000 per year, and reduction in under-employment in rural areas
- Contributing to the goal of reducing child malnutrition from 29% to 22%
- A growth rate in the value of exports of the agricultural and forestry sector of at least 6% per year.

1.19 The strategic outcomes of the SOP include (and which should provide a clear "road map" for sectoral expenditure allocations):

- Increases in production and productivity, giving priority to smallholders
- Development of human resources and capacities, giving priority to smallholders
- Integration and development of the agro food chains organized according to commodity groups

- Enhanced trade competitiveness in order to reach a solid position in the free trade agreements (especially the DR-CAFTA), which will translate into a significant increase in exports
- Development and strengthening of agriculture in the context of the Honduran economy
- Improvement the well-being of the rural population
- Strengthening the organization of producers and ethnic groups

1.20 Following the formulation of the SOP, the Ministry of Agriculture took a further step by formulating specific physical targets for agricultural production (e.g., area cultivated, production levels for various commodities). MOA still needs to define clearly the respective roles of the public and private sectors in achieving these production targets, as well as the “rules of the game” and standards, consistent with the stated policy of the Government’s role focusing on creating an enabling environment for expanded private sector investment. This clarification is also vital to identify the types of public expenditures which would be appropriate for the agricultural and forestry sector.

1.21 The current institutional architecture for the agricultural and forestry sector involves the following key institutions and coordinating mechanisms, which also has important implications for how the sectoral public expenditures will be managed:

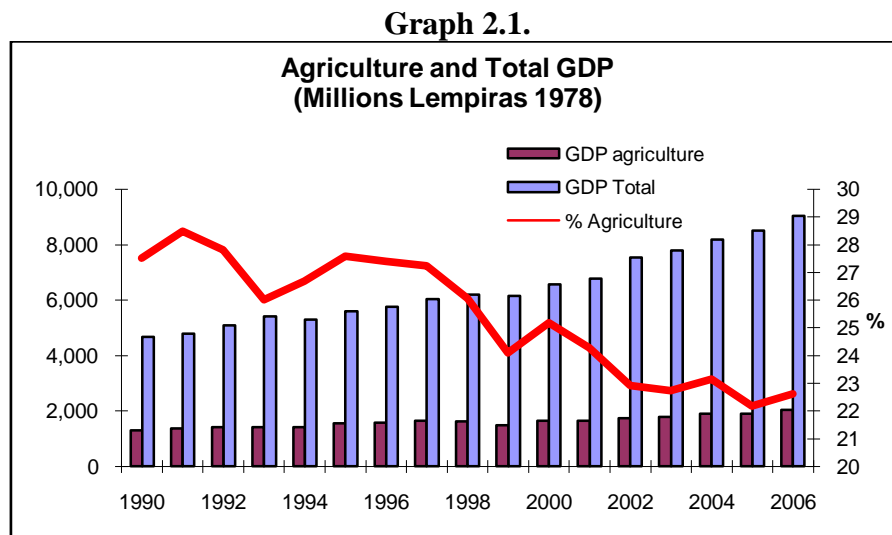
- Ministry of Agriculture: It has the main responsibility for coordinating the sectoral policies, strategies and formulating and executing key programs and services (with a presumed expanded role of the private sector).
- Ministry of State Forestry, with its State Forestry Agency: The recently approved Forestry Law (October 2007) is establishing a new Ministry of State Forestry, but its operationalization is still subject to the formal approval of the Law’s new regulations (still in process).
- Ministry of Environment and Natural Resources: It has primary responsibility for ensuring adequate environmental standards and compliance by all Ministries and private sector, as well as responsibility for coordinating the protected area policies, strategies, and programs.
- An Agriculture Roundtable and a separate Forestry Roundtable (they used to be integrated in one roundtable), which endeavors to bring together the various actors (public and private sectors and donors) to exchange information and coordinate programs, to the extent possible. These sectoral roundtables are part of a country-level roundtable system, which operate with common principles and guidelines, coordinated by the President’s Office
- A recently established Counsel of Agricultural Development (CODA), which involves the Government’s agricultural and forestry sector agencies, and which endeavors to coordinate sectoral policies, strategies and public expenditures, chaired by the Minister of Agriculture, and comprised of other sectoral Ministers and heads of agencies. It has decision-making powers, unlike the above mentioned roundtable system. There is a national level CODA, as well as regional CODA’s, which are intended to facilitate coordination of strategies and investment programs at the field level.

1.22 As will be outlined in Chapter 3 of this report, one of the major weaknesses in the agricultural and forestry sector of Honduras is the absence of clear, complementary and effective institutional roles, capacities and coordination mechanisms. These weaknesses, if not addressed adequately, will seriously impair the formulation and implementation of strategic public expenditures. Based on an assessment of international good practices, and Honduras’ specific sectoral PER institutional capacities and experiences, Chapter 3 and the recommendations (in Chapter 4) of this report also endeavors to highlight a strategy framework and action plan for addressing these institutional weaknesses.

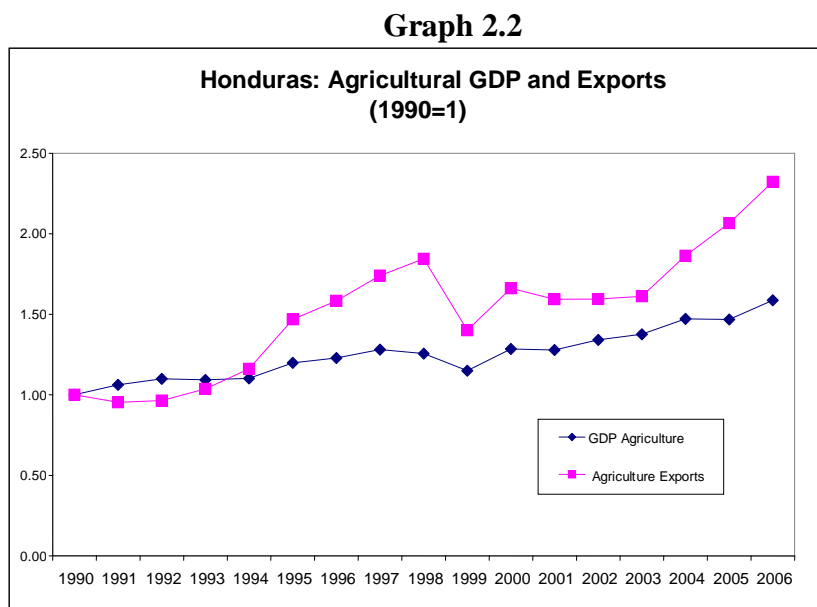
## II) HISTORICAL ANALYSIS OF PUBLIC EXPENDITURES IN THE AGRICULTURAL AND FORESTRY SECTOR (1985-2006)

### A) Structure, Composition and Evolution of Agricultural and Forestry Public Expenditures

2.1 The evolution of agricultural GDP in Honduras showed a modest rate of growth during the 1990s (only 1.6% yearly in average in 1990-99), but a clear acceleration since year 2000. The sector has been losing its share in total GDP from about 28% to 23% as shown in Graph 2.1., although it still comprises about one fifth of total GDP.



2.2 The average rates of growth have been 4.8% for 2000-2005. This performance has been strongly influence for the recent evolution of agricultural exports (graph 2.2)

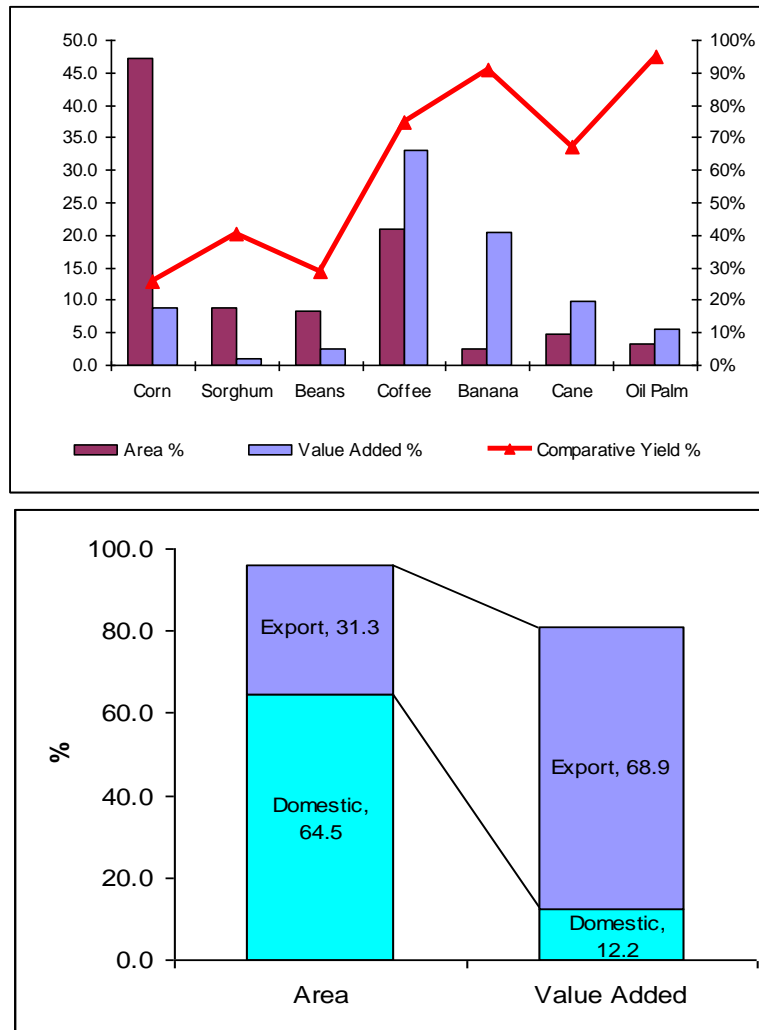


Source: Banco Central de Honduras

2.3 This export dynamism has been accompanied by some changes in the composition of exports. For instance, five products which in 1990 represented only 5% of sector exports, palm oil, shrimps,

legumes, horticulture, and melons, summed up 34% of sector exports in 2006<sup>9</sup>. This favorable evolution in the external front stands in clear contrast to a sluggish sector oriented to the domestic market, featured by low efficiency and low farmers incomes. An indication of this is the yield of some of main Honduras agricultural products in comparison to other world producers. In this case, we see that crops oriented to domestic markets have relative yields substantially lower than export-oriented products (graphic 2.3, top). Likewise, a measure of these differences can be assessed looking at the distinct proportion between cropped area and value added of domestic versus export oriented crops (graph 2.3, bottom).

**Graph 2.3**  
**Proportion of cropped area and Value Added of**  
**Main agriculture products in Honduras**  
 (% of sector total)



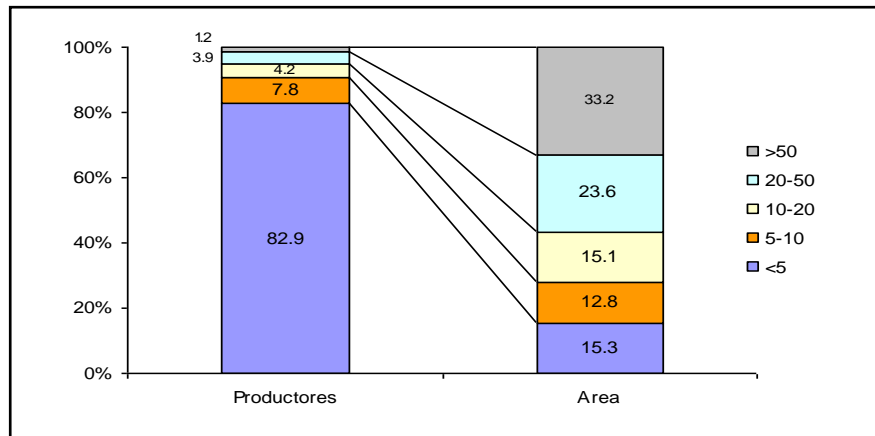
The compared yield refers to the percentile (between 0 y 1) that the yield of a specific crop occupies if compared to the average yield of the same crop for the rest of countries in the world.  
 Sources: FAO, SAG

2.4 This important gap in efficiency and productivity among sub-sectors is of key importance as most Honduran agriculturalists have low income and orient their production to the traditional crops to

<sup>9</sup> The rate of annual growth of these products range from 14% for cultivated shrimps to 121% for palm oil. Accordingly, these products have displaced traditional export products like sugar, lobsters and pineapple in Honduras' agricultural exports.

the domestic market in conditions of low productivity and high land fragmentation: 90% of producers have only 28% of total agricultural land, with an average size of 2.4 hectares (graph 2.4).

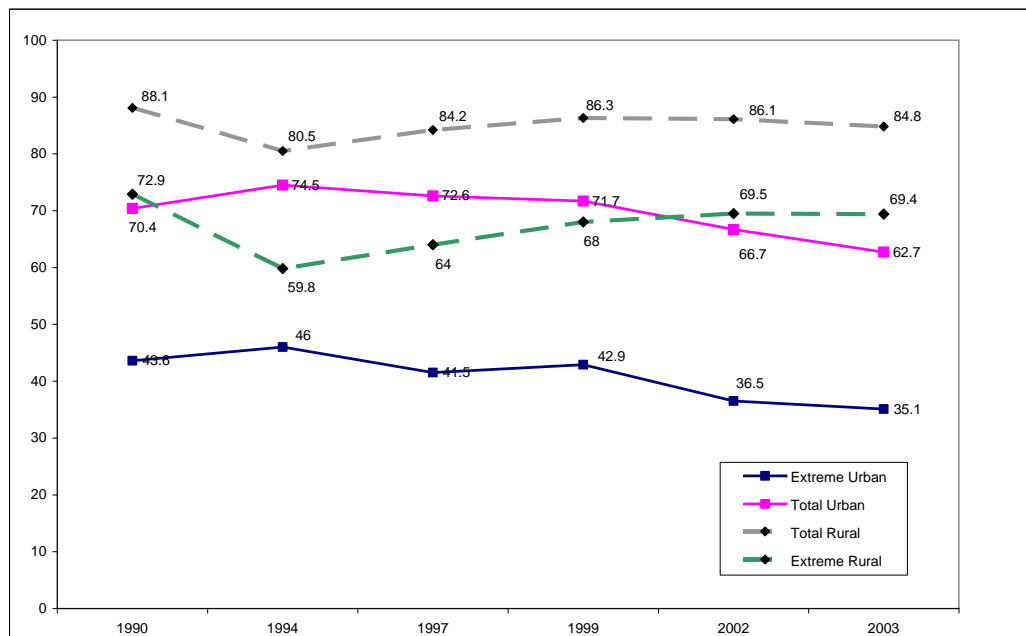
**Graph 2.4.**  
**Producers and agricultural land, by size**  
**(% of total)**



Source: Arthur D. Little, "Estimado de apoyos al sector agropecuario de Honduras 2000-2003" (Estimated Direct Support to the Agricultural Sector of Honduras 2000-2003)

2.5 One of the most visible consequences of this acute fragmentation of land and assets, and of the low productivity of the sector is a widespread prevalence of poverty among Honduran rural population, which in 2003 reached about 85% (graph 2.5). Moreover, in that year almost 70% of rural inhabitants were considered as "extreme poor". The most worrisome of this is that rural poverty showed a rising trend since 1994, trend which has been only very slightly reversed since 2003.

**Graph 2.5:**  
**Population in poverty and extreme poverty**  
**(% of total)**



Source: CEPAL

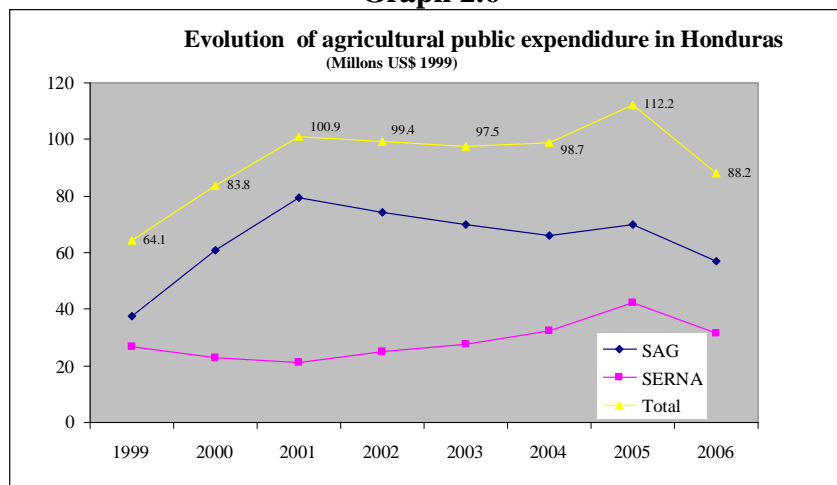
2.6 Honduran agricultural sector faces really big challenges in terms of efficiency and equity. The higher commercial opening related to CAFTA makes these challenges even greater, as the country will be abandoning traditional policies of trade protection for the agricultural sector to concentrate in an

internal agenda of higher competitiveness. This makes agricultural public expenditure of greater importance to enable the country and its various groups better able to face these challenges, and benefit from them. If this expenditure is well oriented and articulated in accordance with sound sector policies, it could promote more productive efficiency, higher incomes and a sustainable reduction in poverty and inequality in the rural sectors of the country. Sound sectoral public expenditures can become an important tool for helping to promote these objectives.

Selected Features of Agricultural Public Expenditures in Honduras

2.7 For the purpose of this paper the study team defined agricultural and forestry public expenditure as any budgetary allocations to the Ministries of Agriculture (MOA) and Ministry of Environment and Natural Resources (SERNA) in Honduras. The evolution of total public expenditure in Honduras since 1999 is shown in graph 2.5). We can see an important increase in 1999-2001, a stagnant period 2002-2004, and a sudden raise in 2005, with an equally drastic drop in 2006.

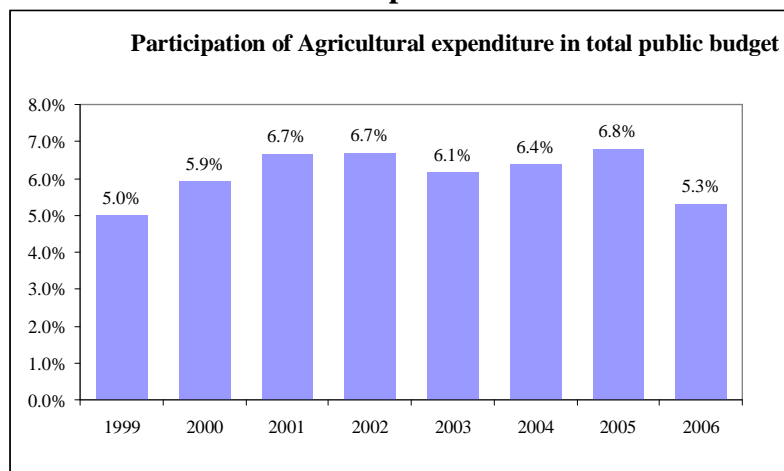
**Graph 2.6**



Source: World Bank, Honduras Public Expenditure Study (2007)  
 SAG: Ministry of Agriculture (Secretaria de Agricultura)  
 SERNA: Ministry of Natural Resources (Secretaria de Recursos Naturales y Ambiental)

2.8 The share of the agricultural sector in total expenditure has ranged from 5% (1999) to 6.8% (2005), as can be seen in graph 2.7. The drop of 2006 meant that its participation was only 5.3% in year 2006. This contrast with the share of agricultural in the total economy which is estimated in about 23% (see graph 2.1)

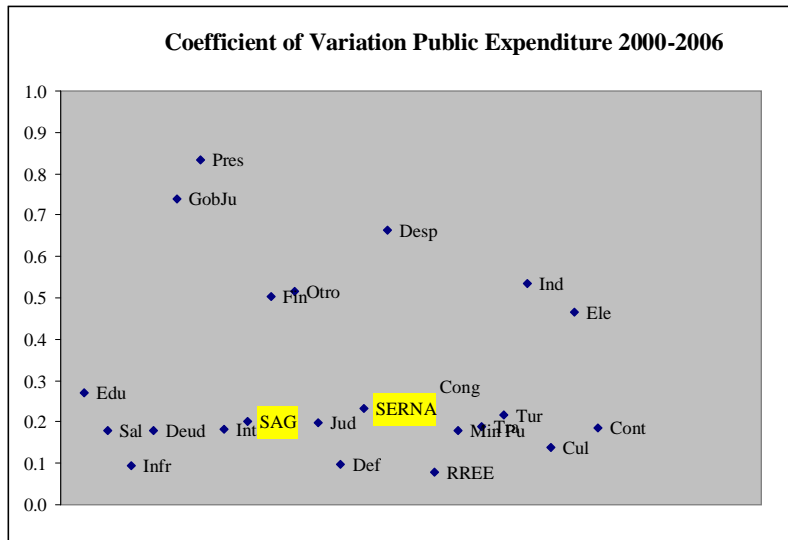
**Graph 2.7**



Source: World Bank, Honduras Public Expenditure Study (2007)

2.9 Although these percentages of the agricultural sector do not reflect the share of agriculture in the economy, this are not necessarily low as the sector occupies the fifth place in participation after education, health, infrastructure and debt interests. With respect to the variability of the expenditure (measured as the variation coefficient in real expenditure 1999-2006) graph 2.8 shows that the expenditure of SAG and SERNA were not the most volatile, locating more in the lower range of annual variability.

**Graph 2.8**



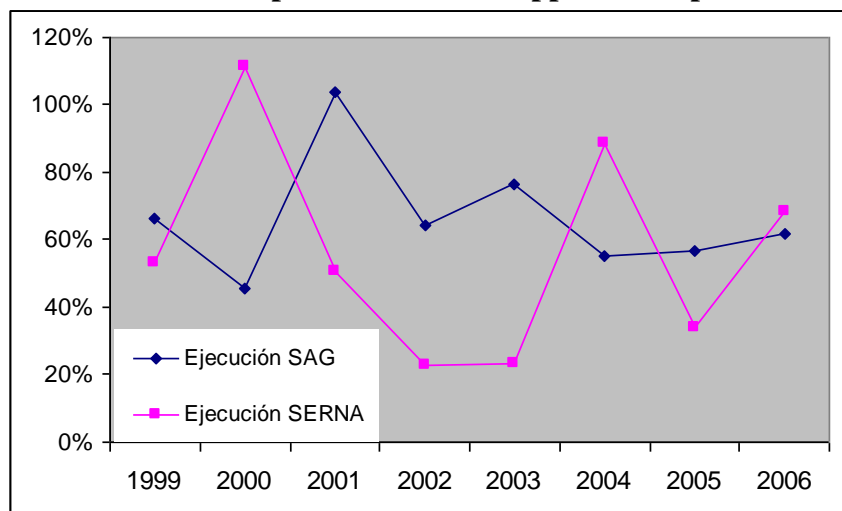
Source: World Bank, idem (2007)

2.10 In general, public expenditure oriented to agriculture has been relatively important and not too volatile, at least up to 2004, with a sudden increase in variation in 2005-2006.

Limited Execution Capacities of Sectoral Agencies

2.11 Graph 2.9 shows the erratic and relatively weak implementation capacity (actual public expenditures vs. approved public expenditures) of SAG and SERNA.

**Graph 2.9**  
**Actual Public Expenditure versus Approved Expenditure**



Source: SIAFI-SEFIN

2.12 During the period reviewed (1999 – 2006), SERNA has shown an average execution rate of about 78.4%, whereas the MOA has achieved an execution rate of only 73%. It is noteworthy that the MOA had a large decrease in the execution rate in 2003 (only 60%), probably because it was the same year when the MOA had a large increase in its approved budget. In the subsequent years, the MOA showed a higher rate of execution, but with a significantly lower approved budget. There are various underlying causes of this relatively low execution rate, including:

- Delays in the disbursement of budgetary funds by the Ministry of Finance to the sectoral ministries (which in turn reflect macro-financial constraints and budgetary system weaknesses)
- Difficulties in complying with the various donor requirements involving procurement and administrative procedures (and which vary amongst different donors, adding another constraint)
- Some internal institutional weaknesses involving the various executing agencies (including weak implementation plans), compounded by a weak monitoring system to track the delayed disbursements of approved funds.

2.13 In general, this limited execution capacity involving both Ministries affects seriously the potential effectiveness of the expenditures. On the one hand, with low execution rates (of approved funds) it will be difficult for these sectoral ministries to mobilize additional public funds from the Ministry of Finance. And on the other hand, this low execution rate means that planned programs and activities are not implemented (or delayed), which results in a negative (and delayed) results of intended impacts. This means that improving the execution rates of the MOA and SERNA require concerted improvements in the budgetary planning and implementation processes on the part of both the Ministry of Finance and the MOA.

#### Recurrent and Capital Expenditures

2.14 The breakdown of capital and recurrent actual expenditures (for recurrent and capital items) for the MOA and SERNA are shown in Table 2.1.

**Table 2.1 Composition of Agricultural and Forestry Expenditures**

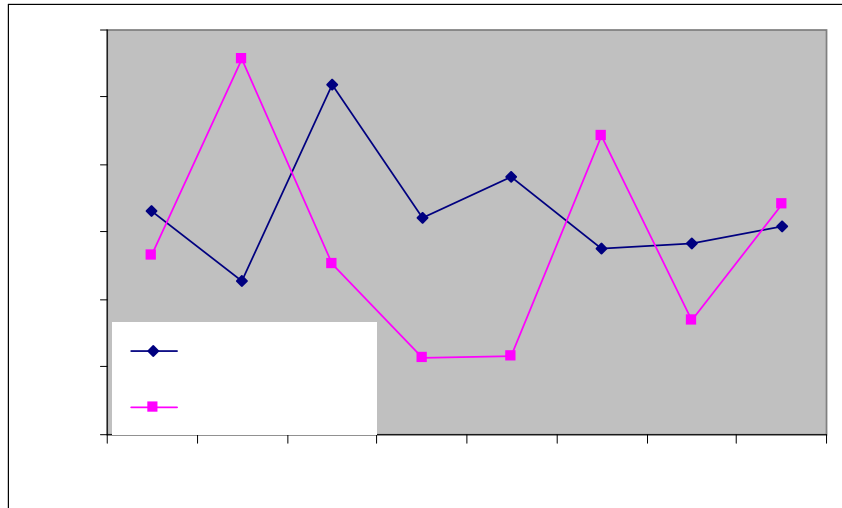
|                                  | 1999         | 2000         | 2001         | 2002         | 2003         | 2004         | 2005         | 2006         |
|----------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| SAG                              |              |              |              |              |              |              |              |              |
| % Operational                    | 79.2%        | 78.7%        | 25.6%        | 37.6%        | 47.3%        | 35.3%        | 41.6%        | 48.6%        |
| % Capital                        | 20.8%        | 21.3%        | 74.4%        | 62.4%        | 52.7%        | 64.7%        | 58.4%        | 51.4%        |
| SERNA                            |              |              |              |              |              |              |              |              |
| % Operational                    | 19.7%        | 18.2%        | 27.8%        | 67.1%        | 23.8%        | 18.2%        | 22.7%        | 19.9%        |
| % Capital                        | 80.3%        | 81.8%        | 72.2%        | 32.9%        | 76.2%        | 81.8%        | 77.3%        | 80.1%        |
| <b>AGRICULTURAL AND FORESTRY</b> |              |              |              |              |              |              |              |              |
| <b>% operational</b>             | <b>54.7%</b> | <b>59.9%</b> | <b>26.1%</b> | <b>43.2%</b> | <b>41.3%</b> | <b>29.5%</b> | <b>33.4%</b> | <b>33.8%</b> |
| <b>% Capital</b>                 | <b>45.3%</b> | <b>40.1%</b> | <b>73.9%</b> | <b>56.8%</b> | <b>58.7%</b> | <b>70.5%</b> | <b>66.6%</b> | <b>66.2%</b> |

Source: SIAFI-SEFIN

2.15 With the exception of 2002, SERNA has shown a greater proportion of its expenditures allocated to capital expenditures relative to the SAG. Taken together for the sector, the percentage of total sectoral expenditures allocated to capital expenditures has been relatively high, ranging between 40% (in 2000) and 74% (in 2001), and which has been increasing over time (since 1999). Nevertheless, this high proportion is associated with the existence of numerous donor-funded projects which are classified as capital expenditures in the Government accounting system (even for expenditures which are really recurrent expenditures, based on international standards).

2.16 This high proportion of donor-funded projects in the agricultural and forestry sector is also linked to the above mentioned constraints in the execution of expenditures faced by both Ministries during the period of analysis. This is reflected in Graph 2.10, which shows an execution rate of 66% in investment projects from the MOA, and of only 56% for projects from SERNA, during the period 1999 – 2006. In the following section, there is a more detailed analysis of the portfolio of on-going projects and programs with external funding in both Ministries, and which provides a better explanation of the underlying factors of these figures.

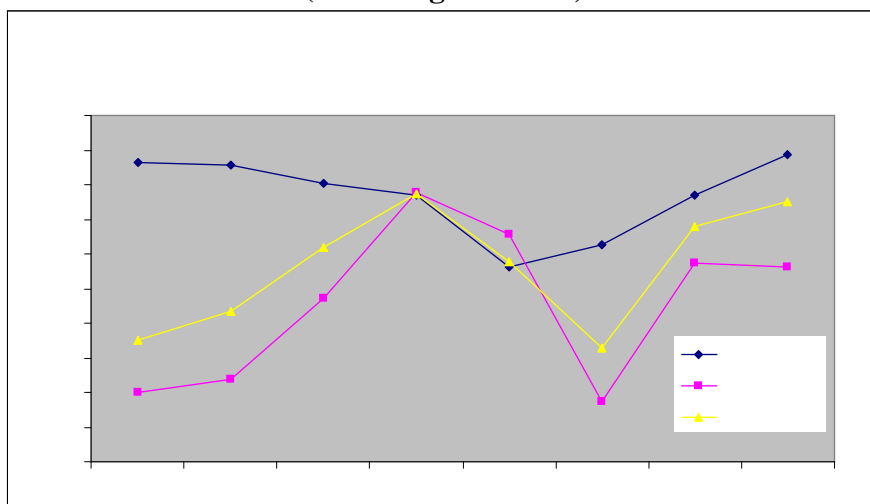
**Graph 2.10**  
**Approved Budget Execution Rate by Ministry**



Source: SIAFI-SEFIN

2.17 With regards to expenditures on salaries, Graph 2.11 shows these allocations as a percentage of total sectoral allocations for the two Ministries, excluding transfer payments.

**Graph 2.11: Share of Salaries of Total Expenditures**  
**(excluding transfers)**



Source: SIAFI-SEFIN

2.18 Graph 2.11 shows that the average proportion of total expenditures allocated to salaries has been about 77% for SAG and 46% for SERNA, with an average of about 56% for the period 1999 – 2006. Moreover, the Graph shows that the percentage has been increasing steadily and significantly in the MOA since 2003, reaching a high figure of 80% of total public expenditure allocations to SAG.

In SERNA, this proportion has been below the maximum rate of 72% reached in 2002. It was found that this category of salaries in the accounts of the Ministry of Finance reflects the salary expenditures of the central administration, and not the allocations for decentralized programs and projects, which are generally classified as capital expenditures. This trend toward higher proportion of expenditures in salaries will be identifying a greater rigidity in the non-salary expenditure capacity of the MOA, due to a higher labor pool, at least at the central level (and excluding subsidies).

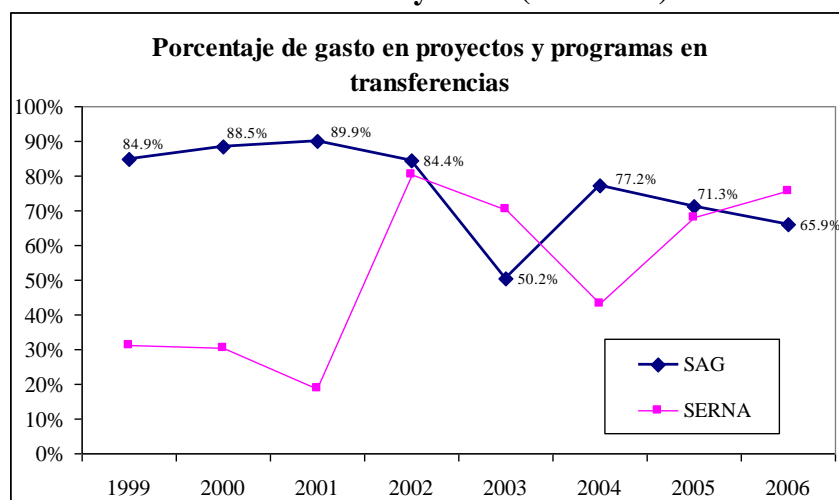
### Analysis of Program and Project Expenditures

2.19 One of the advantages of the analysis of the expenditure data generated by SIAFI is that it has been able to isolate specific expenditures in terms of projects and programs, which enables a more detailed analysis of the effectiveness of sectoral agencies, as well as being able to classify the expenditure according to the types of interventions (and in line with the definitions developed in the conceptual framework of this chapter).

2.20 Table A2.2 shows the average annual expenditure (in constant US\$) in programs and projects of all of the sectoral agencies for two periods: 1999-2002 and 2003 – 2006. The expenditures executed in programs and projects have been maintained at about the same level in real terms (about US\$42.0 M). During the first period (1999 – 2002), these expenditures represented about 45% of total sectoral expenditures, whereas in the period 2003-2006 this expenditure represented about 60% of total sectoral expenditures. This reflects an increased importance of programs and projects in total sectoral expenditures. In addition, it can be observed that there are a growing number of sectoral agencies which incurred expenditures in programs and projects during the period 2003 – 2006. In both periods, the percentage of execution (relative to the approved expenditures) shows a lot of variation, and a relatively low average. This reflects some inefficiency factors in the management of sectoral expenditures (from the perspective of Ministry of Finance, SAG, SERNA and other executing agencies). These trends are further explained below.

2.21 It should be pointed out that the MOA and SERNA execute the major portion of their projects and programs, although in many years these Ministries make transfer payments to decentralized agencies, which are the ones which execute the projects and programs (see Graph 2.11).

**Graph 2.11: Percentage of Project/Program Expenditures For Transfer Payments (Subsidies)**



Source: SIAFI-SEFIN

2.22 Regarding the financing sources for projects and programs, Table A2.3 shows the composition according to external (i.e. from donors) or internal funding sources, during the period 1999 – 2006. On average about 70% of these total expenditures is financing through external sources (loans or

grants), whereas about 30% is financed by the Government (generally as counterpart funds). Only in the case of BANADESA (state bank) and DICTA (refers to Directorate of Agricultural Technology) is there an internal financing plan, although the expenditures of these agencies for projects are relatively small.

## **(B) Agricultural Public Expenditure: Building a Typology**

2.23 The agricultural sector has special features. Agricultural activities are developed by a large number of individual producers, dispersed throughout the territory and which results depends on climatic and biological processes only partially controlled by human action. To design and to implement public policies for the agricultural sector is very different than doing it for urban and industrial sectors. Any intervention in agriculture must be extended across an extensive territory and must consider that are the producers who finally take decisions according to their knowledge, technology and market restrictions.

2.24 The State has a range of potential instruments to intervene in the agricultural sector. There are macro instruments like import duties or export subsidies, or tax policies, which are able to alter relative prices or to change incentives for production, exports and investments. Likewise, there are normative instruments who seek to change or generate new rules for the sector's operation. In this study we focus on another important instrument for the agricultural sector: the policy of public expenditure, which will be interacting with other macro and sector policies, and with private sector decisions. Public expenditures could be direct transfers—like subsidies—or could be in the form of expenditure in public entities and programs which—in theory—will generate goods and services for the rural and agricultural population.

2.25 Within the broad definition of agricultural public expenditure there are diverse goals, types and ranges of intervention. It is important to classify alternative forms of public expenditure, which we will call expenditure orientation. One traditional way of classifying agricultural public expenditure has been according to the “object of intervention” in relation to the agro-economic process, like if the expenditure is oriented to influence the stage of pre-production, production or post-production. This type of “productionist” classification has been extensively used by Ministries of Agriculture in Latin America, giving also clues in the way in which these entities are organized. However, this approach has limitations. For instance, it leaves out interventions which are likely to influence all stages of production at the same time. Also, it may hide the role of policies which are not directly targeted to affect productive processes but to generate greater investment security, to give more information or to assure agro-sanitary conditions to producers in general.

2.26 For these reasons, we use an alternative way of classifying public expenditure as first suggested by López (2004), which is more related to the type of economic good or service which is produced by the public intervention. Extending López idea, we will identify up to three possible types of public expenditure. A first category is related to what Lopez calls “private goods”. Private goods have the feature that their benefits are appropriated privately, after produced these are used by direct beneficiaries to increase their incomes, reducing the stock of the good or service for other potential users, and not producing positive externalities on non-participants. As these benefits are privately appropriated, their provision could, in theory, be generated by private investors, who will charge the direct beneficiaries according to the additional income generated. Public interventions in which direct subsidies are given to producers or in which inputs or goods are directly provided to them, like fertilizers, technical assistance or subsidized and targeted credit, will fall under this classification.

2.27 The second type of expenditures identified by López is in “public goods”. Differently from private goods, in this case benefits are not directly appropriated by a specific group of direct beneficiaries but are potentially usable by a general type of users who do not necessarily are restricted

by the type of good or service being generated. This feature of “low exclusion” mutes incentives for private investors in providing these goods as they could not recover their investments charging beneficiaries. An interesting feature of this type of goods is that these do generate external effects (externalities) in addition to the ones gotten by direct beneficiaries. Goods like rural roads, rural titling, information, agro-sanitation are generally located under this category.

2.28 Finally, going further than López definitions, the study team identified a third type of goods which may be generated by public expenditure, which we will call “goods for equity” or “for poverty reduction”. This type of expenditure make sense where markets do not work well and the private sector alone have problems generating conditions of equity in the access to technology and to key markets by heterogeneous producers. Under these conditions, it is possible for the State, using public expenditure, to warrant conditions of higher access to markets or technologies for poor producers. Interventions of this type are generally oriented to mitigate financial and technological constraints, like allocating key assets to small producers or providing conditions for better access to basic services in the finance, technology and insurance markets.

2.29 We will expect that these interventions will have impacts on equity and poverty reduction, although effects on growth could be neutral or negative in the short run, as beneficiaries (poor producers) may not be able to exert immediate changes in their levels of efficiency and technology adoption. However, if the interventions are successful, it is likely that positive effects on growth could occur in a longer run, as poorer producers can surpass barriers for accessing markets or have less vulnerability for investing in more profitable and productive activities.

2.30 This general classification, as any other, may be debated, as it cannot reflect all possibilities, or in the sense that there are important gray areas among the three definitions when a general classification must be done with available data. However, besides its classification usefulness, this approach has a key advantage from our point of view, which applied empirically, it could be useful for taking strategic decisions about the basic orientation of the public expenditure in agricultural sector.

2.31 In this study we hypothesize that there are differential effects of public expenditure according to these three categories. On one hand, we consider that public goods have the higher potential to generate both more growth and equity in the agricultural sector; whereas expenditure in private goods types is the one with lowest expected impacts both in equity and also in growth (as it tends to substitute private investments). Finally, expenditure in pro-poor or pro-equity programs may have ambiguous impacts on short term growth but should show positive effects on poverty reduction and indicators of equity in rural areas. We also think that this expenditure may have positive impacts on growth in the long term.

2.32 It is important to say that the effectiveness of public expenditure may influence other additional factors besides this general orientation. In particular, some institutional factors or rigidities can be equally or more important when explaining impacts on sector indicators. A public sector with problems to generate programs and projects which are effective will be a problem with or without a favorable orientation in the public expenditure. Likewise, if expenditure is too volatile or is too fragmented, or it is basically oriented to current expenditures instead of capital investments, may be important factors which are to be considered in a more integral analysis.

2.33 The first level results of applying this classification framework for the agricultural and forestry sector of Honduras is presented in Table 2.2, in terms of generating an average for two periods (1999 – 2002 and 2003 – 2006), based on available data.

**Table 2.2: Orientation of Program/Project Expenditures (US\$ 000s)**

|                              | 1999-02 |        | 2003-06 |        |
|------------------------------|---------|--------|---------|--------|
|                              |         |        |         |        |
| Private Goods                | 11,102  | 25.7%  | 18,788  | 38.7%  |
| Public Goods                 | 22,804  | 52.8%  | 18,984  | 39.1%  |
| Equity and poverty reduction | 9,296   | 21.5%  | 10,743  | 22.1%  |
| TOTAL                        | 43,202  | 100.0% | 48,515  | 100.0% |

Source: Data from SEFIN-SIAFI and Annex 1 for details on the categories

2.34 As can be observed, the expenditures in private goods showed a significant increase during the period 2003-2006, whereas the expenditures oriented toward promoting equity and poverty reduction were maintained more or less constant in percentage terms. While there is some judgment in the classification methodology applied to the available expenditure data, the basic pattern is likely to remain the same. In the section below, the report presents quantitative evidence regarding the appropriateness of this expenditure orientation in terms of being able to promote growth and equity in the agricultural and forestry sector of Honduras, drawing on cross-country information.

### C) Empirical Estimations: Emerging Impacts of Sectoral Public Expenditures

2.35 The study team used a theoretical model (described in [Annex 1](#)) that links agricultural public expending to agricultural growth and poverty reduction. The data used for the estimation is based on GPRural, a database built by FAO with information gathered in 18 Latin American and Caribbean countries between 1985 and 2001.<sup>10</sup> Honduras is included in the data, along most countries from Central America.

#### Impacts on sector growth and efficiency

2.36 The results of the estimated model for impacts on agricultural GDP and technical efficiency are presented in Table A1.2. Public expenditure oriented to public goods has a positive and statistically significant impact of 3.2% in agricultural product, while expenditure in private goods has a negative effect of -1.5% which is not statistically significant at 90% of confidence level. On the other hand, expenditure in equity-enhancing goods shows a negative and statistically significant effect of -1.2% on agricultural growth, which can be interpreted as a short term impact, as the same estimation shows that this type of expenditure is having a positive effect on technical efficiency (farmers becoming more productive with given resources) which can be interpreted as a long term effect (as fixed resources become mobile). The expenditure in private goods, by the contrary, keeps a negative effect on technical efficiency (now statistically significant) which suggests that this type of expenditure is not appropriate neither for growth nor efficiency both in the short and long run.

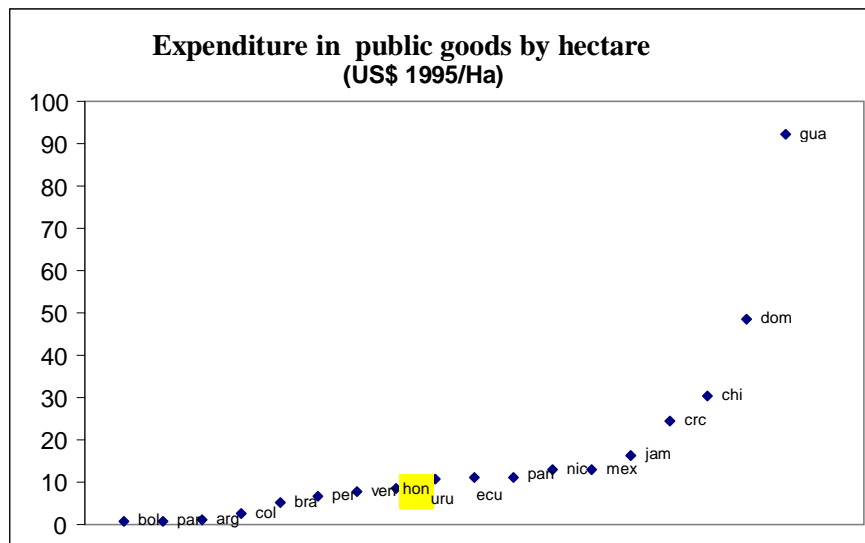
2.37 Other results in the estimation are that domestic demand (lagged per capita GDP) plays an important role in sector growth. The measure of trade openness, on other hand, has an adverse effect on growth, especially in the context of declining agricultural prices due to increasing subsidies to agriculture in rich countries during the 1990s. It must be mentioned that these types of effects may have reversed in the last five years (2002-2006) which is not considered here given the structure of the data of GPRural.

<sup>10</sup> It was not possible to gather together the relevant data to update the analysis up to 2007. Accordingly, it was not possible to properly integrate the available data from SIAFI, and therefore, the study team used the available FAO data to ensure internal consistency.

2.38 Similar results were obtained under different specifications, so we consider that these have quantitative support. In addition, the results are compatible with the ones obtained in a more general analysis of the same data and using a simultaneous equation approach by Santos and Ortega (2006). Also, similar results were obtained in a paper on agricultural expending in the Andean Community.<sup>11</sup>

2.39 The empirical results enable us to situate Honduras in a ranking of 18 countries in the region according to relative performance of agricultural public expenditure in the period 1985-2001. A first question to answer is whether Honduras agricultural expenditure in public goods (which are the most effective for promoting growth) has been relatively low or high in this regional context. For answering this we constructed an indicator of agricultural expenditure per hectare for each country (Graph 2.13) and also divided by US\$ 1,000 of agricultural GDP.

Graph 2.13

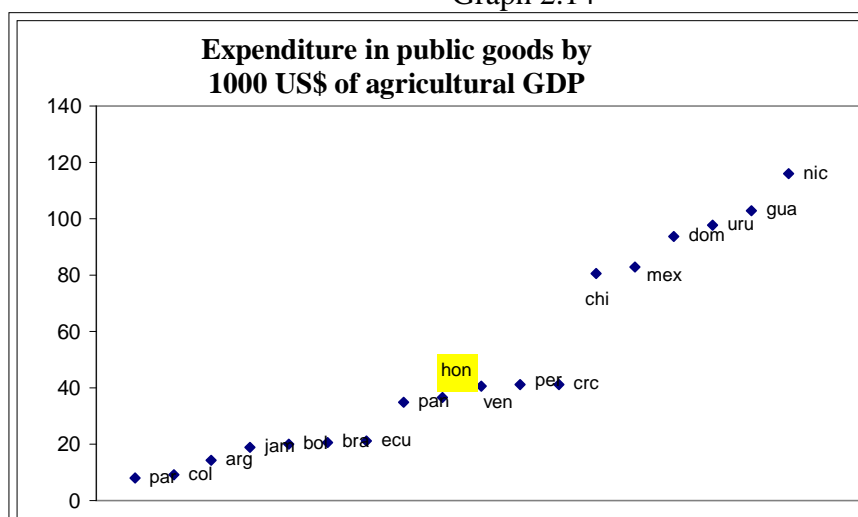


Source: GPRural-FAO

2.40 In graph 2.13 we see that Honduras has a historical agricultural expenditure in public goods which places the country among the ones with lowest expenditure per hectare, although expending more than other 7 countries in the ranking. However Honduras also shows a little more expenditure per US\$ 1,000 of agricultural GDP (graph 2.14), which is a rough indication of less efficiency in this type of expenditure, in comparison with other countries in the region (i.e., Honduras spends more in public funds and gets less GDP growth than other similar countries).

<sup>11</sup> See paper by Zegarra Eduardo y Patricia Vane (2006). “Gasto público, productividad e ingreso rural en los países de la Comunidad Andina: análisis de determinantes e impactos” En Soto Barquero F. J Santos y J. Ortega eds. (2006). “Políticas públicas y desarrollo rural en América Latina y el Caribe: El papel del gasto público”. pp 223-248. Oficina Regional de la FAO para América Latina y el Caribe, FAO, Santiago.

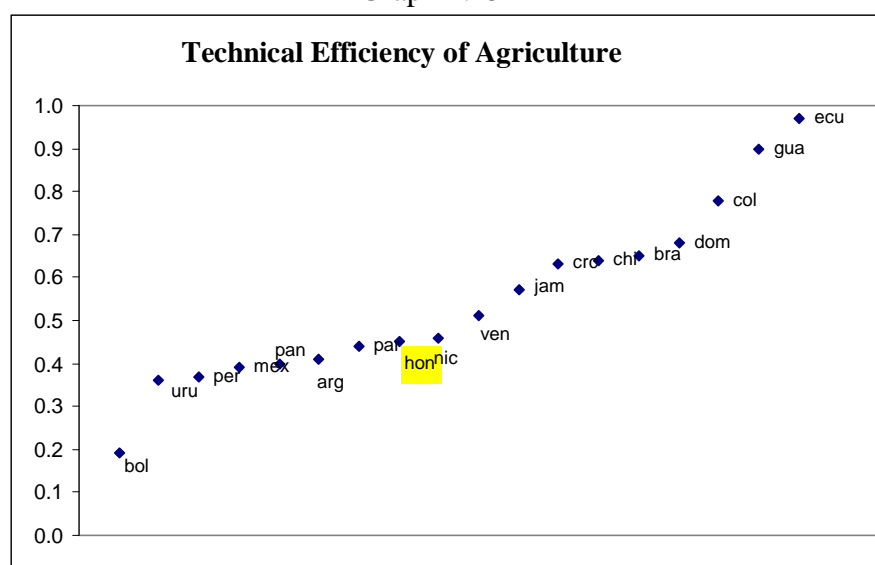
Graph 2.14



Source: GPRural-FAO

2.41 This is confirmed in Graph 2.15, where Honduras appears with one of the lowest levels of technical efficiency in agricultural production, with an average value of 45% (with respect to a general output frontier for these countries), only above seven other countries in the data set.

Graph 2.15



Source: own estimations based on production frontier model

2.42 These results indicate that historically (at least in 1985-2001) Honduras has not been having an expenditure in public goods which has been very effective in promoting growth, or at least, with results close to the ones obtained by similar countries in the region. For instance, Ecuador and Nicaragua show levels of expenditure per hectare which are similar to Honduras but these have higher efficiency coefficients (Ecuador got the highest level of technical efficiency for the sample of countries, with an average of 0.97, maximum is 1). In addition, countries like Guatemala, with the highest expenditure in public goods per hectare, occupies the second place in technical efficiency, and it is clear that this type of expenditure has been important in generating productive dynamism like the one detected in the production equations. Other similar countries with better performance have been Jamaica, Costa Rica and Dominican Republic.

2.43 These results suggest that Honduras can get better results in terms of agricultural growth and efficiency using wisely its expenditure in public goods without necessarily increasing substantially the

total level de expenditure, perhaps taking lessons from similar countries in terms of effectiveness of public programs. A better prioritization and articulation of sector expenditure to policies to increase agriculture competitiveness could be the key to scale up Honduras in the ladder of efficiency seen in Graph 2.15. Likewise, it is important that most the expenditure goes to public goods which is the type of intervention that most favors agricultural growth in the context of LAC countries. Next section will address potential impacts of sectoral expenditures on another key variable: rural poverty.

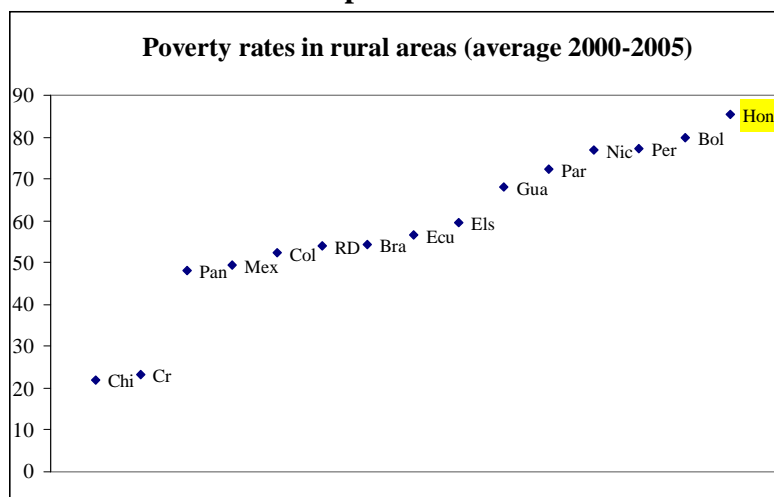
Assessing impacts on rural poverty

2.44 An important goal of agricultural public expenditure is to reduce poverty, especially in rural areas in which agriculture activities are predominant. To evaluate the potential effect of the three types of expenditure in rural poverty in the same sample of countries, we used the ECLAC data on rural poverty for the same period 1985-2001. It should be noted that this is not a perfect panel, as some countries only have poverty measures every four or five years. Some of these even have only two or three measures during this period. The total number of observations was 46, and only 14 of the 18 countries got measures of poverty in ECLAC database.

2.45 We used a model of fixed effects to measure impacts of expenditures on rural poverty. The empirical results are shown in Table A1.3. As can be seen, the coefficient for public goods is negative and statistically significant, indicating that this type of expenditure not only promotes growth but also reduces rural poverty. On other hand, expenditure in private goods have an unambiguously negative effect on rural poverty reduction, this related to the fact that this type of expenditure tends to go to richer and privileged groups in the agricultural sector, and also through its negative impact on growth. Finally, the component on equity-enhancing type of goods, which in theory should have impacts on poverty reduction, has the expected sign (it reduces poverty), but it is statically not different of zero at 90% of confidence.

2.46 These results confirm the crucial importance of public goods in the effectiveness of agricultural public expenditure in LAC countries. In the case of Honduras, this is the country with the highest level of rural poverty in the ECLAC-GPRural sample in 2000-2005, as shown in graph 2.16.

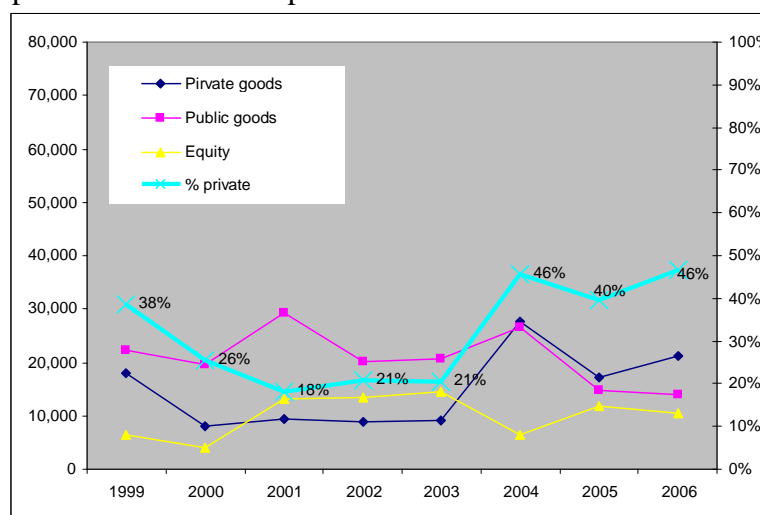
**Graph 2.16**



Source: ECLAC (2007)

2.47 Looking at this situation for Honduras, it is worrisome that since 2001 (which was the last year in GPRural), Honduras has been showing an increase in expenditures oriented to private good type of interventions as shown in Graph 2.17, going from an average of 20% in 2001-2003 to more than 40% in 2004-2006.

Graph 2.17: Shares of Expenditures to Public & Private Goods (1999 – 2006)



Sources: SEFIN-SIAFI (2007), Honduras.

#### D) Qualitative Assessment of Emerging Public Expenditure Issues and Patterns

2.48 In Honduras, the funding of public expenditures from Government’s revenues and from donor funding are closely inter-related, especially given the relatively high dependency on donor funds. Prior to 1990, when there were significant distortions in the economy (e.g., price controls, state marketing of food crops, over-valuation of the exchange rate, generalized subsidies), public expenditures for the sector maintained a stable and growing trend. Since 1990, with the introduction of market-based reforms, sectoral public expenditures decreased, while private sector investments increased, with public expenditures going increasingly to the formation of human capital and poverty reduction. Data showed that the public expenditure allocation for this sector also become increasingly erratic, which continues to this date.

2.49 From the institutional perspective, there are various factors which explain the cyclical trends of public expenditures in the agricultural and forestry sector. First, there is the problem of salary adjustments and increases in government employees at the beginning of each Government, and the resistance to curtail public employees. Second, the public investment priorities of the Government are influenced by the Government policy and sectoral priorities; in the case of Honduras, the agricultural and forestry sector tends to get a lot of attention at the rhetorical level, but does not translate into increased inter-sectoral expenditure allocations. Third, the execution of large projects commit the Government’s funds (in terms of required counterpart funds), leaving limited funds for “new” projects/programs. Fourth, there are public subsidies (which appear to be growing for the agricultural and forestry sector), and the need to finance operational deficits for decentralized public agencies, consume a large share of the public expenditure budget. Therefore, these factors help explain some of the underlying reasons for underfunding the agricultural and forestry sector, even considering that the MOA is not able to spend the limited allocations it receives, due to various underlying constraints. Accordingly, the assessment of the sector being underfunded needs to consider the large gap and disconnect between public sector investment requirements and public resource availability and capacities. A very large share of the public funding goes towards salaries (about 80% of total sector funding), hence there is a need to rationalize the staffing composition and levels. As discussed below, there is documented significant public sector underfunding of the Forestry sector. Therefore, a key message is in the short term to emphasize improved efficiency of existing public expenditure allocations, while building the capacities and systems to effectively absorb and manage increased allocations and expenditures in the future.

2.50 From the perspective of the agricultural and forestry sector, there are additional factors which help explain underfunding of this strategic sector.

(a) There is the low execution of existing sectoral allocations, with an average of about 60% during the period 1986-2006. Some of the underlying causes of this low rate are due to: budgetary cutbacks at the macro-finance level; delays in the disbursement of funds to the executing agencies, starting with delays from the Ministry of Finance, often followed by delays from the MOA and SAG to the executing agencies/departments; delays in the executing agencies fulfilling the required procurement and financial management procedures; each project (and donor) often has its own procurement and financial management requirements. Many of the donor-funded projects experience delayed and inadequate counterpart funding to be provided from the Ministry of Finance, even when this requirement is specified in the Project's grant/loan legal agreement. Similarly, the Ministry of Finance has its SIAFI (Sistema de Informacion y Administracion Financiera), but which still has not been adequately explained to the sectoral ministries.

(b) From the perspective of the agencies which are coordinating the agricultural and forestry sector, the recurrent expenditure continues to exceed investment expenditures (which are measured by the capital goods), and the financing gap has an increasing trend, especially after taking into account the transfer expenditures, which are channeled to some of the sector agencies: IHMA, INA, AFE-COHDEFOR and BANADESA. Most of their expenditures are being consumed primarily to finance recurrent expenditures. This picture, together with an initial low level of financial and physical investment for the agricultural and forestry sector, presents a bleak perspective for the development of the sector and funding new investments.

(c) There is an absence of a completed and sound sectoral medium term expenditure framework or plan, although MOA prepared an initial framework in mid-2007, and is currently in the process of updating it. This framework would enable multi-year investment planning process and cycle, which would be coordinated by CODA (and chaired by the Minister of Agriculture).

(d) Each Government administration devotes varying priorities to address different issues, which result in rigid plans and a lack of continuity in order to generate sustainable results. The agricultural and forestry sector has been no exception, when one assesses the patterns of recent changes in Government administrations.

(e) The planning and budgetary processes have had a strong centralist orientation, such that it has not been able to support adequately the Government's stated policies to promote decentralization, as part of implementing its Territorial Law. Effective implementation of its Poverty Reduction Strategy also requires a more decentralized approach to planning and budgeting, especially for the agricultural and forestry sector.

(f) There continues to be an anti-agricultural and forestry bias with regards to allocating financial resources from the Poverty Reduction Strategy. Based on a recent progress report of the PRS (February 2007), the proportion of ERP funds assigned to the productive sector continues to be very small (less than 10% of total PRS funding). The Government is trying to rectify this discrepancy by changing the composition of the expenditures of the funds allocated through the counties (e.g., Lempira 700 Million in 2006). But, this would require a more fundamental change in the PRSP operational strategies and allocation of funds. It is possible that through the Regional CODAs, and a more proactive role of the MOA's Regional Representatives could help achieve this re-allocation of expenditures.

## Key Expenditure Issues in the Forestry Sector and Implications of the New Forestry Law

2.51 The Forestry sector has a unique importance in Honduras, given the extent of forest cover in the country (about 50% of total land area); the reliance of smallholders and rural population on the forestry resources (about 60% of the rural population relies on forest products as a major source of livelihood). The State Forestry Agency (called AFE-COHDEFOR) has been historically underfunded to fulfill its mandate, while also being well known to be inefficient in its expenditures. The National Congress approved (October, 2007) a National Forestry Law, which has been formally enacted by the Executive branch (in February 2008), and the law became effective in March, 2008. It will help formalize a number of important policy and institutional reforms in the forestry sector. This section provides a brief summary of some of the important past and current expenditure issues and responses, as these responses will continue to influence the transition being ushered by the new Forestry Law.

2.52 At the time of creating AFE-COHDEFOR (in 1974), as a public decentralized entity, it was expected to cover its operational funding requirements through revenues from the sale of timber, such that export revenues enabled AFE-COHDEFOR to generate profits, and remain solvent. In 1992, the Government adopted a new policy regime, based on market-based principles, and withdrawing its public sector role in various sectors/subsectors in order to promote an expanded role of the private sector. In the forestry subsector, the new policies involve returning the forest resources are returned to its original owners (the rural communities) and the marketing of timber is returned to private exporters. Another important implication of the new policies is the substantial curtailment of revenues, such that the funding of the AFE-COHDEFOR would now be required to be provided by the Ministry of Finance. However, the Ministry of Finance has consistently underfunded AFE-COHDEFOR, such it has been forced to continue to generate internal revenues through the sale of timber from public lands in order to help meet its operational requirements.

2.53 The responsibilities of AFE-COHDEFOR focus primarily public good functions in order to maximize and sustain the economic and social benefits of forest resources, ensuring the protection, improvement, conservation of forest resources, where the private sector, especially the surrounding rural communities, play an increasing role in the development and sustainability of the forestry resources. There was a transfer of responsibilities to AFE-COHDEFOR (in 1990) to manage the country's extensive network of protected areas, but this was not accompanied by the required level of budgetary resources.

2.54 To this date, AFE-COHDEFOR continues to experience serious obstacles to obtain adequate budgetary allocations which would enable it to fulfill its core and mandated functions.<sup>12</sup> Accordingly, its Management devotes a disproportionate amount of time mobilizing funds primarily through Central Government transfers and auction of timber sales. This has detracted its efforts from fulfilling its management, conservation and regulatory functions. This underfunding has also been accompanied by low levels of execution of its budgetary allocations (e.g., 55% during the period of 1998 – 2006; 42% in 2000; and 89% in 2002). Table 2.3 provides further details since 1998. The study team concluded that this low execution rate is due primarily to the delayed and uncertain disbursements from Treasury, as well as to the underfunding of core staff and operational expenses, which contribute to a weakened execution capacity. The underfunding also has limited significantly the scope of work which AFE-COHDEFOR has been able to perform, especially as the current policy direction is for AFE-COHDEFOR to rightly focus on public good functions in the management and regulation of the extensive forest reserves. The recently approved Forestry Law (see below) reinforces these functions,

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<sup>12</sup> Various exercises have been carried out over the past 3 years to estimate the realistic budgetary requirements, in line with the new policy directions. The required level is as high as L 800 M per year (about US\$40 M), which is well above the recent historical allocation (of only about L 300 M, or only 40 % of the required level). Then, there are issues related to the composition of the actual expenditures, which also needs further reforms. These issues are supposed to be addressed as part of the implementing the new Forestry Law (see below).

with a new institutional framework, while empowering the local communities to take a more active role in the management and sustainable utilization of forest resources.

**Table 2.3: AFE-COHDEFOR: Approved and Implemented Budget (1998-2006)**

| (Millions of lempiras) |          |          |             |
|------------------------|----------|----------|-------------|
| Year                   | Approved | Executed | % Execution |
| 1998                   | 450.9    | 214.0    | 47.5        |
| 1999                   | 481.4    | 223.7    | 46.5        |
| 2000                   | 519.5    | 216.1    | 41.6        |
| 2001                   | 330.5    | 200.0    | 60.5        |
| 2002                   | 209.2    | 186.7    | 89.2        |
| 2003                   | 314.4    | 145.8    | 46.4        |
| 2004                   | 310.5    | 130.6    | 42.1        |
| 2005                   | 331.3    | 171.2    | 51.7        |
| 2006                   | 262.2    | 131.9    | 50.3        |

Source: Study Team estimates based on available budgetary data

2.55 There have been various attempts to reform AFE-COHDEFOR, which would involve putting it on a more solvent and sustainable path. Most of these attempts have been driven by donor conditionalities (especially from the World Bank and the InterAmerican Development Bank). The last reform effort was in 2003, as part of a donor program to support the PRSP. Government sharply reduced the AFE-COHDEFOR staff by about 50% (from 950 to 450 staff), but did not increase operational funding to enable it to fulfill its public sector functions. As a result, AFE-COHDEFOR has been forced to continue generating revenues through the sale of timber, which contradicts the Government’s own policy directives.

2.56 Over the past 5 years, the Government, together with a very proactive NGO community, has developed a consensus on the National Forestry Law. It was finally approved by the National Congress in October, 2007, and included important institutional reforms (e.g., converting the AFE-COHDEFOR into a semi-autonomous Conservation and Forestry Development Institute (CFI), patterned after the successful National Tourism Institute). Currently, the approved Forestry Law was recently enacted by the President, and has now become effective as Law (March 2008). This will lead to the immediate operational establishment of the proposed CFI, which is to become functional later in 2008. It is estimated that the new Institute would require an additional budgetary allocation of about US\$25 Million to implement various requirements outlined in the new Forestry Law, and which represents a significant increase in budgetary allocations. There will be an urgent need for the new Forestry Team and the CFI, facilitated by a “transition” team, to work out the most appropriate funding level and composition of public expenditures for the Forestry Sector, in line with the provisions of the Forestry Law. Given severe macro-fiscal constraints, it will be important for the team to take a phased approach to reaching the required funding level, while focusing on critical priorities.

2.57 Although the Forestry Law has elevated forestry to a “sector”, it will be important for the Government to ensure appropriate coordination mechanisms between the MOA and the new CFI, especially as they both are providing services to the same rural households. The proposal of activating an Agricultural and Forestry sub-Cabinet may be even more urgent to consider, helping ensure policy, expenditure, and institutional coordination at the higher level. A “test” of commitment of the current Government administration to implementing the needed policy reforms will be evident in the quantum

and timeliness of its budgetary allocations to the new entity (beginning in 2008, with supplemental allocations, and then reflected in the upcoming 2009 budget cycle).

Analysis of Subsidies and Transfers and Some Implications

2.58 In general, one can define agricultural production subsidies as transfer payments which are provided to producers resulting from agricultural policies which aim to raise their incomes and/or reduce their production costs. Such transfer payments could cover general services (via fiscal transfers), such as research and development, infrastructure and marketing, and even the profits (or losses) which the producer receives due to the differential between domestic and international prices of agricultural products (via price subsidies).

2.59 Based on available information, this report focuses on transfer payments which are included in the public expenditure budget (of fiscal subsidies), and constitute a direct and quantifiable benefit to the producer.<sup>13</sup> Based on the study by R. Arias (2005), the transfers in Honduras have concentrated on what the OECD have called “payments based on the use of inputs”, that is, transfer payments are used to pay a portion of the cost to purchase input(s).<sup>14</sup> These payments include three types of transfers, each one which refers to specific policies and strategies.

(a) Transfers involving farm-level services

According to the study by Arias, these transfers refer to technical, sanitary, and phytosanitary services provided to producers at the farm level, on the part of public programs and delivery agencies (e.g., DICTA, PRONADERS, PRONADEL y PAAR).<sup>15</sup> The expenditure trends for these services are as follows:

| <b>Cost/Value of the Service</b><br>(US\$ Millions) | <b><u>2000</u></b> | <b><u>2001</u></b> | <b><u>2002</u></b> | <b><u>2003</u></b> | <b><u>Average</u></b> |
|---|--------------------|--------------------|--------------------|--------------------|-----------------------|
|   | 14.7               | 20.3               | 18.0               | 14.3               | 16.8                  |

2.60 It should be noted that most of these expenditures are classified as public goods, and therefore, there is not a major question about their justification. There are various delivery options in order to maximize their cost-effectiveness and sustainable impacts. It is useful to arrange independent assessments of these expenditures, to help ensure the most effective use and impacts of these expenditures.

(b) Transfers which affect fixed costs and involving input(s) (machinery, credit)

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<sup>13</sup> A broader and comparative country approach has been taken recently to analyze direct support to agricultural commodities via fiscal and price subsidies (using 2003 data), based on the OECD methodology, for Central America and the Dominican Republic. See report by Diego Arias, “Agricultural Support Policies and Programs in Central America and the Dominican Republic in the Light of Trade Liberalization (InterAmerican Development Bank, February, 2007). It is noteworthy that Honduras a relatively low direct agricultural support ratio vis-à-vis the regional average, and, unlike most of the other countries, a large portion of the direct agricultural support is through fiscal expenditures. The price support is being given to a few specific commodities (e.g., rice, milk and pork), which tends to benefit a relatively small number of producers (usually larger ones). The MOA of Honduras is in the process of updating this study, using a similar OECD methodology. Given the relative importance of fiscal subsidies in Honduras, this report focuses on summarizing the results of the country-level study (by R. Arias) which provided inputs to the regional study.

<sup>14</sup> In strict terms, these “transfers to producers result from policy measures based on the utilization of a fixed or variable input, or a specific group of inputs or factors of production”. OECD (Organization for Economic Cooperation and Development). 2002. “Methodology for the Measurement of Support and Use in Policy Evaluation.” Luis Portugal. Agricultural Policies, OECD, 28 June 2002, p. 6.

<sup>15</sup> See Acronyms for these agencies.

2.61 The study by R. Arias shows an average of US\$28.6 M for this type of transfer payment. In this case, these expenditures are not part of a project or program. If they were to be included in a program or project, they would be classified as private goods, given that the benefits are appropriated directly to specific beneficiaries/farmers. The report by R. Arias does not specify the programs and projects which correspond to these transfer payments. There are at least three sources of the financial subsidies to the agricultural and forestry sector:

(i) the National Fund of Production and Housing (FONAPROVI), which is a financial institution of the second floor (which finances credit institutions that lend directly to borrowers) offers medium to long term credit for low income population. In 2005, FONAPROVI was restructured and became BANHPROVI (Production and Housing Bank), provided subsidized interest rates to its target groups;

(ii) Since 2002 the Government has approved a series of laws for financial recovery of the agricultural and forestry sector, which includes restructuring and refinancing of outstanding debts by farmers (mostly large farmers). The Ministry of Finance established a “Solidarity Fund” for the Small and Medium Farmer as a mechanism to transfer a total of about US\$25 M to refinance these debts (for the period 2002-2005). There has not been an evaluation of this intervention in terms of its effectiveness, and based on other country experiences, it poses various risks.

(iii) The National Bank of Agricultural Development (BANADESA) offers credit and related financial services to small farmers (since 1980), mostly on a subsidized basis. There have been various periods when the outstanding debts have been forgiven or restructured, resulting in fiscal losses, and also undermining credit discipline. There is a need for an independent assessment of this credit program, to assess its effectiveness and sustainability.

(c) Transfers which affect the variable costs related to inputs (fertilizers, seeds, water, energy, transportation, insurance)

2.62 The study by R. Arias does not cover this subject, because there were no transfers in Honduras for these variable cost items during the study period. Nevertheless, since the past 1 year there are two programs being promoted by the current Government administration which involve providing subsidies to reduce variable production costs: agricultural insurance and inputs (seeds and fertilizer, called “bono tecnologico”). Both programs are at an early stage of development, and there have not been independent assessments carried out to assess their effectiveness.

2.63 The agricultural insurance program has been operating since 2003. The premium is about 10% of the estimated value of the harvest, and in case of losses, the average coverage is about 80% of the total losses. It is note clear if this program and supporting mechanisms are sustainable, as there has not been an independent assessment to gauge its effectiveness.

2.64 Regarding the bono tecnologico, this program involves providing (at no charge) small farmers improved seeds and fertilizers sufficient to plant 1 manzana (1/2 acre) with basic grains (corn, beans, rice and sorghum). During 2006, the first year of this program, there have been a reported 80,000 producer beneficiaries (presumably small farmers), for a total cost of about US\$5.0 M (and an average subsidy of about \$250 per farmer). This program is supported by technical advice, to help ensure the farmers maximize the benefits (and also to help minimize “leakages” of the inputs).

2.65 This data is not reflected in the above analysis of projects and programs, and would be classified as “private goods”, given that they provide direct and exclusive benefits to specific beneficiaries. This implies that the proportion of total public resources being channeled to private goods would increase (over the already relatively high level). From the above analysis, it would also

question the effectiveness of continuing to use scarce public resources for this type of private good, especially since it will not be possible to sustain these private goods with limited public funds.

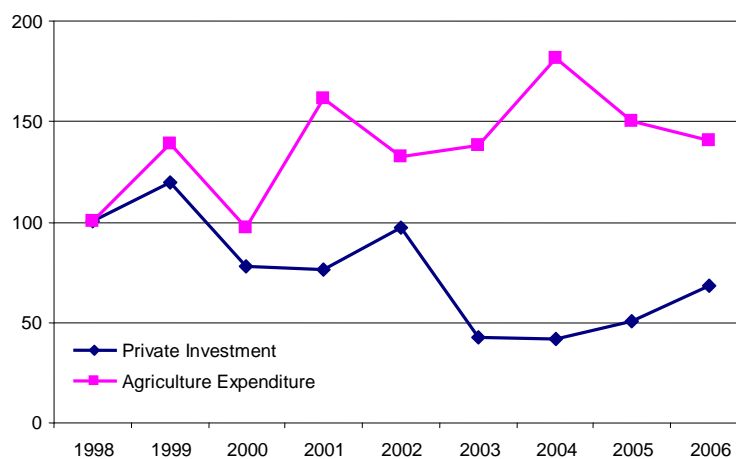
2.66 In 2007, the MOA was making arrangements to carry out an independent assessment of the bono tecnologico, and to work out a “road map” for enabling the benefiting farmers to “graduate” to more sustainable approaches of assistance. There have been delays in making arrangements for this study. MOA is encouraged to expedite this evaluation.

Private and Public Sector Investment Relationship: Some Preliminary and Emerging Perspectives

2.67 The relationship between public expenditures and private sector investment is a debatable subject. Some people argue that public investments displace private sector investments, especially when such investments are oriented toward the creation of physical and financial capital. In the case of human capital, there is less of a debate. Other people argue that public investments help generate the basic conditions to promote private investments, generally through the provision of public goods, and especially when there are “market failures”.

2.68 In the case of Honduras, there is a serious constraint on getting available data which could show the amount and nature of private investments. Using as a proxy variable for private investment capital goods imports for the agricultural and forestry sector (1998 – 2006), Graph 2.18 shows an inverse relationship between public expenditure and private investment, with a correlation coefficient of -0.5. If this is correct, this result would support the hypothesis that public investments tends to displace private sector investment. At the same time, sustainable growth will depend on increased private sector investment, and to achieve the poverty reduction effects, it is important that the interventions of the government help expand access to appropriate assets and investments on the part of smallholders. This latter element could comprise one of the important criteria for establishing public sector expenditure priorities.

**Graph 2.18**  
**Agricultural capital goods import index**  
**and agricultural public investment (1998=100)**

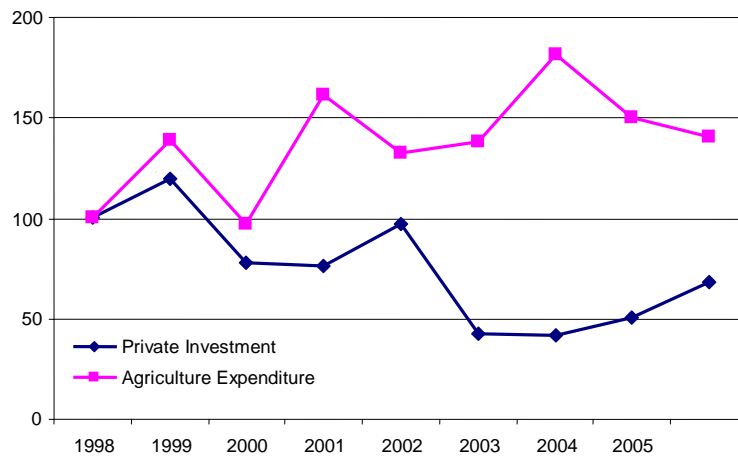


Source: SIAFI, BCH

2.69 Nevertheless, it might be argued that the effect of the public expenditures on private sector investment is not immediate, and that there is a lag (of at least one year). Graph 2.19 illustrates this lag (assuming one year), and suggests a positive relationship between the two variables, although the coefficient of correlation between public expenditures (of the previous year) and subsequent private investment is close to zero. This empirical result may also reflect the weak data base.

**Graph 2.19**  
**Agricultural capital goods import index**  
**and agricultural public investment (with a year lag)**

(1998=100)

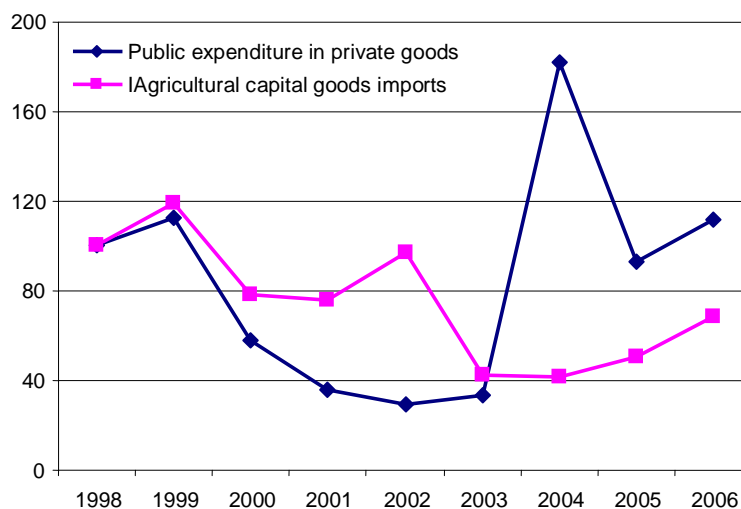


Source: SIAFI, BCH

2.70 In summary, in order to derive more reliable relationship between public expenditures and private sector investment patterns, there is a need to gather and analyze more disaggregated data. Some informal focus group discussions with various representatives from a national private sector business association reveals that the private sector gives high priority to the Government focusing limited public expenditures to public goods, such as productive rural infrastructure (especially roads and electrification), technology transfer, and education.

2.71 In addition, the study team attempted to analyze the correlation between public expenditures in the agricultural and forestry sector on private goods, and the imports of capital goods for the sector (see Graph 2.20).

**Graph 2.20**  
**Public expenditure and private investment (proxy)**  
**(Indices, 1998=100)**



Source: SIAFI/BH

**2.72** The analysis also included a comparison of the levels, percentage variations, differences, and lags, and in all cases the correlation coefficient of these variables was close to zero. Based on available evidence, and notwithstanding the limitations of the data, this rough analysis suggests that public expenditures for the agricultural and forestry sector in Honduras has negligible or no relationship with the private sector investment processes for the agricultural and forestry sector, both at an aggregate level and specific expenditures in private goods. Assessing these relationships, both in terms of cause and effect, is an important subject for further research and analysis in Honduras.<sup>16</sup> The WDR 2008 report gives strong international evidence that a dynamic private sector, with an active and broad-based participation of smallholders, stimulated with different types of appropriate funding mechanisms to promote effective private/public partnerships, can play a strategic role in promoted broad-based growth.

## **E) Summary Assessment of Project Portfolio Under Implementation**

2.73 Honduras has expressed its commitment to support the international initiatives to promote greater harmonization and alignment of donor assistance, as outlined in the Paris Declaration. Honduras has a roundtable system of Government-donor coordination of external assistance, organized by key sectors and strategic themes. The Office of the President is responsible for coordinating this system, and has developed various guidelines to implement these coordination processes. There are now two separate coordinating groups for the agricultural and forestry sector: one for the agriculture sector, and the other for the forestry sector (especially in the light of the approved Forestry Law). Most of the efforts tend to focus on policy, strategy issues, and new investments. There is relatively little attention given to ensuring that the on-going portfolio of projects is fully integrated with the latest framework of sectoral policies and strategies. A good international practice in sectoral public expenditures is to give priority to streamlining on-going projects, consistent with the latest sectoral policies and strategies (in this case, the Strategic Operational Plan, issued in October, 2006). These on-going projects involve a large volume of financial resources, and provide a potentially powerful instrument for generating economic returns.

2.74 This section provides an initial assessment of the on-going portfolio of public sector executed projects in the agricultural and forestry sector, primarily those which are funded by donors. The results are presented according to three situations, building on available information and analyses:

- a) Portfolio of projects for the period 1998 - 2006
- b) Portfolio to December, 2005, based on a portfolio review exercise carried out by the donor working group, and which aims to re-align the projects according to MOA's structure of programs and projects.
- c) Portfolio to December, 2006, based on information available from the Ministry of Finance

### a) Sectoral Expenditures and Portfolio of projects for the period 1998 - 2006

#### (i) Summary by Year and Agency:

2.75 First, Table 2.4 shows that among the main agencies in the agricultural and forestry sector, MOA has received the highest proportion of public expenditures for most of the years between 1998 – 2006 (approximately 70% total sectoral allocations, including donor funds).

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<sup>16</sup> For example, is it possible to establish a quantitative relationship, such as getting an estimate of private investments from household surveys? If so, it might be possible to assess the share of expenditures on agricultural capital goods as a percent of total private investment in agriculture. These factors need closer examination and detailed data to determine these complex relationships.

**Table 2.4:**  
**Comparison of Allocation of Public Expenditures According to the Sectoral Ministries/Agencies**

| Year | SAG          | %     | SERNA      | %     | AFE        | %     | TOTAL        |
|------|--------------|-------|------------|-------|------------|-------|--------------|
| 1998 | 234,776.60   | 36.0% | 416,794.70 | 64.0% |            | 0.0%  | 651,571.30   |
| 1999 | 369,958.20   | 35.9% | 342,064.40 | 33.2% | 308,605.70 | 29.9% | 1,030,658.20 |
| 2000 | 537,424.50   | 64.1% | 284,778.00 | 34.0% |            | 0.0%  | 838,670.60   |
| 2001 | 865,124.40   | 62.8% | 123,469.20 | 9.0%  | 360,718.00 | 26.2% | 1,376,909.10 |
| 2002 | 960,236.30   | 76.5% | 100,795.40 | 8.0%  | 193,747.20 | 15.4% | 1,255,998.90 |
| 2003 | 1,359,800.40 | 77.7% | 174,305.70 | 10.0% | 148,162.20 | 8.5%  | 1,749,011.00 |
| 2004 | 1,151,106.90 | 62.0% | 328,308.90 | 17.7% | 212,458.40 | 11.4% | 1,855,845.80 |
| 2005 | 1,109,884.00 | 68.8% | 284,392.50 | 17.6% | 216,301.90 | 13.4% | 1,613,173.40 |
| 2006 | 928,698.20   | 67.0% | 156,315.10 | 11.3% | 194,043.10 | 14.0% | 1,385,818.40 |
|      |              |       |            |       |            |       |              |

Source: SIAFI

2.76 Second, the figures show large variations in the allocations, which largely is driven by the donor funding.

(ii) Annual Summary for the Sector: Some of the main features include:

- a) Table 2.5 shows the Government's (and the constituent agencies of the agricultural and forestry sectors) historic high dependency on donor funding of the portfolio of projects in the agricultural and forestry sector, whereby 84% - 96% of the total public expenditures (recurrent and capital) for the period reviewed are funded by external donors. More recently, this proportion is decreasing, given that the donor-funded projects are coming to a close, and there has been a lag in the development of a pipeline of donor-funded projects.

**Table 2.5: Financing Shares of Programs and Projects (GoH and Donors)**  
**(000s of US\$ 1999 constant prices)**

|              | 1999-02 (Average / year) |                 |            | 2003-06 (Average / year) |                 |              |
|--------------|--------------------------|-----------------|------------|--------------------------|-----------------|--------------|
|              | GoH                      | Donor           | % Donor    | GoH                      | Donor           | % Donor      |
| AFE-COHDEFOR | 1,916.6                  | 6,462.2         | 77%        | 1,172.1                  | 4,455.5         | 79.2%        |
| BANADESA     |                          |                 |            | 319.8                    | 16.6            | 4.9%         |
| DICTA        |                          |                 |            | 249.9                    | 0.0             | 0.0%         |
| DINADERS     |                          |                 |            | 1,215.2                  | 2,622.7         | 68.3%        |
| ENACIFOR     | 138.6                    | 267.2           | 66%        | 47.2                     | 60.8            | 56.3%        |
| FONADERS     |                          |                 |            | 102.8                    | 693.2           | 87.1%        |
| IHMA         |                          |                 |            | 46.1                     | 37.1            | 44.5%        |
| INA          |                          |                 |            | 902.7                    | 1,299.3         | 59.0%        |
| SAG          | 6,807.7                  | 17,444.8        | 72%        | 6,676.6                  | 15,935.3        | 70.5%        |
| SERNA        | 2,556.2                  | 5,797.3         | 69%        | 1,430.3                  | 4,816.7         | 77.1%        |
| <b>TOTAL</b> | <b>11,419.0</b>          | <b>29,971.5</b> | <b>72%</b> | <b>12,162.7</b>          | <b>29,937.2</b> | <b>71.1%</b> |

Source: SIAFI-SEFIN

- b) Based on available information, it is difficult to discern a clear operational linkage between the portfolio of projects and the current policies and strategies outlined in the Strategic Operational Plan (SOP) for 2006-2010.
- c) Most of the projects are being executed by disparate project management units, which are not integrated within the MOA organizational structure, which are not systematically monitored as part of a single portfolio, which are not subjected to periodic assessments and lessons learned, and which most often are not sustained or integrated in the MOA's programs and services, after the funding is completed.
- d) The information for the sectoral portfolio is managed differently by each agency, such that the sector is not managed as a coherent sector, whereas the Ministry of Finance endeavors to integrate it as a productive sector.
- e) The sectoral allocations showed an upward trend until 2004, and then decreased by about 22% in 2006 (Year 1 of the new Administration).
- f) The execution rate reaches an average of only 59% for the period (actual expenditures as a percentage of total allocation), varying between the range of 45% (in 2003) and 73% (in 2001).
- g) Table 2.6 shows the large differential in the execution rate between projects financed only by Government resources (National Funds/NF) and those financed with both Government and donors funds (NF+EF). Surprisingly, those funded by only Government reach an execution rate of about 100%, whereas those executed with both Government and donor funding reached an average of execution rate of only 55.2%. In part, this reflects the donor procurement procedures, which require additional efforts by Government agencies.

**Table 2.6**  
**Annual Summary of Budgetary Allocations and Actual Expenditures for the Agricultural Sector**  
**(National Funds/NF) & (NF + External Funds)**  
**(000s of Lempira)**

| Year         | BUDGETARY ALLOCATIONS |                     |                     | ACTUAL EXPENDITURES |               |                    |              | Exec. Rate         |             |
|--------------|-----------------------|---------------------|---------------------|---------------------|---------------|--------------------|--------------|--------------------|-------------|
|              | SOURCE                |                     | TOTAL               | SOURCE              |               |                    |              | TOTAL              | %           |
|              | FN                    | FE+FN               |                     | FN                  | Exec          | FE+FN              | Exec         |                    |             |
| 1998         | 64,837.3              | 586,734.0           | 651,571.3           | 64,443.6            | 99.4%         | 376,494.1          | 64.2%        | 440,937.7          | 67.7        |
| 1999         | 126,690.0             | 903,386.5           | 1,030,076.5         | 115,299.3           | 91.0%         | 553,476.8          | 61.3%        | 668,776.1          | 64.9        |
| 2000         | 99,969.2              | 738,701.4           | 838,670.6           | 52,031.8            | 52.0%         | 422,736.7          | 57.2%        | 474,768.5          | 56.6        |
| 2001         | 106,448.4             | 1,146,991.5         | 1,253,439.9         | 153,957.9           | 144.6%        | 765,799.2          | 66.8%        | 919,757.1          | 73.4        |
| 2002         | 101,815.6             | 1,154,183.3         | 1,255,998.9         | 71,206.3            | 69.9%         | 642,085.1          | 55.6%        | 713,291.4          | 56.8        |
| 2003         | 76,026.4              | 1,672,984.6         | 1,749,011.0         | 98,352.0            | 129.4%        | 686,808.5          | 41.1%        | 785,160.5          | 44.9        |
| 2004         | 164,530.3             | 1,691,315.5         | 1,855,845.8         | 182,251.0           | 110.8%        | 932,613.4          | 55.1%        | 1,114,864.4        | 60.1        |
| 2005         | 119,728.8             | 1,493,444.6         | 1,613,173.4         | 135,028.7           | 112.8%        | 789,463.1          | 52.9%        | 924,491.8          | 57.3        |
| 2006         | 220,411.5             | 1,165,406.9         | 1,385,818.4         | 213,397.4           | 96.8%         | 652,045.2          | 56.0%        | 865,442.6          | 62.4        |
| <b>Total</b> | <b>1,080,457.5</b>    | <b>10,553,148.3</b> | <b>11,633,605.8</b> | <b>1,085,968.0</b>  | <b>100.5%</b> | <b>5,821,522.1</b> | <b>55.2%</b> | <b>6,907,490.1</b> | <b>59.4</b> |

h) Based on other country experiences, it is hypothesized that the execution rate will improve markedly when they are integrated and managed as part of the strategic programs and projects, rather than being managed in a fragmented manner.

(b) On-going Portfolio up to December 2005

(i) Summary by Program and Services: An exercise was carried out in 2005 (by the donor working group, in collaboration with MOA) to allocate the total expenditures for the agricultural and forestry sector according to the structure of programs (4) and services (5) outlined in the PESA. About US\$475 M was committed/approved by donors, and US\$287 M was still available/undisbursed, as of end 2005. There was a sizeable “other” category, given that a lot of the projects involved activities which cut across various programs and services (e.g., financing, access to land, sustainable development of natural resources, marketing, recurrent expenditures). It also reflects the project-orientation, and to some extent, fragmentation of donor assistance and Government expenditures.

(ii) Summary by Donor and According to Programs and Services: The available data shows the expenditure orientation according to donor agency and programs and services. About 66% of the total donor assistance (in 2005) for the agricultural and forestry sector’s programs is being provided by five major donor agencies: World Bank (WB), InterAmerican Development Bank (IDB), IFAD, US (through the Millennium Corporation), and the European Union. About 24% of the services are being supported primarily by US/Millennium Account, USAID, and Taiwan.

(iii) Summary of Sector Financing by Country or Agency: Of the 142 on-going projects in the agricultural and forestry sector, donor funding total about US\$475 M, of which US\$188 have been disbursed as of end-December, 2005. This leaves a balance of about US\$287 M (by end-2005). It is noteworthy that this balance represents about 50% of the estimated sectoral medium term expenditure plan. It was not possible to obtain data on the Government counterpart (which is usually about 10% of the total costs), or projects being funded only by Government resources (which is generally less than 20% of the total sectoral expenditures). There are seven donor agencies which fund about 80% of the total sectoral expenditures (2005): US/Millennium Account; IDB; WB; IFAD; European Union, USAID, and Central American Development Bank. There is relatively negligible co-financing (parallel or joint) of common programs, services and projects, although there is a growing interest to improve coordination in terms of common policies, strategies, and institutional arrangements.

(iv) Financial Summary According to Program of the PRS and Funding Modality:

The following funding modalities characterize donor support, with the majority being provided on a grant basis, for both available donor funds (55%) and undisbursed donor funds (61%).

| <b>Funding Terms</b>     | <b>Available/Approved Donor Funds (%)</b> | <b>Undisbursed Donor Funds (%)</b> |
|--------------------------|---|------------------------------------|
| <b>Grant</b>             | <b>54.6</b>                               | <b>61.2</b>                        |
| <b>Non-Grant/Loan</b>    | <b>45.4</b>                               | <b>38.8</b>                        |
| <b>Total Donor Funds</b> | <b>100.0</b>                              | <b>100.0</b>                       |

2.77 Regarding the orientation of funds by program area of the PRSP, of the amount of donor funds approved/available, there are two extreme allocations: with the highest allocation: Theme 2 (reducing poverty in rural zones (65%)); and with the least allocation: Theme 4 (investing in human capital (0.03%). These actual allocations are somewhat inconsistent with the Government’s pro-poor

orientation, and warrant a re-assessment of the allocation patterns and priorities (especially in the context of preparing for the upcoming 2009 budget cycle).

(c) Portfolio up to 2006: Based on more recent data provided by the Ministry of Finance (SEFIN), the following section summarizes some of the expenditure patterns.

(i) Summary by Programs and Services: MOA has not been able to organize its expenditure data according to major program or service. Ensuring that the allocations are done according to MOA's established programs and projects will facilitate the process of ensuring expenditure priorities are consistent (and re-aligned, where necessary) with the sectoral strategies outlined in the SOP (2006 – 2010).

(ii) Summary of the Portfolio According to Support for Public and Private Sectors. Table 2.7 shows the pattern of donor funding allocations (in 2006) in terms of supporting public and private sectors, with over 80%+ supporting the former. These figures again highlight the importance of taking a proactive approach to managing undisbursed funds as an opportunity to realign on-going expenditures according to the new sectoral priorities.

**Table 2.7**

|                | <b>Portfolio of Agricultural and forestry Programs/Projects Funded by Donor Assistance (as of December 2006 (current Million of Lempiras))</b> |               |              |               |              |               |
|----------------|--|---------------|--------------|---------------|--------------|---------------|
|                | Approved   | %             | Disbursed    | %             | Available    | %             |
| Total          | <b>632.5</b>   | <b>100.0%</b> | <b>279.5</b> | <b>100.0%</b> | <b>353.0</b> | <b>100.0%</b> |
| Public Sector  | 530.5  | 83.9%         | 234.0        | 83.7%         | 296.4        | 84.0%         |
| Private Sector | 102.1  | 16.1%         | 45.5         | 16.3%         | 56.6         | 16.0%         |

Exchange Rate: US\$1.0 = Lempira 19.13

Assessment of Expenditure Alignment with the PESA (2004)

2.78 A FAO sectoral expenditure review for Honduras (in 2006) attempted to derive a quantitative proxy measure of the extent of expenditure alignment with the policy and strategy priorities outlined in the PESA. A simple methodology was used ---- the expenditures of the various sectoral agencies (in 2004) were aggregated and allocated according to strategic themes outlined in the PESA, which enabled an estimate of the extent of alignment with the PESA (in percentage terms). Expenditures on rural development were excluded, since their disaggregated levels were not known. Table 2.8 shows that only about 30% of the total sectoral expenditures were in line with the PESA strategic priorities. This illustrates a common pattern in many countries ---- there is an on-going portfolio of investment projects which have a potential scope of being re-aligned and retrofitted in the light of the Sectoral Strategy Plan, especially in terms of components, outcome performance indicators, implementation arrangements, and expenditure allocations. It would be important for Government to take the leadership in this exercise, and in a coordinated manner, with the support of the donor working group for the rural sector. The Government can also use the budgetary allocation cycle as a mechanism for re-allocating expenditures. It should be noted that a further desegregation of the expenditure data will enable a more accurate allocation, and perhaps this percentage figure might be higher than 30% (but probably not significantly higher). These expenditure allocations/priorities were carried out during the previous Government administration. It would be relevant to assess the alignment patterns over the past 3 years, and to determine the extent of expenditure "misalignment" with the SOP (2006-2010). To illustrate this methodology, the above mentioned portfolio exercise (using data up to December 2005) enabled a similar alignment exercise, and concluded that the alignment for agricultural services (refers mainly to agricultural extension) was about 35%, whereas the alignment according to programs had increased to 92%. This data needs to be further disaggregated to ensure a meaningful assessment of the extent of expenditure alignment with the updated strategies.

**Table A2.6: Comparison of Budgetary Allocations According to the Strategy Elements of the PESA (2004-2021)**

| <b>STRATEGIC THEME ACCORDING TO PESA</b>                            | <b>PROGRAMS</b>  | <b>AMOUNTS (millones of US\$)</b> |
|---|--|-----------------------------------|
| Market Development and Trade Agreements                             | There is no significant activity which is identified.                                      | -                                 |
| Agricultural Phytosanity  | SENASA (*)   | 0.15                              |
| Technology Innovation   | Research and Development (DICTA, PROMOSTA, FISDE, CENITTA, RELATA)                         | 3.0                               |
| Agricultural Education  | Capacity Building and Agricultural Extension (CEDA, PION RURAL, COHASA, ESNACIFOR y otros) | 1.17                              |
| Agricultural/Rural Finance  | BANADESA- Net Loans (*)  | 6.7                               |
| Development of Rural and Irrigation Infrastructure                  | Irrigation & Drainage (SAG)  | 5.3                               |
| Sustainability of Natural Resources                                 | Environment and Management of Watersheds and Forestry (COHDEFOR, SERNA)                    | 20.0                              |
| Access to Land, Judicial Security and Social Equity                 | Access to Land (INA)   | 6.75                              |
| <b>Sub-Total</b>  |  | <b>43.07</b>                      |
| <b>Total Public Expenditures (5 years)</b>                          |  | <b>144</b>                        |
| <b>Proportion of Public Expenditure to Support Strategic Themes</b> |  | <b>30 %</b>                       |

Source: FAO Agricultural Expenditure Study (2006, draft report)

## **F) Synthesis of Selected Ex-Post Evaluations**

2.79 The study team attempted to compile available ex-post studies of completed investment projects in the agricultural and forestry sector. However, there were very few studies carried out and available. This reflects a serious concern and a lack of real commitment by Government as well as donor agencies in ensuring such independent evaluations are carried out on a timely basis. This would have the benefit of identifying relevant lessons learned, and a better design of new projects/programs.

2.80 The study team was able to review and incorporate three available ex-post studies, involving a range of project examples. The main results are presented in Annex 3. The three projects are:

- PROMOSTA: funded by the InterAmerican Development Bank
- Land Administration Program: funded by the World Bank
- Biodiversity and Protected Area Project: funded by the World Bank and GEF.

### Box 2.1: Summary Lessons from Selected Project Evaluations

#### (A) PROMOSTA

One of the principal lessons in the execution of the project is that all of the interventions should be part of contributing to a national plan of generation and transfer of technology, which define the roles of each institution (including the cooperating agency) and the strategies to follow to ensure the

sustainability of the projects formulated and financed with the competitive funds. There is a need to have a manual of certification of the providers of services approved by the member institutions of SNITTA, and not only by DICTA and PROMOSTA.

(B) PAAR Lessons

Among the most important lessons learned, are the following:

- a) The horizontal communication was a key element for the management and solution of problems and increased effectiveness of the decision-makers
- b) The participatory forestry management will enable increased rural incomes and participation in the protection of the forestry resources
- c) The conservation of the soils and forests on upland farms requires more than extension technologies, demanding a support in the provision of initial inputs for the production
- d) The organization and community development require flexibility for responding to the community needs.

(C) PROBAB

- a) Promote the involvement of the communities in the various phases of the Project (design, implementation, monitoring and evaluation)
- b) Combine the conservation efforts of Protected Areas, with activities which help overcome the socio-economic and political conditions
- c) Promote the collaboration with NGOs, local Governments and other public institutions
- d) Ensure that the local committees are representative and open to change
- e) Give close attention to socio-economic conditions and policies
- f) In designing the project, these should be built in a manner which responds to the changes
- g) There needs to be clarity in the institutional responsibilities for the execution of the project

### **III. STRATEGIC FRAMEWORK AND PRIORITIES FOR ENHANCED OUTCOMES AND GOVERNANCE OF SECTORAL PUBLIC EXPENDITURES**

3.1 Based on GoH's Budgetary Policies (2007-2010), SAG's Strategic Operational Plan/SOP (2006-2010), and their on-going exercise to update, refocus and further operationalize their sectoral strategy<sup>17</sup>, this chapter presents a strategic framework for enhancing its public expenditure priorities and governance for the agricultural and forestry sector (2008 – 2012). There are 5 sections, as follows:

- Budgetary structure, taking a programmatic approach
- Medium-term expenditure framework, and criteria for establishing priorities
- Emerging proposed MTEF allocations (2008 – 2012)
- An Emerging Preliminary Financing Plan
- Governance strategy: enhanced processes and mechanisms for better outcomes

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<sup>17</sup> As part of promoting greater focus in supporting a public-private sector partnership to achieve sectoral outcomes and impacts, in early 2008, SAG has initiated an exercise to formulate a Public Investment Strategy for the Agricultural and forestry Sector, with a Focus on Commodity Chains (2008-2012) (draft, February, 2008). It builds on the SOP, and endeavors to enhance its operational content. This section aims to build on this recent work, while also incorporating relevant good international practices for promoting better quality and governance in sectoral expenditures, as outlined in the WDR 2008.

## A) Budgetary Structure

3.2 The budgetary structure is based on strategic sectoral programs (5) and services (5),<sup>18</sup> taking a programmatic approach as outlined in the SOP, together with some adjustments to reflect the recent strategic re-focusing in line with a commodity-food chain approach. These strategic adjustments include: (i) a better identification of the public sector interventions which are more in line with an appropriate role of the state,<sup>19</sup> and giving a stronger focus on supporting public goods and/or reducing poverty for the target groups, and generating a multiplier effect in terms of private sector investments; and (ii) a matrix which illustrates the strategic and operational inter-relationships of the priority commodity chains with the relevant programs and services, and which are demand-driven by the various private sector target groups.

### Prioritization Criteria

3.3 There are two levels of prioritization which need to guide the process of formulating the medium term expenditure framework and annual budgetary allocations:

- The macro level, as issued by the Ministry of Finance (and which needs to be adjusted appropriately to the sectoral level)
- The sectoral level which arises from the SOP, and the recent updated operational strategy, with a commodity focus, applied to the programs and services.

3.4 The Ministry of Finance has issued the following guidelines for preparing sectoral MTEFs (2009-2011), based on 3 considerations: macroeconomic goals and targets, to ensure adequate stability; the main pillars of the current Government's Plan, which focuses on people empowerment; priorities in the budgetary allocations. More specifically, these macro guidelines emphasize 7 principles/criteria which involve ensuring macro-fiscal stability and a balance between growth and poverty reduction interventions.

## B) Medium-term Expenditure Framework and Criteria for Establishing Priorities

3.5 The MTEF (2007-2010) for the agricultural and forestry sector is a planning and budgetary instrument, which is being used by SAG to estimate the preliminary budgetary requirements of the institutions which comprise the public agricultural sector (PAS). In addition, this MTEF includes other Ministries/agencies which are important to carry out the SOP and achieve its sectoral goals, in line with its recently updated sectoral strategy, with a commodity chain focus, and initial rough estimates of sectoral private sector investments.<sup>20</sup>

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<sup>18</sup> The 5 programs are: PRONAGRO; COMPETIVIDAD; PRONAPAC; PRONAFOR; PRONADERS; the 5 services are: DICTA; SENASA; SENINFRA; SEDUCA; INFOAGRO; plus SNITTA

<sup>19</sup> See ref. to Diagram 4.1, which illustrates the various options involving the evolving role of the state and which need to be worked out by each country. For further discussion of this important theme, see the WDR 2008, Chapter 11.

<sup>20</sup> Accordingly, the MTEF for the agricultural and forestry sector in Honduras includes: SAG, and its 3 decentralized agencies; other sectoral agencies/Ministries (SERNA, BANAHEA), and other Ministries/agencies which provide important public investments to help achieve the sectoral objectives and targets (Ministry of Transport, Electrification, Social Fund/FHISS). SAG also is endeavoring to include approximate estimates of the private sector investment, in order to give emphasis to the role of public investments to catalyze private sector investments, with a commodity focus. This does not mean that SAG is attempting to "pick winners", but rather to emphasize the importance of taking a demand-driven approach to programming public investments, which are intended to catalyze expanded private sector investments.

3.6 The SOP has prioritized 4 thematic areas, and 15 component sub-themes, which are associated with the programs and services outlined above, which provide a strategic framework for allocating the sectoral public expenditures, in line with the budget ceilings issued by the Ministry of Finance. These strategic themes/subthemes are as follows:

- a) Food Security
  - Food production and storage
  - Income Generation for small farmers
  - Natural Resource Protection and Management
- b) Productive Transformation
  - Small Rural Enterprise Development
  - Technological Innovation
  - Productive Infrastructure
- c) Competitiveness
  - Productive Commodity Chains (horizontal and vertical)
  - Agro-based Enterprises
  - Rural Service Enterprises
  - Rural Finance
- d) Institutional Strengthening and Development
  - Capacity Building
  - Information Systems
  - Sanitary and Phytosanitary Services
  - Institutional Development
  - Coordination

3.7 Within this broad strategic framework, SAG is formulating an enhanced process for establishing sectoral investment priorities, according to the on-going investment portfolio and proposed programs and projects. The following table illustrates a proposed framework which can be used (by SAG/UPEG) to help apply the prioritization criteria in a consistent manner, given five criteria, in order to derive an overall prioritization ranking for guiding the allocation of scarce funds within budgetary ceilings:

**Table 3.1: Framework for Establishing Sectoral Budgetary Priorities \***

| <b>Program/<br/>Service and<br/>Project</b> | <b>Links<br/>with<br/>Macro<br/>and<br/>Sectoral<br/>Strategies<br/>(Ranking:<br/>1 to 5)</b> | <b>Links with<br/>Commodity<br/>Chains &amp;<br/>Private<br/>Sector<br/>(Ranking: 1<br/>to 5)</b> | <b>Links with<br/>Sectoral &amp;<br/>Inst'al Targets<br/>and<br/>Sustainability<br/>Arrangements<br/>(Ranking:<br/>1 to 5)</b> | <b>Links with<br/>Effective<br/>M&amp;E<br/>Systems and<br/>Governance<br/>Mechanisms<br/>(Ranking:<br/>1 to 5)</b> | <b>Links<br/>with<br/>Other<br/>Key<br/>Prioritiza<br/>tion<br/>Criteria<br/>(Ranking:<br/>1 to 5)</b> | <b>Overall<br/>Ranking<br/>(1 to 5)</b> |
|---|---|---|--|---|--|---|
|---|---|---|--|---|--|---|

**A) Under  
Implementa  
tion**

Listing of  
Projects under  
the Key  
Programs,  
Services  
.....etc

**B) Under Preparation & Approval**

Listing of  
Projects under  
the Key  
Programs,  
Services  
.....etc

**C) Under Identification**

Listing of  
Projects under  
the Key  
Programs,  
Services  
.....etc

\* For each criteria, the budgetary analyst/team would assign a ranking of 1 to 5, with 1= highest priority, and 5=lowest priority. In deriving the overall ranking, it is assumed that each criterion has an equal weight (20% each). Any revision of the weights should be part of a transparent process in setting investment priorities. The lowest overall rankings warrant higher priority in the allocation of proposed, approved and released budgetary public funds. It is understood that this suggested framework could be used as a budgetary planning tool, recognizing that there may be other important factors in making the final allocations (which should be reflected in the fifth criteria), while endeavoring to make the allocation process more transparent and participatory.

3.8 For programs/projects under implementation, SAG/UPEG has adopted the following prioritization criteria for allocating budgetary funds (which are largely consistent with the above sectoral prioritization framework):<sup>21</sup>

- (a) programs/projects which have been subjected to the portfolio review, to help ensure consistency with the strategies as outlined in the SOP, and with a focus on commodity chains and the sectoral targets;
- (b) programs/projects which currently have the availability of external funds and the required local counterpart funds, to avoid situations of cancelling external funds, while also confirming that the proposed activities are also consistent with the sectoral operational strategies;
- (c) programs/projects which are well integrated in the sector's institutional arrangements, to promote greater sustainability of the activities, and which are supporting explicitly the commodity chain approach;
- (d) programs/projects which have effective and functional M&E systems, and which are managed according to results, and accompanied by effective governance and accountability mechanisms (participatory processes, use of transparency commissions, social audits, public expenditure tracking, quality assessment surveys)

3.9 For proposed programs/projects under preparation and approval process, SAG/UPEG has adopted the following prioritization criteria for allocating budgetary funds (which also are largely consistent with the above proposed sectoral prioritization framework):

- (a) Focus on public goods and interventions which help address market failures, especially including the following types of investments:
  - Rural roads (located in areas with high production potential and concentration of low income population

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<sup>21</sup> Higher priority should be accorded to programs/projects which meet a larger number of these criteria.

- Property rights and access to land
  - Agricultural Technologies for low income population
  - Natural Resource and Environmental Management
  - Support to Enhanced Food Security
  - Competitiveness, with a focus on removal of constraints and market failures, public goods and complementarity with private investments
  - Gender equity
- (b) Investments which promote increased agricultural production and productivity and employment, consistent with the concept of public goods (see (a)), and which could have a positive multiplier effect with regards to stimulating private sector investments in supporting the development of integrated commodity chains. Of preference, priority should be given to supporting program-based approaches (PBAs), consistent with the above budgetary structure of strategic programs and services.<sup>22</sup>
- (c) Institutional and environmental sustainability, including support for
- Sustaining project initiatives through sound integration of its institutional arrangements in those of the core programs and services
  - Decentralization
  - Civil society participation and empowerment

### **C) Emerging Proposed Medium Term Expenditure Program (2008-2012)**

3.9 The methodology which MOA is using to formulate the updated sectoral MTEF (2008 – 2012) is based on the following considerations:

- (a) An initial version of the MTEF (2007-2010) which was formulated in 2007, as part of the sectoral expenditure review exercise, and which included consultations with various public and private agencies<sup>23</sup>
- (b) The use of the above budgetary structure, which emphasizes a programmatic approach in focusing on strategic programs and services, and the commodity chains.
- (c) The application of the prioritization criteria outlined above (for both macro and sectoral aspects), which emphasize the requirements of promoting commodity chains, including:
  - A consultation process with diverse stakeholders from the private sector, where they are intended to firm-up y socialize the strategy at an operational level, as part of the budgetary process and cycle for 2009
  - The strategic investment interventions under the responsibility of other Government agencies/Ministries, such as rural infrastructure (e.g., rural roads, rural electrification, communication technology), access to rural finance, whose responsibilities lie with other institutions, such as ENEE, SOPTRAVI, FHIS, HONDUTEL, and private banks.

3.10 Based on the progress to improve the planning and budgetary processes of the sectoral MTEF (2008 – 2012), which is further elaborated below, it is anticipated that SAG/UPEG will make further adjustments and improvements to help ensure realistic and sound allocations, with a better composition and quality, consistent with the strategies outlined above and the budgetary ceilings.

<sup>22</sup> For example, SAG is preparing 3 investment programs which follow a PBA, which can provide direct support to the commodity strategy being pursued by SAG, and which warrant priority within the budgetary ceilings. These refer to SNITTA; SENASA; and PRONAFOR. In addition, there are 3 new competitive projects being supported by various donor agencies, which form the core of the competitive program, and exhibit many of the positive features of the sectoral strategies in supporting the commodity focus. These six PBAs are likely to consume the vast majority of the sector's budgetary ceilings.

<sup>23</sup> The initial version reflected sectoral expenditure requirements of nearly double the recent expenditure allocation trends, and well above the budgetary ceilings issued by the Ministry of Finance. This highlights the gap between required and likely allocations, and the need to apply prioritization criteria.



3.12 Table A2.3 presents preliminary estimates of both public and private sector investments according to the main commodity chains, while recognizing that the public sector funds are intended to help catalyze increased and broad-based private sector funding.<sup>26</sup> The figures reflect substantial increases in current expenditure allocations, and their basis and prioritization still requires SAG to conduct a more systematic consultation process with diverse private sector stakeholder groups at the regional level, as part of taking a demand-driven approach to allocating public sector investments. The proposed expenditure levels exceed realistic budgetary ceilings, and hence further work is needed to prioritize and align them with the updated sectoral priorities. Some of the current public sector allocations for several commodity groups (e.g., livestock, fruits and vegetables, pigs, beekeeping) seem to be excessive vis-à-vis the proportion being invested by the private sector. In part, these figures and proportions reflect the difficulties of getting reliable information regarding private sector investment intentions, especially since currently there is limited access to credit from the private banking system.

3.13 Table A2.4 presents an estimate of a matrix which illustrates the budgetary allocations and associated strategic inter-relationships between the programs/services and the main commodity chains. This approach aims to sharpen the expenditure focus towards the development of the commodity chains and target groups. There is a need for the MOA/UPEG to validate the indicative allocations through further consultations at the field level. It provides a good framework to guide the MTEF process.

3.14 The emerging allocations, presented in several ways, suggest the following strategic implications in terms of their likely amounts, composition, quality and next steps to further concretize a consistency with the above sectoral strategy, with a commodity chain focus:

- (a) The budgetary structure should be consistent with the programs and services of the SOP, together with the updated strategy which SAG recently prepared (and under discussion). Several strategic programs have been added to this structure to strengthen the commodity focus, most notably, the competitive program, inclusion of other key Ministries to help support a multisectoral approach to fostering rural growth, and expanded access to rural finance.<sup>27</sup>
- (b) The completed sectoral (partial) MTEF will require a significant increase of public investments over the previous historical levels, which, together with key policy improvements to enhance the rural investment climate, is also needed to provide adequate incentives for expanded private sector investments. The proposed SAG budgetary increase for 2008 represents a nominal increase of 6 % (estimated inflation rate) over the 2007 approved amount; but other additional expenditure requirements and assumed donor funding will exceed the MOA (and associated agencies) budget ceiling.
- (c) The sectoral MTEF allocations require a better quality in the structure and composition of the public expenditures to help ensure an expenditure which is more efficient, effective and equitable. Emphasizing better quality can help justify the proposed increases, which should be consistent with public goods, reflecting priorities which are consistent with the above prioritization criteria, a sound balance in recurrent and capital expenditures, and a

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<sup>26</sup> The Government is still working out the composition of these investments, especially the public investments. There are varying views on the types of public interventions, such that some of them will likely include private goods and transfer payments.

<sup>27</sup> This multisectoral approach is consistent with the analytical findings and recommendations of a Bank-funded study on Drivers of Rural Growth for Central America (2005). Honduras was one of the in-depth country studies, which highlighted the importance of promoting rural infrastructure (especially rural roads and electrification), education and key agricultural technology services in areas with high potential and concentrations of rural population.

good sectoral expenditure record, with effective targeting to the main beneficiary groups. This implies some re-allocations and retrofitting of the existing portfolio and allocations, towards the updated priorities and commodity approach. These adjustments could include the following:

-- Ensure the transfer payments, including input subsidies (“bono tecnologico” program), are well targeted and justified;  
--- Re-allocate and mobilize existing sources of funding to support the sectoral priorities.<sup>28</sup> This would help optimize the use of existing resources, giving it a more strategic, decentralized, and commodity focus, with the explicit intention of stimulating expanded private sector investments by diverse stakeholders.

- (d) There are substantial potential benefits of introducing and operationalizing appropriate demand-driven mechanisms to help ensure sound allocations which favor public goods that are responsive to the priorities of the private sector commodity chain target groups. For example, such mechanisms can be adapted from successful international experience, such as increased use of various types of competitive funds, cost sharing/matching funds (including leveraging overseas remittances), based on transparent eligibility criteria.<sup>29</sup> Accordingly, these demand-driven approaches are conducive to supporting programmatic and flexible approaches to planning and managing public expenditures in order to allocate scarce public funds in a manner which will generate a multiplier effect with broad-based private sector investments. This approach will rely primarily on the private sector actors to make the investment decisions according to market driven forces.
- (e) It is desirable that the sectoral MTEF be updated each year, together with the annual budget, as part of the budgetary cycle, coordinated by the MOA/UPEG (in its coordinating role). It is suggested that the MTEF include allocations for natural resources and forestry, which are vital components of Honduras’ agricultural and forestry sector, and contribute to sustainable poverty reduction. It is understood that the enhanced experiences and capacities will lead to improvements in the composition and quality of the expenditures, which will be increasingly underpinned by regular consultations with relevant Government Ministries/agencies supporting rural areas, private sector stakeholders, and participating donors.
- (f) It is recognized that validating the matrix which shows the interrelationship between the programs/services and commodities will require more time to further develop and complete, based on more extensive consultations. Based on establishing an improved and transparent budgetary consultation process, it is anticipated that these allocations can be substantially improved by the 2010 budgetary cycle, based on a demand-driven approach.

## **D) Preliminary Framework Financing Plan**

3.15 Table 2.8 presents the framework of a preliminary proposed financing plan for the proposed MTEF (2008 – 2012) expenditures (of US\$403 M), showing the main sources of funding (and excludes the important forestry sector and natural resources). The MOA/UPEG team intends to use it as a planning instrument to mobilize the required funds, from the various sources. The upcoming 2009 budget cycle will give impetus to continuing with this exercise.

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<sup>28</sup> For example, currently the GoH has various funding sources which can be tapped to support the updated strategy (e.g., Petrocaribe, several Trust Funds, on-going projects, private banking sources earmarked for the rural sector)

<sup>29</sup> The WDR 2008 reviews some of these successful experiences as part of promoting public-private sector partnerships, and stimulating expanded private sector development, while removing market failures and reducing poverty.

3.16 The following aspects warrant careful attention by the MOA/UPEG team in the course of firming up and realizing the proposed financing plan, under the overall guidance of the Minister of MOA:

- (a) The financing sources are derived from several key actors, to be mobilized in a coordinated manner: public sector (44%); private/banking sector (4%); donors (52%); and municipalities (using central and local government revenues, to be determined); and beneficiaries (also to be determined). In the short term, it is desirable to re-adjust the existing resources/projects toward supporting the updated strategy, to the extent feasible, in line with a portfolio review exercise, especially using national funds, which have more flexibility than donor-funded projects. It is recognized that the funding sources will evolve, depending on the participation and commitment of each actor. The strategic objective is to stimulate a growing proportion of funding from the private sector, especially the private banking sector, giving priority to involving smallholders and medium size farmers and entrepreneurs.
- (b) The private sector presents some preliminary estimates of the private sector which supports the agricultural sector, consistent with market and demand trends by the diverse target groups. While these estimates are still tentative, MOA plans to firm them up based on further consultations with private sector groups at the regional level. The strategy is to further sharpen the public sector allocations in a manner which is responsive to private sector priorities and market demand trends, generates a multiplier effect (of 1:4), and consistent with public good principles. Currently, there appears to be excessive allocations by the public sector to some commodity groups, vis-à-vis the funding from the private sector. These issues will need to be addressed by MOA/UPEG as part of the on-going consultation and MTEF processes.
- (c) There is a likely financing gap in the updated MTEF (2008-2012), especially since many current donor-funded projects will be closed by 2010, and the fiscal constraints are likely to continue in the short term. This funding gap will require a number of parallel actions, including:
- The consistent application of sectoral strategic guidelines and prioritization criteria in order to ensure a transparent and sound allocation of available funds (and in line with sectoral and agency budgetary ceilings, to be “negotiated” by CODA);
  - A significant increase in the share of funding from Government, while mobilizing additional donor funding, especially considering that many of the on-going donor-funded projects are scheduled to close within the next 2 years;
  - Aligning and harmonizing the available donor funding with priority programs, especially to ensure adequate counterpart funding;
  - To the extent the funding gap persists, to re-adjust (downwards) the sectoral result and outcome targets, and their timeframe;
  - Ensuring that available public funds play a catalytic role in expanding private sector investments, including expanded access to rural finance (especially through the private banking sector).

**Table 2.8: Preliminary Financing Plan for the MTEF (Agriculture Sector)**  
(Millions of Lempiras; Lps 19.1 = US\$1.0)

| Program/Service 1/   | Private Invest. * | Public Investment | Donors     | Local Govt. & Beneficiaries** | Total           |
|--|-------------------|-------------------|------------|-------------------------------|-----------------|
|  |                   |                   |            |                               |                 |
| Programs   | -                 | 2222              | 301        |                               | 2524            |
| Competitiveness Program  | 290               | 125               | 2540       |                               | 2956            |
| Services   | -                 | 196               | 99         |                               | 295             |
| SNITTA   | -                 | 2                 | -          |                               | 2               |
| <b>TOTAL MOA</b>   | 290               | 2546              | 2942       |                               | 5777            |
| Decentralized Institutions of the Agriculture Sector (being estimated) | 3                 | 461               | -          |                               | 464             |
| Other Projects Supporting Commodity Chains                             | -                 | 52                | 1098       |                               | 1150            |
| <b>TOTAL AGRICULTURE SECTOR</b>  | 293               | 3058              | 4040       |                               | 7392            |
| Other GoH Institutions/Agencies ***                                    | -                 | 299               | -          |                               | 299             |
| <b>TOTAL AGRICULTURAL MULTI-SECTOR(M Lemp.)</b>                        | <b>293</b>        | <b>3358</b>       | 4040       |                               | <b>L 7691</b>   |
| <b>US \$ Million</b>   | <b>15.3</b>       | <b>176</b>        | <b>212</b> |                               | <b>US\$ 403</b> |

Source: MOA/UPEG (February, 2008)

\* Actual scope for private investment is substantially higher, especially

\*\*To be determined

\*\*\* **Includes AFE-COHDEFOR (and now the newly established CFD). These figures still need to be updated, and will contribute to a large total figure, once firmed up.**

#### **E) Governance Strategy: Enhanced Processes and Mechanisms for Better Sectoral Coordination and Outcomes**

3.17 The WDR 2008 highlights relevant international experience which shows that ensuring sound allocations of sectoral expenditures requires explicit actions and commitment to establish and strengthen appropriate processes and mechanisms for better coordination and governance, to enable coherent and effective linkages between stated strategies, actual expenditure allocations, implementation, and sustainable results. See Box 3.1 for some good practices which emerged from the WDR 2008 report. Some of the initiatives which the Government is considering, being recommended through this report, and/or implementing include the following:

- (a) Sectoral Planning and Budgeting Processes and Coordination: Strengthen participatory and transparent planning and budgetary processes at both sectoral and regional levels, through utilizing the sectoral MTEF and annual operational plan/budget processes, coordinated by SAG/UPEG, as part of the Government's (coordinated by the Ministry of Finance) annual budgetary cycle. This requires: (i) moving more decisively toward a programmatic approach, especially for new expenditure proposals, which is the MOA's intention, but which in practice still tends to follow a traditional supply and project-driven approach;<sup>30</sup> and (ii) strengthening the planning and budgetary capacities of the key

<sup>30</sup> For example, the expenditure prioritization framework outlined in Chapter 3 can be used as a planning tool to help ensure new investment ideas and proposals conform with the program-driven criteria.

participating agencies, especially their planning units, and the role and effectiveness of national and regional CODAs. These are sector coordinating and decision-making counsels established in 2007, and comprised of the agency Managers at the national and regional (9) levels. They are mandated to help ensure improved coordination of policy, strategy, budgetary and operational policies and strategic activities in the agricultural and forestry sector, under the overall leadership of the Minister of the MOA.

In order to help ensure consistent approaches and behavior, there is a need for the MOA, with the support of UPEG, to draw up simple and clear guidelines for these enhanced planning and budgetary processes, and to conduct workshops (at central and regional levels) in order to develop a clear consensus and ownership by the key actors. These would be guided by the central level CODA. In addition, it is suggested that the MOA/UPEG take a more proactive role to work with and support the respective planning units of the relevant agencies during the planning and budgetary cycle. This would facilitate more effective coordination at the technical level, while being reinforced by the direction and decisions provided by the CODA, under the overall leadership of the Minister of the MOA.

- (b) Sectoral Roundtables: The above coordination efforts in the sectoral planning and budgetary cycle need to be complemented by strengthening the roles and effectiveness of the Agriculture and Forestry Roundtables.<sup>31</sup> They are mandated to serve as a consultation mechanism for developing consensus on important sectoral policies and strategic themes/actions involving the key actors, including representatives from the Government, private sector, civil society, and donors. They have not been meeting on a regular basis, and do not appear to play a very important role. Other country experience (e.g., Nicaragua, others) suggests that they could play a potentially useful role in enhancing consensus building and governance, if effectively coordinated. Given that the President's Office (UNAT) is mandated to ensure effective functioning of these sectoral roundtables, it is suggested that the sectoral UNAT team take a proactive role in working with the MOA/UPEG on these matters.
- (c) Agriculture and Forestry Sub-Cabinet. A third level of enhanced sectoral coordination and governance which is still at the proposal stage, but which warrants serious consideration by the Government, is the establishment of an Agriculture and Forestry Sub-Cabinet, as part of the President's Cabinet. It could involve the key central and sectoral Ministries, as well as other relevant Ministries, with the function of achieving a higher level of policy and sectoral coordination and decision-making on more complex issues which cannot be adequately resolved. Accordingly, it could facilitate the effectiveness of the above two levels of sector coordination. The UNAT team can also play an important role in facilitating the role and work of the proposed Agricultural and forestry Sub-Cabinet.
- (d) Sectoral M&E System: Strengthen the processes and capacities of an effective monitoring and evaluation system for the agricultural and forestry sector, while ensuring that the M&E systems of the agroalimentary and forestry sectors are adequately functioning, given the current fragmentation of the overall sector (as indicated above). The previous section has shown that to this date, the M&E systems have been weak and largely ineffective, due

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<sup>31</sup> These roundtables form part of the Government's sectoral/donor coordination system, whereby the Forestry sector has its own roundtable, as distinct from the agricultural sector. This distinction and separate identities are reinforced by the National Congress' recent passage of the Forestry Law, and its official gazetting. There are steps being taken to help ensure adequate exchange of information and coordination between these two roundtables, given their close inter-relationships in addressing the needs of some of the same rural families.

to structural and behavioral underlying causes. The MOA/SAG has a M&E Unit, which is a part of UPEG, with some qualified staff, and which provides a good base to develop a more comprehensive action plan for strengthening the M&E functions and work plan for the agro-alimentary sector. The head of the M&E Unit, under the overall direction of the MOA/UPEG Executive Director, and strong support of the Minister of MOA, could help ensure that the key elements of the M&E action plan include:

- i. a more comprehensive monitoring system for the portfolio of projects under implementation, ordered according to the established programs and services, and focusing on tracking the most relevant performance indicators;
  - ii. two portfolio implementation reviews per year, under the overall direction of the central CODA, and chaired by the Minister of MOA, to focus on assessing and correcting progress, as needed, based on key performance indicators. The UPEG's M&E Unit would work closely with the relevant Project Units to prepare for this portfolio review. The timing of the portfolio reviews can be linked to the annual budgetary process (preparation and mid-year review). The results of these portfolio reviews can provide an important input to the annual implementation report which the MOA prepares, but which is carried out to fulfill a bureaucratic requirement.
  - iii. timely and sound independent evaluations for selected projects, in line with their implementation schedules and arrangements. Thus far, there are very few ex-post evaluations, and for those which have been completed, there is no evidence that their results are carefully reviewed and considered by the Government, and even the donors. The M&E Unit could help coordinate these arrangements, again, in close collaboration with the relevant project unit, and the UNAT's sectoral team.
- (e) Other Enhanced Governance Mechanisms: The WDR 2008 highlights a number of useful governance mechanisms which are showing positive results in other countries in promoting more efficient and better quality public expenditures, and which can be adapted to the Honduras context and priority needs. These complementary instruments could include (and could be coordinated by the MOA/UPEG, in accordance with its capacity):
- (a) sharper performance indicators, focusing on results, outcomes and impact, with explicit linkages to the updated sectoral strategy;
  - (ii) periodic public expenditure reviews at the sectoral level, including assessing the efficiency and equity aspects. It could take place immediately following a new Government administration, preferably as an input to updating the sectoral strategic plan and MTEF. It is important to coordinate this exercise with a macro-level PER, to help ensure consistency in using the macro-level expenditure parameters, processes and systems;
  - (iii) a sectoral public expenditure tracking system, which could focus on key stages of the expenditure cycle, and could involve the local-based Transparency Commissions;<sup>32</sup>
  - (iv) periodic quantitative and qualitative service delivery surveys, for key service and public good themes (e.g., technology dissemination, phytosanitary services and certification, forestry management plans

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<sup>32</sup> The use of local and independent Transparency Commissions in Honduras are showing promise in terms of involving local officials and civil society representatives, to help verify public expenditures are used for their stated purpose. These same commissions can be used to support and collaborate in carrying out specific sectoral service surveys (see item iv above), which generate a report card on the quality of services provided, as well as generating suggestions on their improvements.

- (f) The sectoral MTEF allocations imply the need for giving priority to improving the use of existing budgetary allocations. Making tangible progress here can help justify the needed increase in sectoral allocations, especially to the extent that they are consistent with public goods and other appropriate interventions which will overcome market failures and effective poverty targeting.

## IV. CONCLUSIONS AND RECOMMENDATIONS

### A) Implications of Recent National and Global Assessments

4.1 The conclusions of this report need to be placed within a broader context by considering the implications of recent national and global assessments on public expenditures which can help guide relevant conclusions and value-added recommendations for Honduras' agricultural and forestry sector. There are many aspects, including the methodological approaches and tools used in this country case study, which may also be used for the analysis and policy design work in other developing countries which are facing similar challenges as Honduras.

4.2 First, the conclusions of the recently completed World Bank PER emphasized two major challenges facing Honduras' economy and the well-being of its population, with important implications for the key messages arising from this sectoral PER: (a) historically, Honduras has a relatively low economic growth rate, certainly well below its potential growth, resulting in one of the countries with highest poverty rates in Latin America; (b) the persistence of poverty (> than 50% of the population, with 80% located in rural areas), has not decreased very much over the past 15 years, notwithstanding substantial increases in public expenditures and poverty reduction interventions over the past 5 years, through its poverty reduction strategy program; (c) there are serious fiscal underlying pressures facing the country in order to ensure needed macroeconomic stability (e.g., Government commitment to continue to raise teacher salaries, expand social services, increase infrastructure and poverty reduction expenditures).

4.3 These macro-level conclusions suggest two important implications for this report and its messages: (a) there is a serious constraint in the Government's fiscal capacity to increase substantially public expenditures over the next 3-5 years, especially as there are increasing demands from various key sectors; (b) it is vital that the national and local Government strengthen their systems and capacities to manage a more efficient and equitable public expenditures for all sectors, especially those which have a potential for large impacts on rural poverty reduction like the agricultural and forestry sector.

4.4 Second, the global perspective is derived by considering the relevance to the Honduras context of some of the key messages arising from the WDR 2008 regarding sectoral public expenditures, which are outlined in this report. See Box 1 for a brief summary of key messages.

#### Key Sectoral Constraints, Strategy Thrusts, and Emerging Debate

4.5 The study's assessment of the public expenditures for the agricultural and forestry sector, in addition to considering the above national and global reviews, also is placed in the context of addressing cumulative sectoral structural problems inherited from past Government administrations, and in line with the Government's sectoral strategies for the long-term (PESA, 2004-2021), medium term (SOP, 2006 – 2010), and the on-going exercise to update and operational its short-to-medium agricultural and forestry strategy (2008 – 2012). This report summarizes the more important sectoral constraints and corresponding strategies which provide a framework for prioritizing sectoral public expenditures. The current main thrust of the Government's updated sectoral strategy focuses on

enhancing the operational content and modalities of 4 main strategic themes (food security; productive transformation; competitiveness; and institutional development). These are being linked to the development of differential commodity chain operational strategies, driven by local and international market demand forces, and an expanded role of the private sector.

### **Box 5.1: Perspectives & Good International Practices of Sectoral Public Expenditures: WDR 2008**

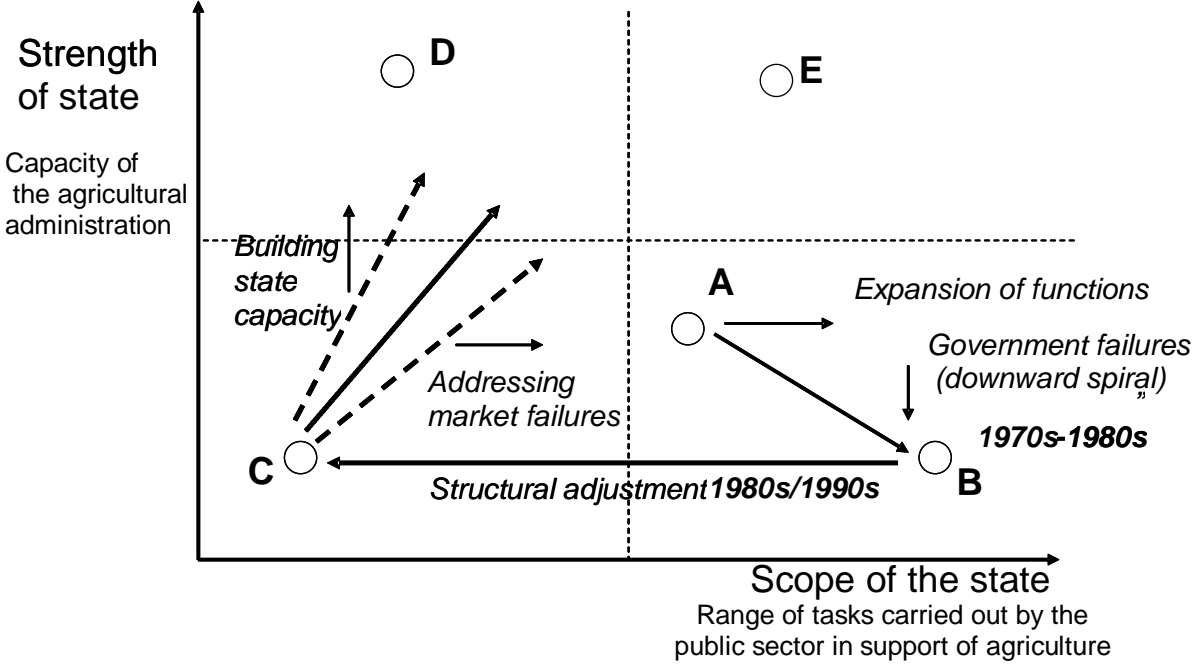
The WDR 2008 report placed special attention to addressing relevant experiences and lessons involving good international practices of enhanced sectoral public expenditures. Of great importance, the WDR also highlighted the dominant message and clear trend of their being under-investment and mis-investment in the agriculture sector of most developing countries. There are 8 important messages from the WDR work which have special relevance with regards to the Honduras context (further details for each item are provided in the expanded Spanish version of this report):

- (b) Importance of the agricultural sector: refers to its vital importance in the country's economic structure and ensuring actions are taken to ensure it plays a transformative role in promoting broad-based growth & poverty reduction.
- (c) Importance of the political-economy dimensions: refers to the importance of securing political support for the ARD agenda, at various levels of the country's political system (executive/Cabinet level, legislative
- (d) Importance of promoting and strengthening good governance at both the country AND sectoral levels: refers to the negative effects of not having good governance systems, structures and mechanisms in place, especially for better accountability and a functional monitoring and evaluation system;
- (e) Appropriate & Transformed Role of the Government: refers to finding the most appropriate roles for Government, private sector and civil society, taking into account the range of activities and state capacity (see Figure 1)<sup>33</sup>
- (f) Elements of a Good Strategy and Operational Plan: refers to 4 key elements, which if formulated and carried out appropriately, will have a positive impact
- (g) Operational Strategies to Improve Governance of Sectoral and Budgetary Management: refers to internal reforms of the Ministry of Agriculture, revamping the frontier of MOA's in finding the right balance and innovative partnership modalities, & establishing strengthened regulatory arrangements
- (h) Strengthening Decentralization and Local Governance: refers to clarifying and carrying out expanded decentralization of roles (central vis-à-vis local governments), fiscal aspects of revenue generation and expenditure allocations (with revenue-sharing), and community-driven development

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<sup>33</sup> In summary, the main message of this figure is that each country needs to find its appropriate role for the state vis-à-vis its capacity, while recognizing that international experience of successful agricultural economies (such as Honduras) should endeavor toward points (D) and (E). There is a tendency that many countries seeking to reduce poverty will over-expand the functions of the State (toward points A and B, while having limited capacities).

**Figure 1.1: Role and Capacity of State (Source: WDR 2008: Chapter 11, plus footnote (33))**



4.6 These strategy thrusts are generally sound, although there is still some debate on the appropriate role of the state to be more consistent with good international practice (as outlined in the WDR 2008) and with the most effective means to helping to realize Honduras' potential. There is some risk that the Government effectively may choose what to produce ("winners"), rather than enabling producers to make these commodity choices, in accordance with market forces. The GoH/MOA-driven updated strategy aims to provide a framework for guiding and prioritizing its sectoral expenditures to address the above mentioned constraints and to help tap substantial unrealized potential in the sector by diverse stakeholders. The extent to which the operational sectoral strategy takes a programmatic and market-driven commodity chain approach is still under discussion and emerging, with strong political pressures for the Government to generate tangible production results in the short-term (especially in the remaining two years of the current administration). There is evidence that recent public expenditure patterns are increasing the amount of transfer payments, including inputs subsidies, as private goods, in response to these short-term pressures to show production results.

## **B) Key Conclusions and Implications of the Historical Analysis of Sectoral Public Expenditures**

4.7 The study's historical quantitative analysis of Honduras' sectoral public expenditures was used to better inform and underpin the report's assessment of expenditure trends (level and quality), criteria and future priorities, and enhanced processes for attaining better governance and sustainable impacts. Some of the main conclusions include:

- Honduras has a low orientation index of agricultural expenditure compared to other similar countries --- a low level of sectoral expenditure allocations (less than 5% for most years) vis-à-vis the economic importance of agriculture and associated activities (about 40% of GDP), especially considering the cumulative under-investment in addressing various structural constraints and tapping its vast agricultural potential;
- Honduras has exhibited relatively low efficiency levels in the execution of its sectoral expenditures, averaging about 60% since the year 2000 ----- and measured as sectoral expenditures as a percentage of the expenditure levels approved by the National Congress. The expenditure rate has increased in 2007 (to about 90%), and it appears that some of the underlying causes of the low expenditure rates of the past are being currently addressed by MOA and other sectoral agencies.
- There is a mixed assessment on the quality of sectoral expenditures, as reflected by various indicators: there are under-investments/allocations for public good type of expenditure activities (especially agricultural research and development, phytosanitary services, property rights and land access, key rural infrastructure); since 2002 there are increasing trends toward private good expenditures, including input subsidies (through the "bono tecnologico"), while there being relatively low producer and consumer price subsidies; there is a relatively high ratio of recurrent to capital sectoral expenditures (about 60:40 ratio), especially if one considers a proper classification of donor-funded expenditures, which in actuality cover portions of recurrent expenditures.
- There are about 142 projects in the agricultural and forestry sector (as of 2007), for a total cost of about US\$475 M, an average total expenditure level of about \$50-70 M per year.
- There has been a relatively high dependency on external donor funding, with about 50-70% (varying by period) of the sectoral expenditures funded by external donors (on a grant and loan basis). The projects tend to be implemented and managed in a fragmented manner, with many of them relying on project management units, especially those which are donor funded, which are not well integrated with the stated strategic programs and services. There is potential scope for retrofitting many of these on-going projects to better support the Government's updated sectoral strategies and targets (e.g., especially regarding the recent competitiveness program and the commodity chain approach). There is also substantial scope for introducing

appropriate harmonizing and alignment actions which can enhance the effectiveness, sustainable impact and reduce the transaction costs of external assistance. With many of these donor-funded projects coming to a close (by 2010), and there is a fiscal challenge for Government to assume a growing share of sectoral expenditures, while at least maintaining the expenditure levels.

4.8 The quantitative analysis explored the potential and limitations of using public expenditure in the agricultural and forestry sector of Honduras to generate sustainable impacts on growth, efficiency and poverty reduction. The study team used panel data compiled by FAO in a comparative study of public spending for 18 countries in the LAC region (1985-2001), to assess the effectiveness of this type of public expenditure. A general model was estimated for the whole dataset of countries and situated Honduras in a comparative ranking, looking at its relative performance in terms of efficiency and equity impacts.

4.9 A stochastic production frontier model was derived to assess the impacts of public expenditure on sector growth and efficiency, and a fixed-effect model to estimate impacts on rural poverty. The analysis shows that there is consistent evidence that only the expenditure in public-good-type of investments promote growth and reduce poverty, whereas expenditure in private-good-types are clearly detrimental both to growth and poverty. Finally, there are ambiguous results for the equity-enhancing type of expenditure, with apparently negative effects on growth, positive effects on efficiency and neutral effects in terms of poverty reduction.

4.10 Looking at these results, a recent worrisome trend in Honduras is the increase in private-good type of expenditures, which increased from 20% in 2001-2003 to more than 40% of sector expenditure in 2004-2006. It appears that the proposed allocations for 2008 will increase this trend, partly driven by MOA's focus on meeting various production targets, rather than focusing on public goods and services which can help generate a multiplier effect of expanded private sector investments. If these type of private good allocations continue to be increased, this would not be the best strategy to promote competitiveness and to reduce rural poverty for this low-middle income country. Given Honduras' pressing macro-fiscal constraints, these historical results would suggest finding more productive ways to leverage scarce public resources.

### **C) Emerging Framework and Challenges for Enhanced Sectoral Public Expenditures**

4.11 The study, including an updating exercise in February 2008, was carried out in close collaboration with the UPEG team of the MOA. With the support of this sectoral PER study, including an important sectoral expenditure planning workshop held in May 2007, the MOA/UPEG team, especially more recently, is endeavoring to promote and coordinate the development of an enhanced and operational framework and governance processes for sectoral expenditures. In mid-2007, the MOA/UPEG team formulated an initial sectoral MTEF (2007-2010), which was used to help guide and formulate the 2008 agriculture sector budget. The scope of this sectoral MTEF is still limited to the institutions which are under the administrative jurisdiction of the MOA, and which exclude the vital forestry sector agency, natural resources and their associated expenditures. The recent passage of the Forestry Law (2007) is leading to a further segmentation of institutional responsibilities, with the vital forestry sector considered as a separate "sector", from the point of view of government administration and expenditures. Nonetheless, more recently, the UPEG team is making efforts to formulate a sectoral MTEF, including forestry and other associated Ministries/agencies which are important to attain sectoral strategies and outcomes, and to use various coordination mechanisms to ensure coherence expenditure priorities (e.g., effective use of national and regional CODAs, strengthening the sectoral roundtable consultation processes, activating a Agricultural and forestry sub-Cabinet, to gain the President's support).

4.12 MOA's recent updating of the sectoral strategy has identified sound operational criteria for setting expenditure priorities for on-going and proposed sectoral investments, is endeavoring to develop a MTEF which reflects an increasing shift toward a programmatic approach (according to key programs and services), an increasing share of public goods and services in the expenditure composition, and to introduce enhanced participatory and transparent processes and mechanisms for promoting better governance and results for the sector. The key elements of these proposed improvements, and operational methodologies for their appropriate application, are presented in this report, and which are being considered by the Government. At the same time, there are still strong pressures in Government to increase public transfers and input subsidies, while also recognizing the need to improve the targeting and delivery mechanisms, and "exit" strategy to ensure adoption of improved technologies by smallholders will be sustained. These proposed improvements are at an early stage of discussion, and hence there is still an absence of a broad-based consensus on the above improvements by the diverse sectoral ministries, and also strong pressures and vested interests to continue the inclusion of separate and fragmented projects in the expenditure plans.

4.13 Many of these good expenditure practices suggested in this report can be potentially exhibited through the Government's recent (late 2007) launching of a "Partnership Competitiveness Program". Currently, it is comprised of three separate but coordinated competitive projects, which focus on promoting complementary public and private sector investments to attain key sectoral goals and targets, with a focus on promoting private sector-driven priority commodity chains. This major program offers some innovative avenues for enhancing both broad-based growth and poverty impacts on smallholders, as well as tapping the potential benefits of implementing the Central American Free Trade Agreement. The content and modalities of this competitiveness program, including the public expenditure composition and modalities for cost sharing, are in the early stages of being developed and launched. Through this program, there are promising steps being taken by MOA leadership to address many of the previous weaknesses in the agricultural and forestry expenditure portfolio, as indicated above, including: taking a programmatic approach to addressing and implementing a competitiveness strategy, adopting coordination mechanisms to enhance harmonization and alignment of the external assistance, implementation modalities, and achievement of common goals.

4.14 Hence, an overall conclusion of this study is that Honduras is at a cross-road in formulating, adopting and effectively implementing sound expenditure strategies and programs for the agricultural and forestry sector, which can generate sustainable impacts. The decisions and actions taken by its Management over the next 1-2 years will determine which pathway it will take, especially in enhancing the composition and quality of sectoral expenditures. These decisions can also positively influence the momentum and continuity of improvements with the new Government administration beginning in 2010.

4.15 Table 4.1 outlines the summary of the main messages and recommendations arising from this assessment, and which build on good international practices (as reflected in the WDR 2008). The recommendations comprise elements of an action plan which are suggested for consideration by the officials of the MOA, who currently are undertaking the challenge of promoting the transformation of the agricultural and forestry sector. The action plan is intended to enhance the quality aspects in terms of institutionalizing the promotion of increased efficiency, equity, and sustainable impacts of public expenditures for Honduras' agricultural and forestry sector. The action plan is intended to be updated and adjusted by the Honduran officials, based on implementation experience and learning-by-doing. Finally, it is hoped that the suggested recommendations, which focus on enhanced expenditure processes and governance, may also stimulate useful ideas and actions in other countries which are facing and addressing similar challenges.

**Table 4.1: Summary of Key Messages and Recommendations/Action Plan**

| Key Themes and Messages  | Recommendations   | Instruments & TimeFrame  |
|--|---|--|
| (1) Linkages with the Macro-economic framework, PRS and private sector | MOA, as sector coordinator, & SERNA to strengthen the operational linkages of the SOP, sectoral MTEF and annual budgets with the policy and expenditure guidelines of Ministry of Finance (MT and annual), and of the PRS/President's Office, through the planning and budgetary processes and cycle. Key coordination mechanisms are to be strengthened and used effectively (e.g., CODA, activating the Agricultural and forestry sub-Cabinet, collaboration among the various agency planning and evaluation units (known as UPEGs))   | <ul style="list-style-type: none"> <li>- Annual budgetary cycle (and use the 2009 cycle to make further enhancements)</li> <li>- Working meetings and workshops during planning &amp; budgetary cycle (by Sub-Cabinet group, CODA Central and Regional offices, Sectoral Roundtables, sectoral/agency planning units, other key budgetary meetings)</li> </ul>   |
| (2) Good practices of sectoral public expenditure mgt.                 | MOA, through the UPEG and relevant TA, to help disseminate and adapt relevant good international lessons and practices on enhanced public expenditure mgt.(especially in relation to the facilitating role of the public sector to transform the sector, public-private partnerships, coordination mechanisms, competitive and matching funds, focus on public goods, effective poverty interventions)  | <ul style="list-style-type: none"> <li>- MOA/UPEG to distill and disseminate key lessons from the WDR 2008(esp. Chapter 11)</li> <li>- periodic short-term training workshops (focused on the various sectoral planning units)</li> </ul>  |
| (3) Budgetary Structure and Composition                                | (a) SAG, with the support of the CODA and Finance, and facilitated by the UPEG, to adopt a programmatic structure to its sector/agency budgets, more closely aligned to its strategies, programs and services, and sectoral goals/targets. The agencies should endeavor to enhance the composition of the budgetary allocations to focus on relevant public goods, within the budgetary ceilings, and use the potential offered by the SIAFI, with the support of Finance.<br><br>(b) Complete preparation of the feasibility reports for three priority programs: SNITTA (Innovation technology program; SENASA (phytosanitary program); PRONAFOR (agricultural and forestry program, to be coordinated by AFE-COHDEFOR) | <ul style="list-style-type: none"> <li>- MTEF for the Agricultural and forestry Sector (2008-2012), updated annually</li> <li>- Sectoral and agency annual budget (beginning with the 2009 budget cycle, thereafter)</li> <li>- Working Groups (especially among the planning units, coordinated by UPEG)</li> <li>- Short-term training workshops (focused on the planning and budgetary cycle and relevant instruments) (b) Preparation and start-up of the program feasibility report (during 2008)</li> <li>(b) Agency/department preparation teams to complete the feasibility reports, in accordance with good practices and the updated sector strategy.</li> </ul> |
| (4) Operational framework and  | SAG/UPEG and SERNA, under the overall direction of the expanded CODA, to prepare  | - Sectoral MTEF, to be updated and improved as part of the 2009  |

|   |   |  |
|---|---|--|
| guidelines for a sectoral MTEF  | and disseminate the operational guidelines for preparing an improved sectoral/agency MTEF and annual budget, including sound prioritization criteria, coherence with the updated strategy and macro budgetary policy and guidelines, decentralization strategy (working with and through the regional CODAs and municipal planning processes), and taking a programmatic approach   | budget cycle<br>- Working Meetings (with the various planning units, coordinated by SAG/UPEG, and involving the regional CODAs)<br>- Training Workshops  |
| (5) Operational linkages between sectoral planning and budgetary activities, taking a programmatic approach | SAG (and various decentralized agencies), SERNA, with the active support of the various UPEGs (planning units), and under the overall direction of CODA, to strengthen their operational linkages and collaboration, through their planning, and administrative/budgetary units, together with Finance and Presidency planning units, consistent with the updated sectoral strategy and outcome indicators, based on a program and performance-based management approach to budgetary allocations. Steps should be taken to promote decentralized (and bottom-up) approaches to the planning & budgeting processes, using the regional CODAs  | - Annual updating of the sectoral MTEF (using the 2009 budget cycle)<br>- Sectoral Annual budget (using 2009 cycle, and within the framework of the sectoral MTEF)<br>- Sectoral working groups and workshops (focused on the planning and budgetary cycle, at both national and regional levels)<br>- Training workshops to enhance capacities and facilitate the processes (including regional levels)                       |
| (6) Transfer Payments/Subsidies   | (a) MOA, with the support of its UPEG, to disaggregate and rationalize transfer or direct support payments to farmers, in line with sound sectoral strategies and expenditure guidelines.<br>(b) SAG/UPEG to complete the study assessing direct support to farmers (using the OECD methodology).<br>(c) UPEG to coordinate an independent assessment of the effectiveness and impacts of agricultural subsidies (e.g., agricultural inputs), as well as their exit and sustainability strategies.<br>(d) UPEG, in collaboration with the relevant executing agencies, and the overall guidance of CODA, to help harmonize and align the various modalities and eligibility criteria of the various transfer programs and projects. | (a) Sectoral MTEF (2008-2012), for the 2009 budget cycle<br>- Sectoral annual budget for 2009<br><br>(b) Direct Farmer Support Study (by March 2008)<br><br>(c) Independent Evaluation of the Bono Tecnológico Program (in 2008)<br><br>(d) Harmonization of relevant regulations and eligibility criteria for specific subsidy and trust fund programs, agricultural insurance schemes, competitive and matching fund schemes |
| (7) Management and Governance of the On-going and proposed Portfolio of Sector Programs and Projects        | (a) SAG and SERNA, with the active support of their planning units(UPEGs), and supported and directed by CODA, to carry out twice per year a review of the portfolio of on-going projects, taking a strategic approach to make the needed adjustments so that they  | (a) Sectoral on-going portfolio review exercises (2 per year), timed according to key stages of the budgetary cycle (mid-year review and annual allocations)   |

are coherent with the updated strategies and outcome indicators. The results of this review should be reflected in budgetary re-allocations, as relevant;

(b) CODA to adopt a requirement that all agencies proposing new programs/projects (exceeding US\$0.5 M) need to prepare a: (i) brief concept note, which should be reviewed and endorsed (by CODA, President's Office, and Finance) prior to proceeding to the feasibility study stage. This will help ensure the rationale of the program is sound and fully consistent with the updated strategy and prioritization criteria; and (ii) a feasibility report, to be reviewed/endorsed by the same actors

(b) Clear guidelines for a program/project concept note and feasibility report, and related review processes (begin with the 2009 cycle, to be phased in over 2 years)

(8) Stakeholder Participation

SAG and SERNA, with support from the UPEGs, to:

(a) promote the active participation of key stakeholder groups (especially civil society, private sector and donors) in the planning and budgetary cycle for each Ministry and agency, and overall sector;

(b) elaborate and agree with several Transparency Commissions (TC) a Memo of Understanding to collaborate in carrying out social audits of selected sectoral expenditure programs/projects (e.g., input subsidy program)

(c) Explore collaboration with the National Anti-Corruption Commission (NACC), to strengthen the governance and accountability processes for sectoral expenditures (e.g., building on the initiatives for social audits, work of the local transparency commissions)

(a) Sectoral MTEF and annual budget activities (use the 2009 to start an improved process)  
- Memo of Understanding (between MOA and relevant stakeholder groups, such as TC and NACC) for specific tasks/activities.

(9) Monitoring and Evaluation of Sectoral Public Expenditures

(a) SAG and SERNA, with the support of their UPEGs, and in collaboration with UNAT (from President's Office) and Finance, to: (i) prepare and carry out an operational plan to strengthen each agency and sectoral expenditure M&E system and institutional arrangements; (ii) mobilize the funding to support the action plan; (iii) to submit periodic M&E progress reports of strategic programs to the CODA, and the Sectoral Roundtable Groups (and linked to the portfolio review process)

(b) The Sectoral M&E Units to forge joint collaboration with the NACC and TC to carry out/support social audits of selected sectoral

(a) (i) Agency and Sectoral M&E Action Plan and annual work plan (beginning for 2008); (ii) mobilize and reflect the needed funding in the MTEF and annual budget (iii) semester and annual sectoral and agency expenditure progress report (as part of the portfolio review process, beginning in 2008)

(b) MOU and Shared Work Plans to prepare social audits of selected programs (begin in 2008)

expenditures.

(c) Relevant sectoral agency M&E Units, in collaboration with the relevant executing entity and donor agency, and guidance of CODA, to prepare a work plan and TOR for conducting independent ex-post evaluation studies of strategic and “large” (say, exceeding US3.0 M) programs/projects, within 6 months following closure. The scope of the study could include: physical and financial progress, key achievements and lessons, and sustainability strategy.

(d) CODA to review and disseminate the completed evaluation studies (and in collaboration with relevant donor agency)

(e) Update the sectoral and institutional performance indicators, in line with the updated sectoral strategy and M&E reports, and strengthen the results monitoring system, to be reviewed and guided by the national and regional CODAs

(c) and (d) Ex-post evaluation studies of selected programs and projects and workshops to review and disseminate their findings

(e) Updated sectoral performance indicators and enhanced results monitoring system (during 2008)

(10) Development of Planning and Budgetary Capacities

SAG/UPEG, with support from RUTA, and overall guidance of CODA:

(a) prepare a concept note for a practical (and “hands-on”) technical assistance program to strengthen the capacities of UPEG (and other sectoral units) to improve the planning and budgetary processes, institutional arrangements (including “core” staff), and activities of the agricultural and forestry sector, focusing on the MTEF and annual budgets, as tools for achieving the sectoral outcomes and targets, in line with the updated sectoral strategy.

(b) Submit the proposal to CODA, UNAT and Finance to seek their approval and endorsement

(c) Prepare a detailed proposal, as the basis for mobilizing donor funding (preferably on a grant basis)

(a) Draft Concept Note of the TA proposal

(b) Approved Concept Note (in 2008)

(c) Detailed TA proposal, and secure donor funding (in 2008)

(d) Implement TA proposal (with a focus on using the annual budgetary cycle, beginning in 2009)

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**A Production Frontier Model for Agricultural Public Expenditure**

This study uses a Stochastic Production Frontier model to establish the basic relationships between agricultural-rural expenditure in FAO dataset and agricultural GDP. For each country, a production function (or production frontier) is defined which is homogeneous of degree one in productive factors (land, labor, other inputs), and other variables, and which can be described with the following expression for each country “i” and time period “t”:

$$Q_{it} = F(L_{it}, T_{it}, Z_{it}, G_{it}, A_{it}) \quad (1)$$

where “Q” is total production, “L” is labor, “T” is land used in Q production; “Z” are other production inputs like fertilizers; “G” is the level of rural-agricultural public expenditures which generates goods and services to the agricultural sector, and “A” is a level variable which indicates general factors of the national economy which affect agricultural production (domestic demand, trade regime, etc.).

The approach of stochastic production frontier introduces two random components in (1). On one hand, there is the traditional random error  $V_{it}$  which describes deviations of the expected value of Q and which are not correlated with independent variables in (1), and on the other, it introduces a second random element,  $U_{it}$ , which reflects the level of technical inefficiency (not observable) of the country in the agricultural production with respect to a “production frontier” in the region.

A simple form of incorporating these elements is:

$$Q_{it} = F(L_{it}, T_{it}, Z_{it}, G_{it}, A_{it}) \exp(V_{it} - U_{it}) \quad (2)$$

where  $E(V)=0$ , and  $U \geq 0$ . The model assumes a symmetric normal distribution for V and a truncated normal for U. In addition, in this case this last facto may vary along time, i.e., inefficiency may change in a dynamic fashion.

For the econometric specification we assume a Cobb-Douglas functional form with constant returns to scale in all factors, and decreasing marginal productivities for each factor. The econometric specification is:

$$\ln Q_{it} = \alpha + a \cdot \ln L_{it} + b \cdot \ln T_{it} + c \cdot \ln Z_{it} + d \cdot \ln G_{it} + m \cdot \ln A_{it} + V_{it} - U_{it} \quad (3)$$

where a, b and c represent marginal productivity of each production factor, whereas d and m represent impacts of public expenditure and other factors in agricultural production. An attractive feature of this model is that it allows establishing the level of efficiency ( $1-U_{it}$ ) or inefficiency ( $U_{it}$ ) in agricultural production for each country at any point in time. We will use this information to explore if the level of public expenditure has any impacts on this level of productive efficiency (besides its direct impact on the production function).

Un important element of our approach to public expenditure is that we expect distinct impacts according to its orientation in terms of our three categories: (i) private goods; (ii) public goods; and (iii) equity-enhancing goods. In general, we hypothesize that expenditure in public goods have positive effects both in the production function and in the efficiency level of the agricultural sector. By the contrary, we consider that expenditure in private goods tends to have null or negative effects both in product and efficiency. For equity-enhancing expenditure, we expect to have neutral effects in production frontier and efficiency in the short term. Given this, we will distinguish between public

good expenditures (G\_pub), private goods (G\_priv) and equity-enhancing expenditures (G\_equi) in our econometric version of (3).

$$\ln Q_{it} = \alpha + a \cdot \ln L_{it} + b \cdot \ln T_{it} + c \cdot \ln Z_{it} + d_1 \cdot \ln G_{pub_{it}} + d_2 \cdot \ln G_{priv_{it}} + d_3 \cdot \ln G_{equi_{it}} + m \cdot \ln A_{it} + V_{it} - U_{it} \quad (3)$$

In addition, we will estimate the following relationship,

$$1 - \text{est}(U_{it}) = \text{Eff}_{it} = e_i + f \cdot G_{pub_{it}} + g \cdot G_{priv_{it}} + h \cdot \ln G_{equi_{it}} + k \cdot \text{liberty}_{it} + n \cdot \text{tradeop}_{it} + n_{it} \quad (4)$$

where  $\text{est}(U_{it})$  is our estimated value in (3') of the technical inefficiency of the country "i" in period "t". It is of interest to know if the expenditure in public, private and equity-enhancing goods have effects both in (3'), the production function, like in 4, technical efficiency of the country. Liberty and tradeop reflect an annual index of political and civil liberties in the country developed by the Freedom Institute, and tradeop is trade openness measure for the corresponding country.

### Data used for model estimation

For expenditure, we used a panel dataset built by FAO (called GPRural) for years 1985 to 2001 in 18 countries of Latin America and Caribbean region. We complemented expenditure variables with other data needed for estimating the model described before, taken basically from FAO and other international sources.

For avoiding problems of endogeneity for some variables with applied some adjustments. For instance, the index of trade opening (imports + exports/GDP) was regressed on per capita GDP and agricultural land to obtain a deviation from the expected value as measure of openness. Equally, the variable of GDP per capita was lagged one period in the estimated equations.

For applying our typology of sector public expenditure in three categories we used the classification used by FAO in a recent study on this matter (FAO, 2007). The section below presents the specific classification of items from FAO dataset and our assignment for each category. Some expenditure items were assigned in proportions to two categories. For instance, irrigation was split up in private and public good categories (50% each), or integrated rural development, which was 75% assigned to equity-enhancing expenditure and 25% to private good type of expenditure.

## **ANNEX IV. Classification of Public Expenditure in Categories**

Different items of Agricultural Public Expenditure were grouped in three categories: (i) private goods, (ii) public goods y; (iii) equity and poverty reduction oriented:

### ***Private goods***

Commercialization  
Production promotion  
Forestry promotion  
Fishing and aquaculture promotion  
Targeted rural productive promotion (50%)  
Irrigation (50%)  
Integrated Rural Development Programs (25%)

### ***Public goods***

Training  
Communication and information services  
Soil and natural resources conservation  
Rural electrification  
Irrigation (50%)  
Land programs (Agrarian Reform)  
Associative promotion  
Housing  
Water rights regulation  
Agricultural property regularization  
Education  
Research  
Justice  
Rural roads  
Phito and Zoo sanitation  
Recreation and Sports

### ***Equity and poverty reduction oriented***

Targeted rural productive promotion (50%)  
Integrated Rural Development Programs (75%)  
Public services in rural areas  
Social infrastructure for rural communities  
Promotion of atarean groups  
Promotion of ethnic groups  
Promotion of women  
Promotion of rural families  
Basic sanitary conditions in rural areas (water and sanitation)  
Water for rural communities  
Health and nutrition

**Table A1.1: Mean values for variables used in the model**

| country | GDP<br>agrop | GDP<br>total | Land<br>agrop | Labor<br>agrop | Fertiliz. | Public good<br>Expend. | Private good<br>Expendit | Equity<br>Expendit. | Liberty<br>Index |
|---------|--------------|--------------|---------------|----------------|-----------|------------------------|--------------------------|---------------------|------------------|
|         | Mill US\$    | Mill US\$    | Miles Ha      | Miles pers     | tm        | Miles US\$             | Miles US\$               | Miles US\$          |                  |
| arg     | 10,694       | 245,122      | 173,755       | 1,468          | 449,860   | 229                    | 190                      | 80                  | 5.82             |
| bol     | 1,031        | 6,515        | 36,076        | 1,329          | 7,987     | 25                     | 13                       | 7                   | 5.62             |
| bra     | 37,915       | 668,993      | 249,114       | 14,786         | 4,582,514 | 3,509                  | 1,179                    | 2,794               | 5.21             |
| chi     | 3,837        | 56,648       | 15,662        | 943            | 367,077   | 47                     | 265                      | 80                  | 5.12             |
| col     | 11,377       | 81,630       | 45,211        | 3,737          | 532,508   | 25                     | 179                      | 42                  | 4.65             |
| crc     | 1,007        | 10,815       | 2,844         | 313            | 128,361   | 168                    | 70                       | 25                  | 6.74             |
| dom     | 1,235        | 11,995       | 3,604         | 659            | 85,296    | 154                    | 122                      | 26                  | 5.5              |
| ecu     | 4,109        | 19,061       | 7,904         | 1,210          | 119,375   | 92                     | 60                       | 19                  | 5.47             |
| gua     | 2,744        | 13,743       | 4,314         | 1,671          | 159,013   | 21                     | 226                      | 74                  | 4.32             |
| hon     | 585          | 3,873        | 3,326         | 727            | 75,406    | 3                      | 20                       | 36                  | 5.29             |
| jam     | 349          | 4,957        | 495           | 276            | 22,954    | 11                     | 7                        | 4                   | 5.76             |
| mex     | 12,490       | 293,363      | 104,847       | 8,537          | 1,709,627 | 4,183                  | 1,508                    | 459                 | 4.38             |
| nic     | 613          | 2,692        | 6,521         | 397            | 39,871    | 14                     | 50                       | 35                  | 4.18             |
| pan     | 502          | 7,570        | 2,121         | 243            | 33,834    | 67                     | 12                       | 9                   | 4.74             |
| par     | 1,818        | 8,870        | 23,553        | 632            | 32,644    | 38                     | 22                       | 7                   | 4.12             |
| per     | 3,624        | 58,642       | 31,132        | 2,738          | 178,731   | 131                    | 158                      | 77                  | 4.35             |
| uru     | 1,491        | 18,227       | 14,840        | 191            | 88,488    | 42                     | 152                      | 203                 | 6.35             |
| ven     | 3,105        | 72,499       | 21,722        | 839            | 370,002   | 191                    | 230                      | 85                  | 5.44             |

Source: GPRural, FAO

**Table A1.2**

| <b>Model of Stochastic Production Frontier for Agriculture</b> |         |           |       |      |
|--|---------|-----------|-------|------|
| dependent=log(agricultural GDP)                                |         |           |       |      |
|  | Coef.   | Std. Err. | z     | sign |
| log(expenditure public goods)                                  | 0.0325  | 0.0146    | 2.23  | **   |
| log(expenditure private goods)                                 | -0.0154 | 0.0124    | -1.24 |      |
| log(expenditure equity goods)                                  | -0.0124 | 0.0074    | -1.67 | *    |
| log(agricultural land)   | 0.4249  | 0.0732    | 5.81  | **   |
| log(labor)   | 0.3882  | 0.0962    | 4.03  | **   |
| log(fertilizers)   | 0.0364  | 0.0173    | 2.10  |      |
| log(percapita GDP)(-1)   | 0.4274  | 0.0519    | 8.24  | **   |
| Trade openness (deviation)                                     | -0.2430 | 0.0561    | -4.33 | **   |
| Constant   | 2.4278  | 0.8437    | 2.88  | **   |
|  |         |           |       |      |
| /mu  | 0.5821  | 0.1630    | 3.57  | **   |
| /eta   | 0.0167  | 0.0024    | 6.94  | **   |
| /lnsigma2  | -1.6250 | 0.5439    | -2.99 | **   |
| /ilgtgamma   | 3.0372  | 0.5832    | 5.21  | **   |
|  |         |           |       |      |
| sigma2   | 0.1969  | 0.1071    |       |      |
| Gamma  | 0.9542  | 0.0255    |       |      |
| sigma_u2   | 0.1879  | 0.1071    |       |      |
| sigma_v2   | 0.0090  | 0.0008    |       |      |
|  |         |           |       |      |
| Observations   | 263     |           |       |      |
| Countries  | 18      |           |       |      |
|  |         |           |       |      |
| Log likelihood   | 196.1   |           |       |      |
|  |         |           |       |      |
| <b>Technical efficiency in agriculture</b>                     |         |           |       |      |
|  | Coef.   | Std. Err. | t     |      |
|  |         |           |       |      |
| log(expenditure public goods)                                  | 0.0015  | 0.0033    | 0.44  |      |
| log(expenditure private goods)                                 | -0.0069 | 0.0027    | -2.52 | **   |
| log(expenditure equity goods)                                  | 0.0088  | 0.0016    | 5.61  | **   |
| Liberty index  | 0.0010  | 0.0023    | 0.46  |      |
| Trade openness (deviation)                                     | -0.0016 | 0.0124    | -0.13 |      |
| Constant   | 0.5085  | 0.0184    | 27.59 | **   |
|  |         |           |       |      |
| sigma_u  | 0.207   |           |       |      |
| sigma_e  | 0.022   |           |       |      |
| rho  | 0.989   |           |       |      |

**Table A1.3: Model of determinants of Rural Poverty  
(Fixed Effects)**

|                                   |                    |   |        |
|-----------------------------------|--------------------|---|--------|
| Fixed-effects (within) regression | Number of obs      | = | 46     |
| Group variable (i): pais_id       | Number of groups   | = | 14     |
| R-sq: within = 0.3065             | Obs per group: min | = | 1      |
| between = 0.5243                  | avg                | = | 3.3    |
| overall = 0.4816                  | max                | = | 5      |
|                                   | F(4,28)            | = | 3.09   |
| corr(u_i, Xb) = 0.3461            | Prob > F           | = | 0.0315 |

| Rural Poverty  | Coef.     | Std. Err.  | t     | P> t  | [95% Conf. Interval] |           |
|----------------|-----------|------------|-------|-------|----------------------|-----------|
| Public goods   | -3.525264 | 1.500401** | -2.35 | 0.026 | -6.598697            | -.4518308 |
| Private goods  | 2.238254  | 1.310386** | 1.71  | 0.099 | -.4459512            | 4.922458  |
| Equity goods   | -.7148035 | 1.224385   | -0.58 | 0.564 | -3.222843            | 1.793236  |
| Percap GDP(-1) | -9.673219 | 6.440603   | -1.50 | 0.144 | -22.8662             | 3.519758  |
| Constant       | 77.56137  | 10.45572** | 7.42  | 0.000 | 56.14379             | 98.97895  |

|         |           |                                   |
|---------|-----------|-----------------------------------|
| sigma_u | 14.951    |                                   |
| sigma_e | 3.777521  |                                   |
| rho     | .93999352 | (fraction of variance due to u_i) |

F test that all

u\_i=0: F(13, 28) = 30.32 Prob > F = 0.000

\*\* Significant at 95%; \* Significant at 90%

Table A2.1: Evolution of Central Government Expenditures by Public Institutions (Mill. US\$ of

|  | 1999          | 2000          | 2001          | 2002          | 2003          | 2004          | 2005          | 2006          | % en 06     | Prom           |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|-------------|----------------|
| Education                                | 242.8         | 305.9         | 364.2         | 379.8         | 460.3         | 487.1         | 512.4         | 578.8         | 34.9%       | 416.4          |
| Health                                   | 138.1         | 179.0         | 184.1         | 201.2         | 252.9         | 223.7         | 231.8         | 230.4         | 13.9%       | 205.2          |
| Infrastructure and Public Works          | 122.5         | 133.3         | 103.8         | 128.0         | 126.6         | 122.0         | 138.8         | 109.0         | 6.6%        | 123.0          |
| Interest on external debt                | 120.8         | 93.7          | 72.1          | 73.1          | 76.7          | 83.4          | 88.2          | 91.3          | 5.5%        | 87.4           |
| Government and Justice                   | 12.9          | 12.3          | 20.4          | 18.0          | 43.8          | 43.7          | 79.3          | 84.9          | 5.1%        | 39.4           |
| Presidency                               | 12.9          | 13.1          | 16.6          | 14.4          | 23.9          | 26.9          | 34.1          | 82.9          | 5.0%        | 28.1           |
| Interior                                 | 38.9          | 59.0          | 59.6          | 61.7          | 62.2          | 66.1          | 66.5          | 79.5          | 4.8%        | 61.7           |
| <b>Agriculture y livestock</b>           | <b>37.4</b>   | <b>61.0</b>   | <b>79.6</b>   | <b>74.2</b>   | <b>69.8</b>   | <b>66.1</b>   | <b>70.0</b>   | <b>56.9</b>   | <b>3.4%</b> | <b>64.4</b>    |
| Finance                                  | 23.1          | 23.4          | 24.4          | 27.4          | 77.5          | 45.3          | 66.0          | 55.9          | 3.4%        | 42.9           |
| Contingency/Others                       | 233.0         | 265.0         | 310.6         | 206.4         | 114.0         | 129.1         | 93.1          | 55.6          | 3.3%        | 175.9          |
| Judiciary                                | 26.2          | 28.1          | 28.2          | 34.0          | 34.9          | 34.1          | 29.6          | 46.8          | 2.8%        | 32.8           |
| Defense                                  | 37.4          | 43.2          | 51.5          | 50.7          | 48.5          | 46.9          | 47.3          | 45.5          | 2.7%        | 46.4           |
| <b>Natural resources and environment</b> | <b>26.7</b>   | <b>22.8</b>   | <b>21.3</b>   | <b>25.2</b>   | <b>27.7</b>   | <b>32.6</b>   | <b>42.1</b>   | <b>31.3</b>   | <b>1.9%</b> | <b>28.7</b>    |
| President affairs                        | 2.6           | 2.8           | 7.0           | 8.0           | 17.7          | 16.8          | 19.3          | 23.6          | 1.4%        | 12.2           |
| Congress                                 | 19.0          | 23.5          | 29.8          | 23.1          | 28.2          | 33.4          | 38.2          | 18.8          | 1.1%        | 26.8           |
| External affairs                         | 14.2          | 17.8          | 16.1          | 15.6          | 17.0          | 16.6          | 17.3          | 18.2          | 1.1%        | 16.6           |
| Public Ministry                          | 11.9          | 11.1          | 13.7          | 17.4          | 16.2          | 16.2          | 18.5          | 17.5          | 1.1%        | 15.3           |
| Labor and social promotion               | 10.1          | 10.5          | 11.8          | 10.6          | 13.1          | 13.9          | 17.3          | 13.1          | 0.8%        | 12.6           |
| Tourism                                  | 8.2           | 7.3           | 8.1           | 10.9          | 7.8           | 8.6           | 13.2          | 8.4           | 0.5%        | 9.1            |
| Industry and commerce                    | 21.6          | 5.6           | 8.2           | 6.7           | 10.9          | 10.7          | 6.7           | 7.2           | 0.4%        | 9.7            |
| Culture, arts and sports                 | 5.8           | 6.3           | 6.9           | 5.2           | 6.7           | 5.9           | 4.8           | 4.9           | 0.3%        | 5.8            |
| Electoral Power                          | 8.2           | 13.5          | 23.9          | 16.7          | 13.0          | 14.6          | 21.9          | 3.4           | 0.2%        | 14.4           |
| Contraloría general                      | 1.5           | 2.2           | 2.7           | 2.3           | 2.0           | 1.8           | 1.9           | 1.7           | 0.1%        | 2.0            |
| Payments of concessional loans           | 105.7         | 79.6          | 49.9          | 71.1          | 35.0          | 5.4           | -9.8          | -5.3          | -0.3%       | 41.5           |
| <b>Total</b>                             | <b>1281.6</b> | <b>1420.1</b> | <b>1514.6</b> | <b>1481.5</b> | <b>1586.5</b> | <b>1551.1</b> | <b>1648.7</b> | <b>1660.4</b> |             | <b>1,518.1</b> |

Source: World Bank, Study on Honduras Public Expenditure (2007).

**Table A2.2: Public Expenditures in Programs and Projects (SAG & SERNA)**  
**(000s of US\$, 1999 constant prices)**

|                                     | 1999-2002 (Average per year) |                 |              | 2003-06 (Average per year) |                 |              |
|-------------------------------------|------------------------------|-----------------|--------------|----------------------------|-----------------|--------------|
|                                     | Approved                     | Executed        | % Exec.      | Approved                   | Executed        | % Exec.      |
| AFE-COHDEFOR                        | 7,722.8                      | 8,378.8         | 108.5%       | 9,233.2                    | 5,627.6         | 61.0%        |
| BANADESA                            | 0.0                          |                 |              | 230.1                      | 336.4           | 146.2%       |
| DICTA                               | 0.0                          |                 |              | 249.9                      | 249.9           | 100.0%       |
| DINADERS                            | 0.0                          |                 |              | 5,100.0                    | 3,837.9         | 75.3%        |
| ENACIFOR                            | 452.0                        | 405.8           | 89.8%        | 97.3                       | 108.0           | 111.1%       |
| FONADERS                            | 0.0                          |                 |              | 2,003.2                    | 796.0           | 39.7%        |
| IHMA                                | 0.0                          |                 |              | 29.9                       | 83.2            | 278.1%       |
| INA                                 | 0.0                          |                 |              | 3,378.6                    | 2,201.9         | 65.2%        |
| SAG                                 | 38,734.6                     | 24,252.5        | 62.6%        | 37,877.0                   | 22,611.8        | 59.7%        |
| SERNA                               | 12,694.0                     | 8,353.4         | 65.8%        | 11,090.1                   | 6,247.0         | 56.3%        |
| <b>TOTAL</b>                        | <b>59,603.5</b>              | <b>41,390.5</b> | <b>69.4%</b> | <b>69,289.2</b>            | <b>42,099.9</b> | <b>60.8%</b> |
| % attributed to agricultural sector | <b>45.3%</b>                 |                 |              | <b>60.5%</b>               |                 |              |

Source: SIAFI/SEFIN

**Table A2.3:**

**Preliminary Estimate of Public and Private Investment Requirements by Commodity Chain for the Agricultural Sector (2008 – 2012) (In Millions of Lempiras)**

| Commodity Chains          | TOTAL              |                   | Total Investment<br>(2008-2012) | Percentage Share   |                   |
|---------------------------|--------------------|-------------------|---------------------------------|--------------------|-------------------|
|                           | Private Investment | Public Investment |                                 | Private Investment | Public Investment |
| Grains                    | 8,135              | 300               | 8435                            | 96                 | 4                 |
| Livestock                 | 26                 | 209               | 234                             | 11                 | 89                |
| Fisheries and Aquaculture | 4,559              | 174               | 4,780                           | 95                 | 5                 |
| Coffee                    | 3,250              | 221               | 3,471                           | 94                 | 6                 |
| Vegetables and Fruits     | 30                 | 475               | 505                             | 6                  | 94                |
| Agro-industries           | 3,103              | 193               | 3,296                           | 94                 | 6                 |
| Poultry                   | 52,009             | 150               | 52,159                          | 99.7               | 0.3               |
| Pigs                      | 26                 | 221               | 246                             | 10                 | 90.0              |
| Beekeeping                | 27                 | 239               | 267                             | 10                 | 90                |
| <b>TOTAL</b>              | <b>71,167</b>      | <b>2183</b>       | <b>73395</b>                    | <b>97</b>          | <b>3</b>          |
| <b>US\$ Million</b>       | <b>3726</b>        | <b>115</b>        | <b>3841</b>                     | <b>-</b>           | <b>-</b>          |

Source: MAG/UPEG (February, 2008)

**Table A2.4: Emerging MTEF for the Agriculture Sector According to Key Commodity Chain**  
(Millions of Lempiras; Lps 19.1 = US\$1.0)

| Program/Service 1/   | Grains     | Live-stock | Fish & Aquac. | Poultr y   | Coffee     | Fr. & Veg. | Agro-Ind.  | Pork       | Beek-ing   | Total       |
|--|------------|------------|---------------|------------|------------|------------|------------|------------|------------|-------------|
|  |            |            |               |            |            |            |            |            |            |             |
| Programs   |            |            |               |            |            |            |            |            |            | 407         |
| Competitiveness Program  |            |            |               |            |            |            |            |            |            | 806         |
| Services   |            |            |               |            |            |            |            |            |            | 32          |
| <b>TOTAL MOA</b>   |            |            |               |            |            |            |            |            |            | 1246        |
| Decentralized Institutions of the Agriculture Sector (being estimated) |            |            |               |            |            |            |            |            |            | 461         |
| Other Projects Supporting Commodity Chains                             |            |            |               |            |            |            |            |            |            | 177         |
| <b>TOTAL AGRICULTURE SECTOR</b>  |            |            |               |            |            |            |            |            |            | 1883        |
| Other GoH Institutions/Agencies ***                                    |            |            |               |            |            |            |            |            |            | 299         |
| <b>TOTAL AGRICULTURAL MULTI-SECTOR(M Lemp.)</b>                        | <b>299</b> | <b>208</b> | <b>174</b>    | <b>150</b> | <b>221</b> | <b>475</b> | <b>193</b> | <b>220</b> | <b>240</b> | <b>2183</b> |
| <b>US \$ Million</b>   | <b>16</b>  | <b>11</b>  | <b>9</b>      | <b>8</b>   | <b>12</b>  | <b>25</b>  | <b>10</b>  | <b>11</b>  | <b>12</b>  | <b>114</b>  |

Source: SAG/UPEG (February, 2008) (note: detailed figures/allocations are being firmed up by SAG)

## **Summary of Key Themes Arising from Available Ex-Post Evaluations of Agricultural and Forestry Projects in Honduras**

### (A) Summary of the PROMOSTA Evaluation

.The Project generated favorable results and impacts with regards to scaling up the conglomeration of smallholders who use private service providers for the generation and transfer of technology, which enabled improving the physical yields per ha and the levels of income. Nevertheless, it was recognized that internal conflicts between DICTA, UAP and UTP, introduced a growing instability and confusion regarding the leadership in the execution of the project, which delayed the strengthening objective of SNITTA.

Another important objective was the selection of the producers, potential beneficiaries of the project, with regards to a demand-driven approach in finding favorable local conditions to facilitate the technology transfer services, and the identification and formulation of competitive projects. There were 5,296 producers trained, and 32,144 were assisted in technology transfer services.

The processes of certification of suppliers of services was one of the most important aspects in the achievement of the project's objectives, in that conditions were created for achieving a wide market of these services, with special interest in those local enterprises linked to farmer organizations.

The absence of a baseline for scaling up affected the putting in place an effective and flexible system of monitoring and evaluation which would enable adjusting the targets, together with the beneficiaries, as well as to re-assign the budgetary funds based on efficiency criteria. This became the central feature of the Project, in that there was a discrepancy between the targets of the project by component and the budgetary allocations of the Operational Plan presented by SAG and SEFIN.

One of the principal lessons in the execution of the project is that all of the interventions should be part of contributing to a national plan of generation and transfer of technology, which define the roles of each institution (including the cooperating agency) and the strategies to follow to ensure the sustainability of the projects formulated and financed with the competitive funds. There is a need to have a manual of certification of the providers of services approved by the member institutions of SNITTA, and not only by DICTA and PROMOSTA.

Within the subSWAp of SNITTA there is a need to assess the experience of PROMOSTA in order to make the needed adjustments with regards to the other approved projects and financed by the cooperation. This is a conditionality which should be complied to improve the allocation of expenditure funds.

### (B) SUMMARY OF THE PAAR EVALUATION

The project was officially launched on December 22, 1997, and was closed on January 31, 2004, going from an original 4 years to 7 years, for a total amount of US\$41.8 M. The final expenditures were US\$43.7. The implementation agencies included 4 agencies: INA, Catastro, AFE-COHDEFOR and DICTA.

Once the project was closed, the completion report evaluation obtained the following ratings:

- (a) Outputs: Satisfactory

- (b) Sustainability: Likely
- (c) Institutional Development Impact: Satisfactory
- (d) Execution of Loan: Satisfactory

The project objectives responded to:

- a) modernizing the registration of agrarian properties
- b) Strengthening the AFE-COHDEFOR, with a new normative role and promoting the role of local communities to manage natural resources
- c) Promote agricultural and forestry practices in upland farms, which are geared toward stabilizing incomes and preventing land invasions
- d) Rationalizing the National System of Protected Areas, selected for its conservation and management, and those areas which are representative of the national ecosystems

Among the most important lessons learned, are the following:

- e) The horizontal communication was a key element for the management and solution of problems and increased effectiveness of the decision-makers
- f) The participatory forestry management will enable increased rural incomes and participation in the protection of the forestry resources
- g) The conservation of the soils and forests en upland farms requires more than extension technologies, demanding a support in the provision of initial inputs for the production
- h) The organization and community development require flexibility for responding the community needs.

Regarding the financial management of the Project, the total cost of the project was programmed to be US\$41.8 M, of which IDA provided US\$34.0 M, GoH provided US\$6.4, and the beneficiaries contributed US\$1.4 M. Finally, the project was executed with US\$40 M from IDA and US\$3.7 M from GoH, for a total cost of US\$43.7. This was due to:

- (a) Variations in the exchange rate of the US\$, from the moment of engaging the loan to its completion.
- (b) The Government's share was reduced after Hurricane Mitch caused major production damages (in 1998), which re-oriented national funds toward the reconstruction needs.
- (c) The contribution from the beneficiaries (US\$1.4 M) was not taken into account in the final cost of the project.

The Bank approved reallocation of the Credit 4 times, given the pilot nature of the project, which required flexibility and re-allocation of funds, in accordance with changes in circumstances, such that during this period, Hurricane Mitch occurred.

It was expected that immediately following PAAR in January 2004, there would be an immediate continuity with the follow-on Project (Rural Forestry and Productivity Project). Nevertheless, there was a delay of about 1 year before it became effective in 2005, to begin operations in 2006, and to reactive initiatives which were pending assuring its sustainability; during these two years, personnel continued to work at the central level, without major field level actions.

- (D) Summary of Evaluation of PROBAB

The Project was financed through a grant from the GEF. Its duration originally estimated to be 3 years, and it extended to 7 years (from August 1998 to June 2005). The execution was under the charge of AFE-COHDEFOR, through its Protected Areas Department, which formed a project management unit for this objective. Its geographical scope is 1.2 M of hectares located in the Atlantic Forest Regions, The Mosquito and Olancho, where there are 11 Protected Areas, having different categories and representation of ecosystems.

At the completion of the Project, it was given the following ratings:<sup>34</sup>

Output: Satisfactory

- a) Sustainability: Likely
- b) Impact on Institutional Sustainable: Modest
- c) Execution of Bank funds: Satisfactory

The objectives of the project responded to:

- a) Contribution to integrating in Honduras the section of the MesoAmerica Biological Corridor
- b) Promote a better and greater participation of selected Protected Areas
- c) Support activities in the transitional areas for sustainable development of natural resources.
- d) Strengthen national capacities for biological monitoring

Among the positive factors during the execution, they include:

- a) In the presence of the Project's area of influence, there were other institutions, such as UNESCO, the Nature Conservancy, European Union, USAID, and Swedish Aid, all of which helped address problems in the PA.
- b) The high touristic potential of the protected areas of the Caribbean (Pico Bonito, Cuero and Salado, Jeannette Kawas, Punta Izopo, and others), led GoH, through the Honduran Institute of Tourism to prioritize investments in these projected areas.
- c) The existence of NGOs which are managing protected areas or working in the transitional zones created a favorable environment for the project, and were converted in excellent allies.
- d) The presence of indigenous villages in the project area, especially the Miskitos and Tawahkas, who had traditions of conserving natural resources, facilitated the field activities.

The relevant lessons learned including the following:

- h) Promote the involvement of the communities in the various phases of the Project (design, implementation, monitoring and evaluation)
- i) Combine the conservation efforts of Protected Areas, with activities which help overcome the socio-economic and political conditions
- j) Promote the collaboration with NGOs, local Governments and other public institutions
- k) Ensure that the local committees are representative and open to change
- l) Given close attention to socio-economic conditions and policies
- m) In designing the project, these should be built in a manner which responds to the changes
- n) There needs to be clarity in the institutional responsibilities for the execution of the project

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<sup>34</sup> World Bank (2005). Implementation Completion Report on a Global Environment Facility for a Biodiversity in Priority Areas Project. Tegucigalpa, Honduras

With regards to the financial performance of the project, initially it was estimated that PROBAB would have a total cost of US\$9.0 M. At the close of the project, the cost increased to US\$8.0 M. There was a GEF grant contribution of US\$7.0 M, a counterpart contribution of the GoH of US\$1.0 M, and beneficiaries, for US\$0.2 M.

During the execution phase there was a reallocation of US\$200,000 to finance emergency subprojects in the project area, resulting from the damages caused by Hurricane Mitch; US\$500,000 which were initially programmed to support the management plans were allocated to support studies of land tenure of the Mosquito indigenous groups.