GOVERNANCE AND ANTI-CORRUPTION IN HONDURAS:
AN INPUT FOR ACTION PLANNING

LISTENING TO THE VOICES OF PUBLIC OFFICIALS, FIRMS, AND USERS OF PUBLIC SERVICES

Draft – January 9, 2002

Analysis prepared by the World Bank Institute
at the request of the Government of Honduras
for discussion with the Consejo Nacional Anti-corrupción
This draft report has been produced by the World Bank Institute in response to a request for technical assistance received from the government of Honduras. The findings and analysis presented here are based on in-depth governance diagnostic survey that was carried out during the summer of 2001. The survey field work was coordinated for the World Bank by Maria Gonzales de Asis, Raul Monte and Francesca Recanatini and carried out in Honduras by the survey firm Mercaplan.

The main authors of this preliminary draft report for discussion are Tugrul Gurgur and Francesca Recanatini, under the supervision and with contributions by Daniel Kaufmann. Arturo Barrio, Sergiy Bilestky and Jairo Acuna-Alfaro provided valuable assistance. Maria Gonzales de Asis, Humberto Lopez, Joseph Owen, and the members of Honduras’s “Consejo Nacional Anti-Corruption” provided substantive and very useful inputs. A preliminary version of the main findings was distributed to the members of the Consejo at the end of October. This draft report is for internal Bank review and for review by the authorities and stakeholders in Honduras. It is intended as an input to the dialogue and for action program formulation.

This draft report would not have been possible without the cooperation of 1,403 public officials, 200 enterprises and 2000 private citizens who were surveyed for this project. Their participation offered an opportunity to present their own voices on the governance challenges in Honduras.
INTRODUCTION

CROSS-COUNTRY PERSPECTIVE

ASSESSING GOVERNANCE IN HONDURAS

3.1 Corruption in Honduras: The Extent of the Problem

3.2 Administrative Corruption: The Experience of Users and Firms

3.3 State Capture

3.4 Purchasing Public Sector Positions

3.5 Political Contributions

3.6 Public Procurement

LOCALIZING VULNERABILITIES - A REGIONAL ANALYSIS

CORRUPTION: COSTS AND VICTIMS

5.1 The Cost of Administrative Corruption

5.2 Is Corruption Regressive?

A FEW KEY SECTORS

6.1 Judicial System

6.2 Education

6.3 Informal Economy

DETERMINANTS OF GOOD GOVERNANCE

7.1 Corruption: A Cultural Phenomenon?

7.2 An Institutional Analysis

7.3 Reporting Corruption and Embracing Reforms

FIGHTING CORRUPTION: AN INPUT TO ACTION PROGRAM FORMULATION

4

8

22

25

29

33

42
1 INTRODUCTION

Honduras is the third poorest country in Latin America, after Nicaragua and Haiti, with a high incidence of poverty and very low social indicators. According to the Government’s Poverty Reduction Strategy Paper (PRSP), about two thirds of the population lived below the poverty line in 1999. The lack of economic growth, recurrent macroeconomic imbalances, a very skewed distribution of income, and the poor quality of investment in human capital are some of the key factors contributing to such high level of poverty and weak social indicators.

During the 1990s successive administrations aimed at achieving faster economic growth through the implementation of a comprehensive reform package. This package focused on three different areas: (i) macroeconomic stability, (ii) public sector efficiency, and (iii) private sector development (through deregulation and trade and financial liberalization). Advances in all the three areas have faced however significant setbacks, only in part due to Hurricane Mitch. First, Honduras macroeconomic performance appeared to be very vulnerable to electoral cycles. This vulnerability, added to the damage brought by Hurricane Mitch in October 1998, led to an average per capita growth rate of 0.5 percent per year for the past decade. Such low growth rate is clearly insufficient to guarantee a significant reduction of poverty.

In terms of public sector efficiency and private sector development, both government and the civil society had been increasingly concerned during the 1990s with the quality of governance and the lack of transparency in both private and public sector. Hurricane Mitch, in October 1998, underscored the urgency of addressing these issues by undertaking a long-term strategy. Thus, improved governance and greater transparency became key priorities in the Government’s development agenda, and some progress has been made over the last three years.

A broader, systematic and participatory strategy to improve governance is however still needed. The Government of Honduras, therefore, requested the World Bank Institute’s (WBI) support to mobilize civil society and launch a participatory process for the development of its governance reform. As a first step, WBI organized (together with the Inter-American Development Bank) a Regional Integrity Workshop in February 1999, which brought together representatives from Central America to share their experiences and lay the foundation for the development of national integrity plans. Secondly, WBI facilitated the creation of a national steering committee with the purpose of developing the governance and anti-corruption reform. This committee includes representatives from both the civil society and the government and is coordinated by Cardinal Oscar Rodriguez. One of the first actions of the steering committee was the assessment of the current quality of governance in Honduras through three large-scale governance and corruption diagnostic surveys, carried out jointly by MERCAPLAN and WBI.

This report discusses the main findings of this diagnostic effort, carried out during the summer of 2001 and based on factual and experiential evidence. The rationale for a survey-oriented diagnostic approach is that voicing the experiences of the people who interact with the State and implement State policies is essential for the development of a well-informed, effective anticorruption strategy. This report channels into action the voices of 2000 users, 200 private enterprises, and 1,403 public officials who participated in the survey.

---

1 See Box 1 for details.
2 The most important progresses made are the strengthening of the Office of the Comptroller and the Office of Administrative Probity, the elaboration of standard bidding documents for public works, and the expansion of the integrated financial management system throughout the public sector to increase the transparency of the budget process and financial management.
The main objective of this effort is to facilitate and support the design of an integrated strategy to fight corruption and promote good governance through the strengthening of public institutions. The detailed micro data provides rich information on the different sides of corruption, from administrative corruption to state capture, and helps assessing the real extent of this problem across governmental agencies and regions. In addition, the in-depth analysis allows us to link different forms of corruption to specific institutional and regional aspects and test the accuracy of some of the “myths” that surrounds mis-governance.

Box 1. Hurricane Mitch – A New Set of Challenges for Honduras

Following Hurricane Mitch, Honduras faced new challenges ranging from the reconstruction of the country, to rebuilding its devastated economy by searching for an equilibrium on its economic growth that allows social equity. Honduras has progressed in overcoming the destruction caused by this natural disaster, through the efforts of the civil society, private and public sectors. One of the reasons for Honduras strong recovery was the implementation of strong economic and structural reforms in the 1990’s. Honduras advanced towards the development of a “new system” by creating a new agenda for the master-planning of the country. This situation was a unique opportunity to build stronger foundations and better relationships between the government and the community.

In the aftermath of Hurricane Mitch, Honduras received decisive support from the World Bank (WB), International Monetary Fund (IMF), Central American Bank for Economic Integration (CABEI), Inter American Development Bank (IADB) among others that focused on the urgent needs of the country. Honduras, has been considered one of the most corrupt countries in Latin America. Honduras overcame this situation by rebuilding community trust in government officials that implemented a transparent and fair distribution of donations received. Public officials made a strong commitment to reduce poverty and to build better social policies creating the Master Plan for Reconstruction and Transformation (MPRT). The strategy of the Government to rebuild the country that includes structural reform and poverty reduction policy, Honduras will experience a presidential election and the presidential candidates held a meeting on September 19, 2001. At the meeting, they compromised with members of the private sector & civic community who participated in the crafting of a long term vision plan for the Country. The National Agreement of Transformation for the Human Development of the XXI Century will be conducted whomever party winning the election. The plan will focus on security improvements, gender equity, reduction of poverty, corruption elimination, the consolidation of human rights, the improvement of the education system and the strengthening of democracy.

In sum, the diagnostic effort undertaken provides significant inputs to policy makers and civil society for program formulation and implementation. It further complements traditional sources as experts’ opinions or case study analysis, by identifying institutional weaknesses and areas for reform, and by measuring the economic and social costs of corruption. It also facilitates the consensus-building process among key stakeholders (both Government and civil society) by focusing on institutions and their performance, rather than individuals, and thus de-politicize the debate. In addition, the surveys can be used to establish quantitative benchmarks for monitoring the success of institutional reforms already underway, and, if necessary, to redirect them to concentrate efforts on priority areas.

There have been previous attempts at gathering information about the perception of corruption in Honduras (see Casals & Associates). The main findings of those studies were:

1. Administrative corruption refers to corruption surrounding the implementation of laws, rules, and regulations, while state capture describes corruption that affects the actual design of the laws and regulations themselves.
There is low tolerance towards corruption
Women in rural areas are more tolerant of corruption
One of five Hondurans was a victim of corruption
The Group affected the most by corruption are men between the ages of 23 and 25, with higher levels of education as well as a higher economic status.
The groups considered the most corrupt were:
  o Customs officials
  o Politicians
The groups considered the least corrupt were:
  o The church
  o Teachers

This diagnostic study offers a few key messages:

- **Corruption and mis-governance are regarded as the most serious problem in Honduras.** Corruption is seen as the worst problem by firms and the third worst by users and public officials, after crime and cost of living. Government ineffectiveness and regulatory burden are seen as lesser problems by the enterprises as compared to weak rule of law.

- **Corruption exacerbates poverty and is a real obstacle for the private sector.** Poorer users (smaller firms) are disproportionally penalized by paying bribes that represent a greater share of their income (their gross monthly revenues). Furthermore, one eight of firms reports that corruption was the main reason to not invest. On the other hand, paying a bribe does not necessarily translate in better quality of the service received. These findings are in line with the evidence collected for other Latin American countries.

- **But corruption needs to be tackled with a variety of measures since it takes many different forms,** from administrative corruption, to State Capture, corruption related to procurement and purchasing of positions in the public administration. The surveys suggest that agencies with transparent and depoliticized decision making procedures, merit-based personnel management systems, and citizen-feedback mechanism are less likely to display high level of corruption and more likely to satisfy the demand of the citizens for public services.

- **Learning from the good experiences.** There is a significant insitutional and geographical variation in terms of mis-governance across Honduras. User satisfaction with public service delivery varies greatly, with the Atlantic Littoral and the South regions ahead of the other regions in terms of quality of services and lower corruption.

- **There is a real willingness to fight corruption.** Firms feel very strongly about eliminating corruption, reporting willingness to pay of almost 10 percent of their monthly revenues to resolve this problem. Public officials are also very much in favor of reforming the public sector and improving governance, especially in terms of clearer and simpler procedures, greater accountability and a more merit-based system.

These results complement and reinforce the findings and the recommendations of the last Country Assistance Strategy (CAS) presented to the World Bank Board in December 1999, the
PRSP discussed by the Board in October 11, 2001, and the HIPC Decision Point Document for Honduras, discussed by the Board in July 2000.

In particular, the CAS efforts to promote governance and transparency focuses on three interrelated components\(^5\): (i) promoting greater transparency within the Public Administration; (ii) strengthening existing structures of control, especially in the areas of public acquisitions and public auditing; and (iii) supporting the Government efforts to increase the participation of the Civil Society in the development of a National Integrity Plan.

The Government’s PRSP considers a very high priority the issue of tackling corruption because of its impact and costs on the productivity of public investments. Similarly, corruption can constitute an obstacle to effective legal intervention in the protection of the public interests when legislative and judicial management is weak and the legal framework provides unlimited immunity to some officials. Moreover, legal and regulatory insecurity is also considered a disincentive to investors due to the high risk of unfair and arbitrary actions.

Finally, the HIPC initiative\(^6\) is closely linked to the preparation and implementation of a participatory, comprehensive anticorruption strategy and its presentation to the national and international community. In particular, this relief program allows for the delivery of interim assistance between the so-called ‘decision’ and ‘completion’ points. For the relief to be irrevocable, Honduras has to reach the completion point. The completion point is achieved once a set of actions included in the decision point document are implemented. The development of the Anti-corruption Strategy is one of these pre-agreed actions.

Hence, considering the above, the following report is structured as follows. Section 2 provides a brief cross-country perspective of the problem of corruption in Honduras. Section 3 starts exploring the new survey data, by focusing on the different types of corruption present in the country, from administrative corruption, to purchasing of public positions and state capture. The discussion focuses on both perceptions and actual experiences of enterprises and users. This overview is complemented by a discussion on the quality of service delivery in Honduras. Section 4 offers a regional analysis of this issue, while Section 5 completes this governance assessment by providing additional evidence on the costs and consequences of corruption and the link between corruption and growth. Section 6 focuses on the experience of three key sectors: the Judiciary, education and the informal economy.

This detailed and extensive overview sets the stage for the results discussed in Section 7 which are the key institutional weaknesses present within the public administration that may be contributing to corruption and mis-governance? Section 8 discusses some preliminary results and outlines the key elements for a comprehensive strategy.

\(^5\) Furthermore, the CAS concentrates on poverty reduction and sustainability with a strong emphasis on improving the quality of human capital, strengthening the social safety net, supporting indigenous and Afro-Honduran peoples development, mainstreaming gender, and stimulating rural development. The CAS supports faster growth as an essential complement to poverty reduction through a stable macroeconomic framework, and debt sustainability, infrastructure rehabilitation, strengthening the financial sector and private sector development. Finally, it also seeks to ensure that progress can be sustained supporting environmental management and disaster preparedness, institution building, and governance improvements.

\(^6\) Under the HIPC initiative, Honduras qualified in July 2000 for debt relief after the application of traditional debt relief mechanisms amounting to US$556 million in net present value terms or above US$900 million in debt service terms.
2 CROSS-COUNTRY PERSPECTIVE

Recent interest in governance and its impact on development has led to proliferation of data measuring various aspects of governance. A common concern with corruption indicators is that they can be inconsistent or unreliable or affected by the biases of the observer. A country rated high by one agency or panel of experts may be rated lower by another. We discuss next the results of two sets of aggregate indicators on governance.

The first, developed recently by the World Bank, relies on a new database containing over 300 governance indicators compiled from a variety of sources. These indicators are aggregated into six indexes corresponding to six well-defined governance components: Voice and Accountability, Political Stability, Regulatory Burden, Government Effectiveness, Rule of Law, and Control of Corruption. The first two indicators measure the extent to which those in authority are selected and replaced; capacity of the state to implement sound policies are captured by the next two indicators, and the final two capture the respect of citizens and the state for the rules which govern their interactions. These governance indicators cover about 170 countries and are updated periodically.

Figure 1 presents the detailed results for six aspects of governance in Honduras. The cross-country evidence suggests that corruption and rule of law are the main challenges currently faced by Honduras. Among 170 countries, Honduras ranks in the bottom quartile in terms of control of graft and respect to rule of law. This suggests that although over the years the country has been quite successful reducing the regulatory burden, rule of law institutions have been particularly misgoverned, creating incentives for corruption. Furthermore, while Honduras ranks closer to the Central American average in terms of Voice and Accountability, Political Stability and Government Effectiveness, the Regulatory Framework index is well below this average, suggesting the need for concentrated reforms.

The second set of cross-country indicators is based on the Global Competitiveness Report (GCR), an annual publication produced by World Economic Forum in collaboration with Harvard University. These indices shed light to the extent of specific types of corruption. The Global Competitiveness Survey is conducted every year as background for the GCR report. This cross-country survey covered in 2001 more than 3000 enterprises in 60 countries. As Figure 2 shows, based on a preliminary analysis of such recent survey, bribery is more pervasive in Honduras in all areas as compared to other Central American countries, and particularly so in the area of connecting to public utilities.

These quick cross-country comparisons highlight the most serious challenges faced by Honduras in terms of governance. These aggregate indicators do not however provide sufficient information to highlight specific institutional weaknesses and help design the necessary reforms. Such conclusions can only be achieved by carrying out in-depth country specific analysis of governance and institutional quality.

---

Figure 1: Aggregate Governance Indicators
Percentile Rankings (c.2000)

- Control of Corruption
- Rule of Law
- Regulatory Framework
- Government Effectiveness
- Political Stability
- Voice and Accountability

Legend:
- Honduras
- Central America Average
- Chile

Note: Bars represent mean estimates for the percentile rank on each of the governance indicators. Source: "Governance Matters" by Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton, May 1999.

Figure 2: Unbundling of Corruption (GCS 2001)

Legend:
- Honduras
- Central America Average
- Chile

3  **ASSESSING GOVERNANCE IN HONDURAS**

Working with partners in the field, the World Bank has developed a methodology to carry out country specific, in-depth governance and anticorruption assessments. These diagnostic tools are designed to evaluate the costs of corruption and underlying institutional factors that might help explain poor governance. This section presents a diagnosis study of Honduras’s public sector. Its findings are based on data obtained from these in-depth surveys of 200 enterprises, and 2,000 citizens, and 1,403 public officials from 48 public institutions.

Figure 3, based on this detailed survey data and two aggregate indicators, sets the stage for the analysis carried out in the next pages by providing an overview of the many faces of corruption in Honduras and three other Latin American countries – Peru, Colombia and Ecuador. The two top aggregate indicators – Transparency International and WBI Graft – suggest that the four countries face similar challenges in terms of mis-governance. The detailed information described in the following lines highlights that Honduras faces quite a different challenge from the other three countries, especially in terms of the extent of corruption within the public administration (as reported by public officials).

---

3.1 Corruptio n in Honduras: The Extent of the Problem

As emphasized before, this diagnostic study is built on a novel methodology developed by WBI that emphasizes the importance of surveying simultaneously users and providers of public services, and collecting both experiential and opinion data to obtain a more complete and objective picture of governance. Thus, the diagnostic surveys used help paint a picture of good governance and corruption in Honduras both as perceived and as experienced by users, enterprises and public officials. In other words, the analysis goes beyond simple perceptions and relies on actual experiences.

We focus in this section on the level of corruption as perceived by the respondents, to set the stage for the experiential data presented next. Even though perceptions of the level of corruption may be different from actual corruption, understanding these perceptions is still critical since these opinions are often based on direct experience and citizens use them to formulate an opinion of government policies and institutions. Moreover, the independent surveying of three different types of stakeholders permit triangulation and improve the validity of the results.

First, we analyze how corruption is ranked with respect to other problems. All three groups – users, enterprises, and public officials – consider corruption as a very serious problem in Honduras. As Figures 4 and 5 show, corruption is seen as the worst problem by the enterprises and the third worst by users and public officials, after crime and cost of living. Crime, violence, and drug smuggling, which are symptoms of lack of respect for rule of law, are also seen as very serious by all three groups. Government ineffectiveness (e.g. instable economic policies, bureaucratic inefficiencies) and regulatory burden (e.g. regulations of business) are seen as minor problems by the enterprises as compared to lack of rule of law.

The citizens’ view of the significance of this problem in Honduras has not changed in the recent years. Corruption has been considered a serious problem over the last 5 years and both public officials and enterprises do not perceive any significant change for the better. Firms, in particular, noticed a deterioration in the quality of governance within public sector. As Figure 6 shows, majority of the public officials believe that the corruption level has not been changed in the last 2 or 5 years. About 14 percent report a reduction in the last 2 years, as compared to 12 percent who report an increase during the same time period. Enterprises, on the other hand, are more pessimistic (Figure 6). More than 50 percent of firms thinks that the problem of corruption has worsened over the last 2 years both at high level (political corruption, state capture) as well as at the lower level (petty/bureaucratic corruption). Less than 10 percent of firms reports a reduction in the public sector corruption, but about one third does not perceive any difference in behavior over the past 5 years.

Public officials’ view on the gravity of the problem of corruption varies significantly across geographical regions in Honduras (Figure 7). Public officials in the South and Eastern regions report lower levels of corruption than respondents in the West region. This suggests the existence of a potentially significant geographical variation of mis-governance across the country. This particular theme will be explore more in detail in Section 4.
Figure 4: Challenges Facing Honduras
(based on Users and Public Officials Surveys)

- Crime
- Cost of Living
- Corruption
- Unemployment
- Drug Consumption
- Violence
- Trafficking of Drugs
- Cost of Education
- Cost of Health Services
- Lack of Housing
- Violence
- Drug Consumption
- Trafficking of Drugs
- Cost of Education
- Cost of Health Services
- Lack of Housing
- Violence
- Drug Consumption
- Trafficking of Drugs
- Cost of Education
- Cost of Health Services
- Lack of Housing
- Violence
- Drug Consumption
- Trafficking of Drugs
- Cost of Education
- Cost of Health Services
- Lack of Housing
- Violence
- Drug Consumption
- Trafficking of Drugs
- Cost of Education
- Cost of Health Services
- Lack of Housing
- Violence
- Drug Consumption
- Trafficking of Drugs
- Cost of Education
- Cost of Health Services
- Lack of Housing
- Violence
- Drug Consumption
- Trafficking of Drugs
- Cost of Education
- Cost of Health Services
- Bad road conditions

Figure 5: Obstacles Doing Business
(based on Enterprise Survey)

- Corruption
- Crime
- Smuggling
- Violence
- Cost of Living
- Business Registration
- Cost of regulations
- Bureaucratic Inefficiency
- Monopolies
- Instable Economic Policies
- Access and Costs of Financing
- Lack of technological development
An additional aspect worth exploring is how public institutions are ranked by respondents in terms of honesty. Respondents were asked to rank public institutions in terms of honesty and corruption. Table 1 summarizes their responses and shows the best five and the worst five institutions as reported by each group. The Judicial Branch, National Police, and National Transit Administration are the three agencies that are perceived as seriously corrupt by at least 2 out of 3 groups. The most honest institutions, on the other hand, are Central Bank, the Ministry of Security, the Ministry of Finance, and BANADESA.
Table 1. Top and Bottom Rated Institutions in Terms of Dishonesty

<table>
<thead>
<tr>
<th>Top 5 institutions perceived as the most corrupted</th>
<th>Users</th>
<th>Enterprises</th>
<th>Public Officials</th>
</tr>
</thead>
<tbody>
<tr>
<td>Judicial Branch</td>
<td>Judicial Branch</td>
<td>Judicial Branch</td>
<td>Judicial Branch</td>
</tr>
<tr>
<td>National Police</td>
<td>National Transit Administration</td>
<td>National Police</td>
<td>National Transit Administration</td>
</tr>
<tr>
<td>National Transit Administration</td>
<td>Municipalities</td>
<td>National Police</td>
<td>Armed Forces</td>
</tr>
<tr>
<td>Supreme Court</td>
<td>National University</td>
<td>Municipalities</td>
<td>National Police</td>
</tr>
<tr>
<td>Municipal Governments</td>
<td></td>
<td>National University</td>
<td>National Comptroller’s Office</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bottom 5 institutions perceived as the least corrupted</th>
<th>Users</th>
<th>Enterprises</th>
<th>Public Officials</th>
</tr>
</thead>
<tbody>
<tr>
<td>NGO</td>
<td>NGO</td>
<td>Private Industry</td>
<td>Central Bank</td>
</tr>
<tr>
<td>Central Bank</td>
<td>Central Bank</td>
<td>BANADESA</td>
<td>Ministry of Security</td>
</tr>
<tr>
<td>National Tax</td>
<td>BANADESA</td>
<td>NGO</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>Ministry of Security</td>
<td>Ministry of Finance</td>
<td>BANADESA</td>
<td>Ministry of Government</td>
</tr>
<tr>
<td>Ministry of Agriculture</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Furthermore, Figure A3 in Appendix 3 shows the most corrupt and the least corrupt ten agencies as perceived by users, firms, and public officials. The ranking of institutions is calculated from combining the perceptions of all three groups. According to this ranking, the Judiciary, Transit Administration, and Police are the three most corrupt agencies, followed by the National University\(^9\), municipal governments, Supreme Court, the Army, FHIS, labor unions, and the congress. The five least corrupt public institutions, on the other hand, are the BANADESA, the Ministry of Security, the Central Bank, the Ministry of Agriculture, and the Ministry of Finance.

### 3.2 Administrative Corruption: The Experience of Users and Firms

But, what is the extent of corruption in Honduras? To answer this question we move from perception data and focus over the next sections on the experiential data collected in the three diagnostic surveys. For the purpose of our analysis below, firms are classified by ownership (foreign vs. domestic) and size (small, medium, large). A “foreign” firm is defined as the one with at least 51 percent of ownership in hands of foreign investors, regardless of the location of the firm’s headquarters. Domestic firms with less than 10 employees are defined as “small-size”, between 10 and 49 employees as “medium-size” and more 49 employees as “large” firms. According to this classification, the sample in the Enterprise Survey consists of 48 small, 78 medium-size, and 55 large domestic firms, and 19 foreign firms.

Users are classified in terms of their income (low-income, medium-income, high-income) and location (North, East, West, South, Central, and Atlantic). Users with less than 1,800 L in monthly income are classified as low-income, with 1,801 L to 9,000 L as medium-income, and with more than 9,000 L as high-income. The survey sample of users consists of 330 low-income, 1,124 medium-income, and 342 high-income respondents. For 206 users income classification is not possible due to the lack of data. We should emphasize that the cutoff points used to classify income groups may not take into account the official poverty line – they were chosen to get sufficient number of observations in each group in order to ensure statistically reliable analysis.

\(^9\) Public perception of corruption in the National University may reflect the recent highly publicized crisis that involved mismanagement of university budget and social security funds.
Therefore, the “low-income” group is more representative of the very poor, the “medium-income” group is more representative of low-middle income, and the “high-income” group is more representative of high-middle and high-income groups. Out of 2,000 users, 601 of them live in the North, 957 in the Central, 109 in the West, 111 in the South, 95 in the East, and 127 in the Atlantic Littoral regions.

The analysis of perceptions displays how serious and widespread corruption is in the public sector of Honduras, but it does not show the extent and the frequency of corruption in provision of specific public services. Table 2 reports responses of firms to the questions about public services that are important to do their business, such as business permits, registration, etc. The survey provides information on (i) the quality of services, (ii) the frequency of bribery, (iii) the amount of bribe paid, and (iv) the quality of complaint mechanisms currently in place within the public sector. The major findings reveal the following:

- Majority of enterprises receive high quality of services from state banks and fire inspectors. On the other hand, phone installation and national taxation are ranked mostly negatively.
- More than 13 percent of firms report that they were made to feel that bribe is necessary when obtaining export/import credits and when applying for phone service installation.
- The average bribe paid by the enterprises varied from under 1,000L in sanitary registration and water services to over 10,000L in export/import permits, vehicle inspection, and environmental inspection.
- In general, managers choose not to voice their complaints in public agencies that offer low quality services. For example, less than 15 percent of the enterprises who have received sub-standard services in state banks did not file formal complaint. In export/import permits and national tax services, which are criticized for frequent bribery and low service quality, this ratio is over 35 percent.

<table>
<thead>
<tr>
<th>Table 2: Enterprises</th>
<th>Percentage of respondents receiving high quality of service</th>
<th>Percentage of respondents who were made to feel that bribes were necessary</th>
<th>Amount paid in unofficial payments, L.</th>
<th>Percent of respondents who complained of the quality of the service but did not make formal complaints because they believe it would not make a difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports/Imports Permits</td>
<td>41%</td>
<td>13%</td>
<td>12909.09</td>
<td>37%</td>
</tr>
<tr>
<td>National Taxation</td>
<td>40%</td>
<td>7%</td>
<td>5880.00</td>
<td>36%</td>
</tr>
<tr>
<td>County Taxation Procedures</td>
<td>44%</td>
<td>5%</td>
<td>2616.67</td>
<td>28%</td>
</tr>
<tr>
<td>Inspection of the Vehicles</td>
<td>45%</td>
<td>7%</td>
<td>10893.33</td>
<td>37%</td>
</tr>
<tr>
<td>Vehicle Registration</td>
<td>55%</td>
<td>6%</td>
<td>2262.50</td>
<td>22%</td>
</tr>
<tr>
<td>Business Registration</td>
<td>53%</td>
<td>4%</td>
<td>4100.00</td>
<td>31%</td>
</tr>
<tr>
<td>Property Registration</td>
<td>55%</td>
<td>4%</td>
<td>1550.00</td>
<td>27%</td>
</tr>
<tr>
<td>State Bank Credits</td>
<td>73%</td>
<td>2%</td>
<td>100.00</td>
<td>14%</td>
</tr>
<tr>
<td>Sanitary Registration</td>
<td>52%</td>
<td>3%</td>
<td>300.00</td>
<td>25%</td>
</tr>
<tr>
<td>Fire Inspection</td>
<td>73%</td>
<td>2%</td>
<td>4500.00</td>
<td>22%</td>
</tr>
<tr>
<td>Environmental Licences</td>
<td>64%</td>
<td>2%</td>
<td>50000.00</td>
<td>28%</td>
</tr>
<tr>
<td>Phone installation</td>
<td>35%</td>
<td>17%</td>
<td>3318.75</td>
<td>31%</td>
</tr>
<tr>
<td>Electric Connection</td>
<td>44%</td>
<td>7%</td>
<td>2505.56</td>
<td>31%</td>
</tr>
<tr>
<td>Water and sewage system</td>
<td>49%</td>
<td>5%</td>
<td>650.00</td>
<td>30%</td>
</tr>
</tbody>
</table>
From the information on frequency and size of bribes the composition of bribe payments for an average firm is estimated, as shown in Figure A.4. Over 65 percent of bribe payments go to three public services: export/import permits, phone installation, and vehicle inspection. Bribe payments to sanitary inspection, state banks, property registration authority, and water and sewerage systems constitute less than 4 percent of the total sum paid in bribes by a firm.

Is the experience of users different? Table 3 presents their responses to the questions about frequency of corruption and quality of public services.

- Similarly, the majority of users is satisfied with the quality of services provided by state banks. In contrast, less than 40 percent report high quality when getting social services and when applying for phone installation.
- At least 10 percent of the users were made to feel that bribe was necessary when obtaining driver’s license, construction permits, or judicial certifications.
- Average amount of bribes paid ranges from about 100 L in social services and in education to more than 700L in national taxation.
- Users not only report receiving high quality services from the state banks but they also believe that there are mechanisms to voice their complaints if the quality of the service is sub-standard with only 9 percent of discouraged who think it would not make a difference. On the other hand, phone installation, electric connection, and social services have bad reputation in terms of responding to customer complaints.

<table>
<thead>
<tr>
<th>Table 3: Users</th>
<th>Percentage of respondents receiving high quality of service</th>
<th>Percentage of respondents who were made to feel that bribes were necessary</th>
<th>Amount paid in unofficial payments, L</th>
<th>Percent of respondents who complained of the quality of the service but did not make formal complaints because they believe it would not make a difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Driving License Procedure</td>
<td>49%</td>
<td>13%</td>
<td>189.05</td>
<td>15%</td>
</tr>
<tr>
<td>National Tax Processes</td>
<td>47%</td>
<td>6%</td>
<td>746.67</td>
<td>18%</td>
</tr>
<tr>
<td>Property Tax Procedures</td>
<td>46%</td>
<td>6%</td>
<td>124.92</td>
<td>19%</td>
</tr>
<tr>
<td>Construction Licenses</td>
<td>42%</td>
<td>10%</td>
<td>317.69</td>
<td>21%</td>
</tr>
<tr>
<td>Vehicle Registration</td>
<td>52%</td>
<td>9%</td>
<td>182.81</td>
<td>14%</td>
</tr>
<tr>
<td>Expedition of Identity Card</td>
<td>56%</td>
<td>6%</td>
<td>136.96</td>
<td>13%</td>
</tr>
<tr>
<td>Registration of Property</td>
<td>45%</td>
<td>3%</td>
<td>203.33</td>
<td>18%</td>
</tr>
<tr>
<td>Procedures at State Banks</td>
<td>67%</td>
<td>2%</td>
<td>187.50</td>
<td>9%</td>
</tr>
<tr>
<td>Service in Health Centers</td>
<td>48%</td>
<td>2%</td>
<td>622.78</td>
<td>21%</td>
</tr>
<tr>
<td>Social Service</td>
<td>34%</td>
<td>2%</td>
<td>112.50</td>
<td>28%</td>
</tr>
<tr>
<td>Judicial Certification</td>
<td>53%</td>
<td>10%</td>
<td>441.59</td>
<td>16%</td>
</tr>
<tr>
<td>Phone Installation</td>
<td>37%</td>
<td>8%</td>
<td>706.07</td>
<td>25%</td>
</tr>
<tr>
<td>Electric Connection</td>
<td>39%</td>
<td>6%</td>
<td>338.95</td>
<td>21%</td>
</tr>
<tr>
<td>Education</td>
<td>58%</td>
<td>2%</td>
<td>100.00</td>
<td>16%</td>
</tr>
<tr>
<td>Water and sewerage</td>
<td>42%</td>
<td>5%</td>
<td>496.20</td>
<td>20%</td>
</tr>
</tbody>
</table>

In Figure A5 the composition of bribe expenditures of an average user is estimated. Most of the bribe payments (as much as 49 percent) goes to phone installation service, national taxation, and to obtain judicial certification.
Figure 8 explores the relationship between quality of services and bribery in more detail. The responses of public officials were aggregated by the institution where they work and a simple correlation between variables that represent quality of service and frequency of bribes in the agency was computed. As the figure shows, there is significant negative correlation between graft and service quality. Similar results are obtained from enterprise and user data sets. Figure A6 in Appendix shows the percentages of firms/users reporting high quality of service and bribes grouped by the type of service. Among 7 public services, the ones that produce the most pleasant experience require fewer bribes. Again, the state banking services and property registry are among the winners while the phone installation service is ranked as the worst.

In general, enterprises pay bribes more frequently than users and an important reason for this is the inadequate telecommunication infrastructure in the country.

3.3 STATE CAPTURE

Most of the previous discussion has focused on bribery and unofficial payments to public officials. However, there are many other forms of corruption, and some of these forms may be as much or even more harmful for a country. The one well-known and, perhaps, the most pernicious is state capture or “grand” corruption defined as systematic efforts of private corporations and other groups of influence to shape to their own benefit the underlying rules (i.e. laws, regulations, decrees, etc).
Figure 9 suggests that bribes have a very significant influence on the key institutions - judiciary, legislative, and executive branches of power - with the responses of both public officials and enterprises being highly consistent. The perceptions of both groups on the extent of state capture are quite startling taking into account the fact that more than a half of respondents report high frequency of bribes in the judiciary.

At the same time, Figure 10 illustrates significant variation in the types of “grand” corruption across regions. Bribes to high judicial authorities are more common in the Center while Atlantic Littoral appears to be the best. On the other hand, bribes to municipal authorities are much more frequent in the Atlantic Littoral than in any other region of the country. We will explore regional variations of institutional performance in more detail later on in Section 8.
3.4 Purchasing Public Sector Positions

Obtaining a position within the public sector is considered as a way to guarantee a steady flow of income and benefits, in addition to the possibility to obtain special favors for relatives and friends. The potential rents associated to the recruiting (and promoting) decisions within the public administration create therefore strong incentives for corruption practices. Bribes associated to recruiting decisions are especially pervasive within public administration ridden by unclear recruitment procedures and inadequate accountability.

As Figure 3 showed, purchasing of public sector positions in Honduras is not the is more common type of corruption and is at levels similar to other Latin American countries. There is however a significant variations both in terms of positions purchased and regions, as Figures 11 and 12 illustrate. In particular, this type of mis-governance is more frequent among high levels of the public administration rather than lower
levels. In addition, the regions of the North, Center and West appear to be more affected by it, revealing that these regions may have more unclear procedures and rules to personnel management.

### 3.5 Political Contributions

An additional, quite detrimental form of corruption is contributions to political parties to influence the decision making process in public administration. In Honduras 39 percent of the firms agree that businesses provide frequent campaign donations to parties and 29 percent think that such donations are critical to obtain favors from politicians. However, when asked if the firm contributed to the last electoral campaign, almost all firms (94 percent) deny making political contributions, although it is likely that the true figure is much higher. (Figure 13).

### 3.6 Public Procurement

Another very harmful form of corruption is the one affecting the public procurement process. In Honduras, corruption to affect the outcome of public procurement is quite common. As Figure 14 shows, 14 percent of public officials and 37 percent of firms believe that enterprises pay bribes to win public contracts. The amount of bribe paid as a percent of the value of public contracts is estimated as 28 percent by the public officials and 12 percent by the enterprises.
Figure 15 shows the extent of corruption in public procurement today and two years ago. Enterprises report a slight decrease in the frequency of this type of corruption. Still, one third of firms interviewed believe bribery in public bidding occurs quite frequently. The amount of kickbacks and extra payments to public officials is estimated to be around 12 percent of the contract’s value.

Furthermore, the enterprise survey sheds light to the quality of bidding process in public procurement in Honduras. As Figure 16 shows, around 40 percent of firms report that the bidding process is of low quality at the municipal level, as compared to 14 percent at the private sector. National public agencies does not fair better. Almost one third of respondents think that the bidding process is substandard at the national level, as compared to only 10 percent who are satisfied with the existing process.
Among the possible reasons for not participating to the public bidding process, the most frequent cited factor, as shown in Figure A., are the lack of political connections at the higher level of the public administration. Around 40 percent of firms stay away from public contracts because they feel that their chance of winning a contract is compromised the contracts are received by some firms without formal announcement and they lack direct contact with the officials. Extra payments and cost of the process are the two other reasons cited by 34 percent of the firms. Only one fourth of the firms complains about the complexity of the bidding process.

Do private companies pay the same amount of bribe to obtain public contracts or does it depend on firm characteristics? Figure 17 shows that small firms pay as much as 15 percent of the public contract, as compared to 11 percent of the large firms and 9 percent of the foreign firms. One possible reason for the higher “rice” paid by smaller firms may be lack of connections with the public administration. In the absence of such connections, small firms may need to use financial means to influence the decision making in government.

![Figure 17: Who Pays More for Public Contracts? (based on Enterprise Survey)](image)

<table>
<thead>
<tr>
<th>% of contract paid as bribe</th>
<th>small firm</th>
<th>medium-size firm</th>
<th>large firm</th>
<th>foreign firm</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>14.80</td>
<td>11.09</td>
<td>11.93</td>
<td>9.09</td>
</tr>
</tbody>
</table>

4 LOCALIZING VULNERABILITIES - A REGIONAL ANALYSIS

The extent of corruption and mis-governance may vary not only with respect to the public services involved, but also depending on geographical and institutional differences. Honduras consists of 6 main regions: North, Center, West, South, Atlantic Littoral and Eastern. Figure 18 shows the top three problems as reported by users in each of these regions. Crime and corruption are seen as more problematic in the Northern and Central part of the country, whereas the cost of living is more acute in Atlantic region and in the East.

Perception of serious problems is not the only interesting issue to explore at a regional level. From a governance assessment’s point of view, how frequency of bribes and quality of services vary across regions is also very significant since it help highlight institutional differences existing across regions. As Figure A.7 shows, corruption is seen as more common in the North and at the Center, and less problematic in the Atlantic and in the Eastern part of the country. The
quality of public services follows a similar pattern (Figure 19). Users reported low quality of services in the North and at the Center, and the highest quality in the Atlantic region.

One possible explanation for this findings is the difference in the degree of urbanization and the level of income across regions. The North and Center regions of the country are the most advanced regions in Honduras. Citizens living in these regions are more aware of their rights and expect high quality services from the government. As a result, they can be more critical in their judgment when it comes to evaluating the public service delivery. Furthermore, since government agencies appear to be more concentrated in these regions, the incidence of corruption is likely to be higher. Finally, due to the media’s involvement and commitment, public awareness is also greater.

In terms of specific public services, it is interesting to highlight how the frequency of bribes paid and the quality of public services varies greatly depending on the region and the service under consideration (Figures 20 and 21). Users report that to obtain a driving license, for example, requires the payment of a bribe almost five times more often in the West region than in the Eastern region. In addition, users in the North and Center report high level of corruption in dealings with national tax authorities, while in the
West region users complain about bribery in education system. In the Atlantic region property tax is the most problematic.

In terms of quality, the Atlantic Littoral region provides services that are higher rated by users. The only exception are property tax procedures. Services provided in the South region, on the other hand, are rated more unevenly, with education rated twice as high as electric connection. In general, majority of users in the North and at the Center of the country are less satisfied with the quality of public services. In other regions the level of satisfaction is as high as 70 percent for services such as identity card, health, education, and national tax. Most variation is observed in electric connection and property tax.
5 **CORRUPTION: COSTS AND VICTIMS**

5.1 **THE COST OF ADMINISTRATIVE CORRUPTION**

How costly bribery is for businesses can be understood by the fact that most firms’ are prepared to contribute financially to eliminate corruption. The willingness of enterprises to pay for the elimination of corruption is a clear signal of the impact that corruption and mis-governance have on businesses. To measure the extent of the issue, enterprises were asked to indicate the percentage of their monthly revenues they are willing to spend to eliminate the most serious obstacles to business development. As Figure 5 shows corruption comes second after security as the most damaging problem faced by the firms. Firm managers are willing to pay more than 9 percent of their revenues to reduce corruption versus around 10 percent to obtain security. Regulatory burden and smuggling are the other two problems that penalize private companies.

But corruption has a negative impact on businesses also through its adverse effect on private investment. Corruption increases the cost of investing for business and discourages firms to engage in investment plans. The firms interviewed reported that investment would raise by 11 percent if corruption in the public sector were eliminated. Small firms, in particular, are less willing to go ahead with new investments (Figure A.2). More than 16 percent of small firms report that they decided not to invest because of corruption, as compared to 3 percent of large firms. Foreign direct investment is also hurt because of corruption: 11 percent of foreign firms report that they have reduced their investment commitments because of mis-governance.

As Figure 22 shows, enterprises report on the average that about 10 percent of their monthly revenues would be available if corruption were eliminated in the public sector in Honduras. The loss of revenues due to corruption is more significant among domestic firms. These firms lose as much as 12 percent of their revenues, compared to 8.8 percent lost by the foreign firms. An additional 10.5 percent would be available for the companies if the public safety were greater. New investment in business would raise by 11 percent if the red tape, bribery, and costs of bureaucracy was eliminated.

This large, potential tax contribution is an indicator of how costly corruption and red tape are for many competitive businesses and for the government itself. Moreover, because of the excessive red tape, firms are not able to focus on their core activities and spent much of their time dealing and negotiating with the bureaucracy. Firms report that their staff spend as many as 5.9 hours per week. Domestic firms spent significantly more time with officials (6.4 hours a week) as compared to foreign firms (2.1 hours a week).

---

**Figure 22: Cost of Corruption to Business**
*(based on Enterprise Survey)*

- % of revenues paid for security
- % of firms decided not to invest due to the cost of bureaucracy
- % of business revenue that would be available if corruption were eliminated

- domestic
- foreign
5.2 IS CORRUPTION REGRESSIVE?

Do small and large firms bear the same burden of corruption? Figure 23 shows the firms’ willingness to eliminate their four major obstacles for business development. Small firms suffer more from smuggling and willing to sacrifice as much as 20 percent of their revenue to eliminate it. They are also more willing to eliminate corruption and red-tape, as compared to medium-size and large firms. This evidence indicates that bureaucratic inefficiency and lack of rule of law in the form of corruption and smuggling penalize especially small businesses.

The cost of corruption does not necessarily arise in the form of explicit monetary payments. As emphasized in the previous pages, the time spent with public officials negotiating procedures and organizing informal events for public officials is also a significant burden for businesses.

According to firms, managers spend almost 10 percent of their time dealing with officials and over 3 percent of their revenue in entertaining them. As Figure 24 shows, time spent with officials is significantly higher for large firms and significantly lower for foreign firms. In addition, small firms allocate a higher share of their revenue to organize meetings with officials.

Enterprises of different size and age need different types of public services. Thus, their experiences dealing with the public sector also change. Figure 25 presents the incidence of bribery by service type and firm size. Foreign firms report more incidence of bribe demands in registration of business, property, and vehicle, and taxation processes. Small firms, on the other hand, face bribe demand from public officials when they apply for export/import permits and phone installation and they report almost no bribe demand in registration services. Only the large firms reported incidence of bribery in dealings with fire and environmental inspections.
Like enterprises, users’ experience also depends on specific characteristics, such as their income level or their geographical location. Section 4 discussed the experience of users across different regions in Honduras. Figure 26 presents the incidence of bribery categorized by income group and type of public service. Users in all income groups reported that they are less likely to face bribery in state banks, health centers, and social services. However, public officials in other offices are more likely to request bribes from low income users. Registration of property, registration of vehicles, and judicial process are among such services, in which low income users face bribe demand about 15 percent of the cases. Moreover, users from high income group face the same problem more often in their dealings with public services such as phone installation, driver’s license and education.
But, do these extra-payments facilitate the users’ dealing with the public sector and translate in higher quality of the service received? 7 percent of the users reported that despite these extra payments, the quality or the speed of the service did not change (Figure A.10). 17 percent of the users were not sure whether paying kick-backs would guarantee the promised service from public agencies. According to users, the poorer groups are especially affected. Almost 12 percent of the users in low income group reported that despite paying bribe nothing did change (as compared to 4 percent of the rich). Furthermore, 30 percent of the low income users who paid bribe were still uncertain about the outcome of their transaction, as compared to 10 percent of the rich.

When it comes to average bribe paid by users and enterprises, the income level and size of the firm still makes difference. As Figure 27 shows the poor pays 14 percent of his monthly income on bribes: 7 times more than the rich in terms of bribe as a ratio of income. Small and mid-size firms also disproportionately bear the burden of corruption and pay at least 2 times more than the large firms.

The mechanisms through which bribes are requested are also very important. As Figure A.8 shows, in most of the cases either the public official asks for bribe or the firm makes extra payment without being asked because it already knows whom to pay and how much. Only in around 10 percent of the cases, a firm approaches a public official without any prior knowledge and offers a bribe. This evidence suggests that there are in Honduras some informal norms, which regulate un-official transactions with the public sector. Public officials are less reluctant to ask for extra payments when they face domestic firms, especially with smaller size. Large firms, on the other hand, initiate the bribe exchange more often than medium or small firms. Furthermore, foreign firms appear to be as informed as domestic firms about the informal norms of bribe-favor exchange.
Figure A.9 presents the same analysis from the user’s point of view and similar results emerge. High income users initiate bribery with their own initiative, whereas low income users are more likely to be asked by public officials for kickbacks. These results indicate that large firms and users from high income groups are ready to use their muscle in order to obtain what they need. Small firms and the poor, on the other hand, are intimidated by the public officials to pay bribe.

6  A Few Key Sectors

6.1  Judicial System

The aggregate governance indicators in Figure 1 highlight the weakness of the rule of law in Honduras compared to other countries. The perceptions of users, enterprises, and public officials are consistent with international evidence. As shown in Table 1, the judicial branch of the government is rated among the most corrupt institutions in Honduras by all three groups.

The survey data can help identifying the most serious problems within the judiciary, as shown in Figure 28. The majority of respondents reports that the judicial system is too complicated, time consuming, inefficient and slow. But, the inefficiency of the legal procedures is not the only factor against good justice. 57 percent of firms and 63 percent of users consider the judicial system unfair and the judges not credible. Moreover, at least half of the respondents questions the competence of the judicial personnel, while the majority considers the widespread corruption as a major obstacle. There are however significant regional differences in the rating of the Judiciary, as Figure A.11 shows. In general, users in the North and West regions appear more satisfied with the judicial system. In other regions, most of users reports that inefficiency within the judicial system is the most serious obstacle. Finally, more than 80 percent of the users agree that paying bribe is a precondition for a speedy judicial process.

<table>
<thead>
<tr>
<th>Figure 28: Factors Against Good Justice</th>
<th>(Based on Users and Enterprise Survey)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>The access to adequate legal representation</td>
<td></td>
</tr>
<tr>
<td>Incompetence from the Judges</td>
<td></td>
</tr>
<tr>
<td>Cost of Bribes</td>
<td></td>
</tr>
<tr>
<td>Difficulties following thru with the process</td>
<td></td>
</tr>
<tr>
<td>The credibility of the judges</td>
<td></td>
</tr>
<tr>
<td>Complicated legislation</td>
<td></td>
</tr>
<tr>
<td>The time period of the process</td>
<td></td>
</tr>
<tr>
<td>users</td>
<td></td>
</tr>
<tr>
<td>enterprises</td>
<td></td>
</tr>
</tbody>
</table>
Not surprisingly, the perceptions of users and firms over the judicial system in Honduras is not positive, as shown in Figure 29. The overwhelming majority of respondents agree that the Judiciary is influenced by economic pressures as well as by political pressures; moreover, the judicial system appears unfair and deserves no trust. 63 percent of firms have serious mistrusts about using the official judicial system to solve business conflicts.

Facing a poorly functioning judicial system, enterprises and users may decide to use alternative mechanisms without going to trials. 14 percent of the users and 9 percent of the enterprises have decided not to go to the courts in the last 2 years when they needed to use the judicial system. Furthermore, 158 users (out of 2000) and 14 enterprises (out of 200) report that they have used alternative dispute resolution mechanisms during the last two years. Among the users, more than 40 percent prefer to negotiate directly or through a lawyer rather than using the judicial system (Figure 30). Intervention of high level public officials is scarce. Survey data from Peru and Ecuador reveal that using private lawyer and especially direct negotiations are more widely used alternatives to the Judiciary system. Using high level officials or contacts within the Police is less frequent.
The weaknesses of the Judiciary are not however the same across Honduras. As Figure 31 highlights, users prefer to rely on private lawyers in the Atlantic Littoral region and in the Eastern region. In the West region and in the Center, users prefer instead to resolve any dispute directly with their counterpart rather than using a lawyer.

6.2 EDUCATION

The education system in Honduras suffers of many deficiencies and problems. As Figures A.12 and 32 show, the cost of education is the most serious problem faced by users. In addition, more than 75 percent of users complain of insufficient physical infrastructure, incompetence of teachers, shortage in coverage, and des-actualization of the education system. The education system is especially weak in the Center and North regions of the country, as Figure 32 points out.

Corruption is perceived as a serious problem in education system. 70 percent of users think that promotions and appointment of teachers are influenced by political pressures and 52 percent of users criticize the incidence of favoritism at schools.
Enterprises interviewed in the diagnostic survey report that they have formal and written contracts with 68 percent of their employees. More than 3/4 of the enterprises agree that companies operating in the informal sector (for example, not paying their taxes, without the appropriate licenses, permits, etc) have significant advantages over those operating in the formal sector. These advantages include significantly lower costs and higher expansion opportunities, which stem from excessive red tape and bureaucratic inefficiencies in Honduras public administration (Figure 33).

6.3 INFORMAL ECONOMY

Enterprises interviewed in the diagnostic survey report that they have formal and written contracts with 68 percent of their employees. More than 3/4 of the enterprises agree that companies operating in the informal sector (for example, not paying their taxes, without the appropriate licenses, permits, etc) have significant advantages over those operating in the formal sector. These advantages include significantly lower costs and higher expansion opportunities, which stem from excessive red tape and bureaucratic inefficiencies in Honduras public administration (Figure 33).
Is informal economy more damaging in some regions than the others? In Figure 34 the respondents are classified by region. In the North the disadvantage of being in the formal economy is reported to be significant by around 55 percent of the enterprises. In the Atlantic region and in the Central parts of the country the informal economy is perceived as more damaging. An overwhelming majority of the enterprises complain of unfair advantage enjoyed by companies operating in the informal economy. The sample size does not allow to reach a statistically significant conclusion about the extent of informal economy other parts of the country.

![Figure 34: Advantages of Being Operated in the Informal Economy: By Regions](based on Enterprise Survey)

<table>
<thead>
<tr>
<th>Region</th>
<th>Additional revenue growth by companies in the informal sector</th>
<th>Companies in the informal market have cost advantages over those operating in the formal sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>East</td>
<td>15</td>
<td>3</td>
</tr>
<tr>
<td>South</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td>West</td>
<td>14</td>
<td>6</td>
</tr>
<tr>
<td>Atlantic</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td>Center</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td>North</td>
<td>12</td>
<td>15</td>
</tr>
</tbody>
</table>

Note: Number of responds is shown inside each bar. “% of enterprises” is calculated within each region

7 **DETERMINANTS OF GOOD GOVERNANCE**

One of the myths surrounding corruption and mis-governance is that some cultures may be more prone to corruption than others. This view overlooks the importance and the role of appropriate incentives and control mechanisms. More importantly, it is also not supported by the evidence collected by the World Bank Institute while carrying out a natural experiment. This evidence is discussed briefly in the next section: incentives matter and significantly change the behavior of people. This result sets the stage for the institutional analysis presented in the following pages: if corruption can be reduced by introducing the proper incentives, which ones matter the most in Honduras, given the existing institutional environment?
7.1 Corruption: A Cultural Phenomenon?

When discussing potential causes of corruption, differences in cultures and costumes are often brought forward as key factors, failing to take into consideration the role played by appropriate incentives and control mechanisms. We carried out a “natural” experiment with the users and the public officials in Honduras by asking what the respondent would do if he found an envelope with 2000 dollars in a parking lot at night: would he return the sum to the police or would he keep it?

![Figure 35: What Would You Do If You Find An Abandoned Envelope with $2,000?](image)

(a) Probability of Getting Caught is 0%

(b) Probability of Getting Caught is 30%

As Figure 35 shows the responses of public officials are quite similar to those of users and enterprises. When the probability of getting caught is zero, 46 percent of public officials would choose to keep the money as compared to 56 percent of the users. When the possibility of detection increases to a mere 30 percent, only 31 percent of the officials would still take it, as compared to 42 percent of enterprises. These findings, in line with evidence from many other countries, are a clear indication that there nothing inherent in the culture of a country that makes public officials and users less honest than citizens in other countries.
7.2 AN INSTITUTIONAL ANALYSIS

So, if culture does not matter, why do institutions perform so differently? Why is corruption more persistent in some institutions? Studies in other countries suggest that several broad sets of institutional issues are associated with better governance and lower levels of corruption. The data from the public officials survey help examine the relationship between characteristics of the public administration and levels of corruption reported by the same public officials. Since many institutional features are centrally determined, one might expect that there would be little variation across public sector bodies. However, the questions on the public official’s survey focused not just on the existence and quality of the official rules, but on the actual implementation of those rules, as well.

Underlying the discussion developed in this section are a series of organization- and respondent-level analyses that relate corruption to the various aspects of public administration. Corruption has been defined both in terms of self-assessments and the external assessments provided by other public officials. The variables created to capture the different dimensions of the public sector are defined in Table 4. These indices have been calculated for each of the 62 government agencies included in the analysis.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate index of corruption</td>
<td>Aggregate index that includes all variables from the indices of corruption described below</td>
</tr>
<tr>
<td>Index of state capture</td>
<td>Composite index that includes 6 variables measuring the extent to which formal and informal groups of influence are able to alter state policies and laws to insure their own interests</td>
</tr>
<tr>
<td>Index of corruption within public sector</td>
<td>Composite index based on perceptions of public officials about the fraud in the institution where they work and in the public sector in general</td>
</tr>
<tr>
<td>Index of corruption within personnel management</td>
<td>Composite index including the measures of job purchase and bribery in the administration of personnel</td>
</tr>
<tr>
<td>Index of corruption within budget management</td>
<td>An index representing the extent of extra official payments in the administration of budget</td>
</tr>
<tr>
<td>Voice</td>
<td>Composite index describing the existence of consumer feedback and complaint mechanisms</td>
</tr>
<tr>
<td>Enforcement</td>
<td>Composite index based on the percent of respondents reporting that rules and guidelines regarding personnel management and budget allocation are strictly monitored and enforced</td>
</tr>
<tr>
<td>Meritocracy</td>
<td>Composite index based on the percent of respondents reporting that decisions on personnel management issues are based on level of education, or professional experience, merit, and performance</td>
</tr>
<tr>
<td>Quality of Rules</td>
<td>Composite index based on the percent of respondents reporting that the rules, guidelines and regulations about personnel management and budgetary allocation are stable and well specified.</td>
</tr>
<tr>
<td>Politicization</td>
<td>Composite index based on the percent of respondents reporting that decisions about hiring, personnel management, and budgetary allocation are not free from political interference</td>
</tr>
<tr>
<td>Transparency</td>
<td>Composite index based on the percent of respondents reporting that decisions about hiring, personnel management and resource allocation in their own agency are transparent and the reports are open to the public</td>
</tr>
<tr>
<td>Wage Satisfaction</td>
<td>The extent of satisfaction with the wages and other benefits</td>
</tr>
<tr>
<td>Mission</td>
<td>Composite index describing whether public officials understand clearly the mission and strategy of their institution, know their role within the organization, and identify yourself with its objectives</td>
</tr>
<tr>
<td>Resources</td>
<td>Composite index based on the percent of respondents that believe that the quantity and the quality of physical, financial and human resources available to their own agency are adequate</td>
</tr>
</tbody>
</table>
The analysis reported in the next pages was carried out in stages. First, we calculated the average value of each index for different groups of government agencies: agencies in the Judicial branch of the government, agencies in the Legislative branch, agencies in the executive branch and municipal agencies. Second, we computed the simple correlation coefficient between the aggregate corruption index and each of the other indices. We then began testing the existence of a (partially) causal link using the indices describing the aspects of the public sector as explanatory variables in a single OLS estimation. These results are summarized in Table 5. It should be stressed that these results are preliminary, since we have not controlled in our analysis for possible endogeneity issues.\textsuperscript{10}

From a policy point of view, it is key to identify the institutional weaknesses that hamper government performance and effectiveness. For this purpose, using the responses of public officials, we separate the 62 government agencies between municipal, judiciary, legislative and executive agencies, and compare their performance on the basis of various institutional characteristics. Table 5 summarizes the results.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Executive Mean</th>
<th>Judiciary Mean</th>
<th>Legislative Mean</th>
<th>Municipal Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate index of corruption</td>
<td>48.9</td>
<td>45.9</td>
<td>50.8</td>
<td>53.1</td>
</tr>
<tr>
<td>Index of state capture</td>
<td>61.7</td>
<td>56.4</td>
<td>65.0</td>
<td>69.6</td>
</tr>
<tr>
<td>Index of corruption within public sector</td>
<td>54.9</td>
<td>49.5</td>
<td>56.5</td>
<td>55.9</td>
</tr>
<tr>
<td>Index of corruption within personnel management</td>
<td>31.4</td>
<td>36.4</td>
<td>26.2</td>
<td>26.4</td>
</tr>
<tr>
<td>Index of corruption within budget management</td>
<td>33.8</td>
<td>21.6</td>
<td>26.7</td>
<td>26.7</td>
</tr>
<tr>
<td>Voice</td>
<td>71.8</td>
<td>79.7</td>
<td>75.8</td>
<td>81.1</td>
</tr>
<tr>
<td>Enforcement</td>
<td>76.9</td>
<td>78.6</td>
<td>75.8</td>
<td>81.1</td>
</tr>
<tr>
<td>Meritocracy</td>
<td>72.5</td>
<td>67.8</td>
<td>75.7</td>
<td>81.1</td>
</tr>
<tr>
<td>Quality of Rules</td>
<td>77.0</td>
<td>78.6</td>
<td>79.4</td>
<td>78.6</td>
</tr>
<tr>
<td>Politicization</td>
<td>45.2</td>
<td>47.5</td>
<td>35.5</td>
<td>39.2</td>
</tr>
<tr>
<td>Transparency</td>
<td>67.2</td>
<td>72.3</td>
<td>70.3</td>
<td>72.7</td>
</tr>
<tr>
<td>Wage Satisfaction</td>
<td>58.2</td>
<td>68.1</td>
<td>55.1</td>
<td>62.3</td>
</tr>
</tbody>
</table>

\textsuperscript{10} This phase of the analysis is currently being carried out. We are also working on disaggregating the concept of corruption into 4 components and studying the effects of public sector characteristics on each components: corruption in the public sector, corruption related to personnel management, corruption related to budget management and state capture.
This simple exercise provides us some preliminary, though quite revealing information. On some dimensions, the four groups of agencies perform in a very similar way, such as for example, in terms transparency, accountability and quality of rules. On other dimensions however the agencies are rated very differently. Judicial agencies for example are rated much worse than other agencies in terms of meritocracy and politicization. On the other hand, the quality of service provided is considered high as well as satisfaction among employees in terms of salary and benefits. Transparency appears to be an issue for the executive branch of the government.

In the case of the legislative branch of the government, enforcement appears weak as well as wage satisfaction. On the other hand, the degree of politicization for these agencies is very low. Local governments perform very well in terms of meritocracy, enforcement and audit mechanisms and accountability. They are crippled however by widespread state capture. In addition, it appears that municipal agencies have access to less resources than other agencies to achieve their mission.

Table 6 shows the results of this institutional analysis for the aggregate corruption index. The first column reports the simple correlation, isolating other potentially important governance factors and considering only the effect of a single variable on corruption. The second column reports the (partial) causal link which is statistically equivalent to regressing aggregate corruption on all institutional variables.

<table>
<thead>
<tr>
<th>Independent variable (indices):</th>
<th>Simple Correlations*</th>
<th>OLS**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transperancy</td>
<td>-0.21*</td>
<td>-0.30*</td>
</tr>
<tr>
<td></td>
<td>(0.10)</td>
<td>(0.19)</td>
</tr>
<tr>
<td>Quality of rules</td>
<td>-0.19</td>
<td>0.05</td>
</tr>
<tr>
<td></td>
<td>(0.15)</td>
<td>(0.31)</td>
</tr>
<tr>
<td>Enforcement of Rules</td>
<td>-0.34***</td>
<td>-0.30**</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(0.15)</td>
</tr>
<tr>
<td>Meritocory</td>
<td>-0.04</td>
<td>0.07</td>
</tr>
<tr>
<td></td>
<td>(0.76)</td>
<td></td>
</tr>
<tr>
<td>Politicization</td>
<td>-0.13*</td>
<td>-0.26</td>
</tr>
<tr>
<td></td>
<td>(0.31)</td>
<td></td>
</tr>
<tr>
<td>Wage Satisfaction</td>
<td>-0.35***</td>
<td>-0.07</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td></td>
</tr>
<tr>
<td>Voice</td>
<td>-0.19</td>
<td>0.34**</td>
</tr>
<tr>
<td></td>
<td>(0.15)</td>
<td>(0.17)</td>
</tr>
<tr>
<td>Mission</td>
<td>-0.10***</td>
<td>-0.31*</td>
</tr>
<tr>
<td></td>
<td>(0.45)</td>
<td>(0.17)</td>
</tr>
<tr>
<td>Resource</td>
<td>-0.034</td>
<td>0.03</td>
</tr>
<tr>
<td></td>
<td>(0.80)</td>
<td></td>
</tr>
<tr>
<td>Audit</td>
<td>-0.07</td>
<td>0.10</td>
</tr>
<tr>
<td></td>
<td>(0.61)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>---</td>
<td>0.39</td>
</tr>
</tbody>
</table>
The relationship between public sector characteristics and corruption is found to be large and significant in the cases of enforcement, mission, wage satisfaction and transparency of the rules (see Figure 36). Agencies with well-defined accountability mechanisms, satisfied personnel, and a clear mission are less likely to display high level of corruption and more likely to satisfy the demand of the citizens for public services. By contrast, a merit-based personnel management, an internal and external audit system and availability of resources appear not to be significant factors affecting the quality of governance in Honduras.

Figure 36: Aggregate Index of Corruption and Enforcement
(based on public officials’ responses)

Figure 37: Corruption in Personnel Management and Meritocracy
7.3 REPORTING CORRUPTION AND EMBRACING REFORMS

Why do people do not report an incidence of corruption they experience or observe? This question is asked to the users and public officials and the responses are somewhat similar. As Figure 40 shows overwhelming majority of the users are quite pessimistic with effectiveness and honesty of the anti-corruption bodies. They believe that those responsible will not get punished and only the most trivial cases will go to the court, leaving “big fishes” behind. They are also afraid of possible reprisals. Quite a few do not know where to report or enough evidence to prove anything. Among public officials fear of reprisal is the most significant factor not to report an incidence of corruption. They also question the sincerity of the investigators and believe that at the end accusations could not be proved. Some officials try to justify corruption with economic and cultural reasons, but they do not constitute the majority. Since majority of the users are quite cynical about
the effectiveness and honesty of the anti-corruption bodies, they are not likely to report a corruption incidence. About 3/4 of the users chose not to report it even they suffered from it.

But, how do public officials themselves feel about possible reforms to combat corruption? Among public officials the most favored reform proposals are related to improvement of public sector management variables, such as reducing the red tape, better rule enforcement, introduction of merit-based personnel management system (Figure 41). Quite few officials are ignorant towards reforms targeting more transparency in government, decentralization and introduction of citizen voice and feedback mechanisms; however, they are not against either. The only reform option that are strongly resisted by public officials is privatization of public services. However, Most of the public officials acknowledge the excessive size of government and they are willing to support reduction in government employees.
Figure 41: Which Reform Proposals Public Officials Support? (based on Public Officials Surveys)

- Privatization of the public services
- Reduction in number of public officials
- Rationalization of the budgetary increases
- Decentralization of state administrations
- Greater supervision of civil society over public sector activities
- Free and better access to state information
- Better supervision of political party financing
- Introduction of meritocratic system in promotions and assignments
- Regulation of penalties and awards based on performance
- Simplification of Administration
- Introduction of Checks and Balances in the Public Sector
- Clearer procedural guidelines
- Introduction of Checks and Balances in the Public Sector
- Simplification of Administration
- Introduction of meritocratic system in promotions and assignments
- Greater supervision of civil society over public sector activities
- Free and better access to state information
- Better supervision of political party financing
- Regulation of penalties and awards based on performance
- Simplification of Administration
- Introduction of Checks and Balances in the Public Sector
- Clearer procedural guidelines

Percentage of support: 0% to 100%
The evidence discussed in the previous pages suggests that Honduras faces a serious corruption challenge. At the same time, the preliminary results presented can foster anticorruption efforts by helping prioritize fundamental areas for reform. This section summarizes some of the main findings of this preliminary analysis and suggests priority areas for policy reform. In particular, the evidence from the governance diagnostic surveys completed during the summer of 2001 provide insights onto:

- governance strengths and weaknesses across key institutions in Honduras, contrasting the vulnerabilities of many institutions with the good example of others,
- the developmental/economic costs of weak governance and corruption, and,
- possible sources for improved governance and public service delivery of the institutions.

Overall, the public service users, enterprises and public officials of Honduras were forthcoming in responding to the 3 surveys, providing structured information about corruption and many other governance dimensions. In general, the refusal rates for each of the three surveys was low. With the exception of few cases, the responses of users, public officials and managers are very consistent in signaling strengths and weaknesses across government agencies. Further consistency checks, triangulation and analysis utilizing different questions aiming at the same underlying governance weakness revealed that the reliability of the results is high. Nonetheless, a margin of error always remain, and it ought to be noted that a number of questions and variables in particular contain a significant element of subjective perception (while others less so).

This diagnostic study offers a set of key messages that complements and reinforces some of the findings of the CAS, PRSP and HIPC Initiative. Indeed, as explained in the introduction and studied throughout the document, the can be summarized as follows:

- **Corruption and mis-governance are regarded as the most serious problem in Honduras.** Corruption is seen as the worst problem by firms and the third worst by users and public officials, after crime and cost of living. Government ineffectiveness and regulatory burden are seen as lesser problems by the enterprises as compared to weak rule of law.

- **Corruption exacerbates poverty and is a real obstacle for the private sector.** Poorer users (smaller firms) are disproportionally penalized by paying bribes that represent a greater share of their income (their gross monthly revenues). Furthermore, one eight of firms reports that corruption was the main reason to not invest. On the other hand, paying a bribe does not necessarily translate in better quality of the service received. These findings are in line with the evidence collected for other Latin American countries.

- **But corruption needs to be tackled with a variety of measures since it takes many different forms**, from administrative corruption, to State Capture, corruption related to procurement and purchasing of positions in the public administration. The surveys suggest that agencies with transparent and de-politicized decision making procedures, merit-based personnel management systems, and citizen-feedback mechanism are less likely to display high level of corruption and more likely to satisfy the demand of the citizens for public services.
Learning from the good experiences. There is a significant institutional and geographical variation in terms of mis-governance across Honduras. User satisfaction with public service delivery varies greatly, with the Atlantic Littoral and the South regions ahead of the other regions in terms of quality of services and lower corruption.

There is a real willingness to fight corruption. Firms feel very strongly about eliminating corruption, reporting willingness to pay of almost 10% percent of their monthly revenues to resolve this problem. Public officials are also very much in favor of reforming the public sector and improving governance, especially in terms of clearer and simpler procedures, greater accountability and a more merit-based system.

The previous findings highlight a fundamental point – reducing corruption is more than just a matter of law enforcement—it requires as well society-wide institutional reforms. A multi-pronged strategy that addresses the various forms of corruption – from state capture to administrative corruption – must address political accountability and transparency, promote a competitive private sector, strengthen institutional restraints, improve public sector management, and embrace civil society participation. A schematic diagram illustrating this approach is provided in Box 2.

It is important to emphasize that while this comprehensive approach applies generally, the detailed components described within each box may vary significantly from country to country. For this reason it is important to carry out an in-depth diagnostic analysis within the country under exam. Only this in-depth exploration can lead to the determination of a series of reform priorities to focus on in the specific country.

It is clear however that reform would need to center on fundamental public sector reforms, while at the same time strengthening civil society participation and engaging constructively the competitive segments of the private business sector – within a coalition-building approach of shared responsibility. The evidence suggests that public institutions characterized by effective voice and accountability mechanisms, efficient corruption reporting mechanisms, clear and well-defined rules, and a reform minded staff, perform better and are able to control corruption more effectively. The evidence also identified public officials support for civil society oversight and meritocracy reform as anticorruption mechanisms. The survey evidence underscores the importance of implementing reforms to enhance transparency and public oversight.
This preliminary report concludes by reiterating the nature of this draft contribution, which is preliminary at this stage and for discussion, while undergoing further revisions and extensions. The report presented evidence on a number of key reform aspects in Honduras and much of the information contained in the data is still under analysis. This report was not designed to provide answers to all questions arising from the data, but rather to encourage a focus debate on how to promote anticorruption efforts in Honduras. It is intended to serve as a concrete input to action by Honduras citizens in their strive to improve governance in their country.

Next, it is expected that the draft analysis and findings contained here will be used by the Consejo Nacional Anti-corrupcion, the executive under the leadership of the President, and other stakeholders in order to promote further concrete action on pro-governance and anticorruption institutional reforms. It is only by addressing the systematic institutional weaknesses within key public sectors and agencies in Honduras that progress will be possible.