

ANNEX

EUROPEAN COMMISSION

Mid-Term Review of the Country Strategy for 2007-2013

HONDURAS

Executive summary

Honduras has been going through an unprecedented **political crisis** since early 2008 which culminated in the removal of President Zelaya on 28 June 2009 and the installation of an unrecognised *de facto* government. The general election held in November 2009, apparently conducted in a transparent and professional manner, marked a turning point for the resolution of the crisis despite continuing political polarisation. As a result of the political crisis, progress towards democratisation and decentralisation, in promoting transparency in public affairs and in fighting corruption and poverty slowed down significantly, while the required social and economic reforms and the necessary modernisation of the country's governance, already considerably behind schedule, experienced a further delay.

The isolation of the *de facto* government by the international community in 2009 and the cutting-off of most aid by donors contributed during that year to the worsening **economic situation** of the country, which was already seriously affected first by the food crisis and then by the global economic and financial crisis. Especially SMMEs were adversely affected by the lack of available credit facilities under a well-conceived anti-crisis policy, hindering them from taking advantage of increased integration into the regional and world economies. In addition, the former prudent, market-oriented economic policy was no longer followed after mid-2008, monetary policy remained inflexible and the country did not implement all the necessary fiscal reforms required by international financial institutions. Ill-conceived social measures, such as a 60% increase in the minimum wage, not only resulted in shrinking state revenues but also contributed to increased unemployment as the workforce was redirected to illegal employment.

Although Honduran governments made some efforts and drew up a **Poverty Reduction Strategy**, succeeded under the Lobo Government by a **National Plan**, real progress in social development has been limited. **Social conditions** have actually worsened during the last few years and poverty, malnutrition and income inequality in Honduras are among the highest in Latin America. The crime rate and insecurity have increased, bringing the murder rate to the highest in Central America and continuing to deter investment. Access to health, education, energy, water and sanitation were problematic for a large section of the population. Degradation of the **environment and natural resources** continued due to illegal logging, the population explosion and lack of supervision of protected areas. **Renewable energy** such as wind, solar, biomass and some geothermal energy seems to have good prospects as the Government began to show greater interest in such sources, in addition to the 33% of energy that is already coming from hydro-electric plants.

The analysis of the political, economic, social and environmental conditions confirms the validity of the current strategy with three main priorities: **1. Poverty reduction, 2. Forestry and natural resources** and **3. Justice and public security**. This is in line with the priorities of EU policy objectives, including those of the Lima Declaration; those objectives which are not direct priorities, such as climate change and migration, are cross-cutting issues in the CSP.

Aid effectiveness has shown mixed success in Honduras. There has been excellent **donor coordination** in the G16 group and donors have aligned with the **Poverty Reduction Strategy** (PRS). The Delegation has cooperated closely with Member States and the main international donors. **Civil society** has been a constant partner in formulating strategies, as have **local authorities**. Members of **Parliament** have also been consulted, for one on this Mid-Term Review. However, the Government has not taken the lead in donor coordination, and cooperation with the authorities has become more difficult from 2008.

Although **Budget Support** was supposed to be the main channel for cooperation under the current CSP, macroeconomic, public finance management and development policy conditions have not been met since mid-2008 and most donors, including the Commission, suspended disbursements, from 28 June 2009 until early 2010.

The performance of Honduras has not been very positive in terms of achieving the **Millennium Development Goals**. The **Poverty Reduction Strategy** aims to achieve most MDGs, in particular in Health and Education. However, the country is not on track to meet the goal for reduction of poverty and no updated PRS or other planning document has been adopted.

The **evaluation of the first National Indicative Programme (NIP1)** under the current CSP is rather difficult as projects and programmes started with delays and are now paralysed by the political situation. However, conclusions can be drawn from the Commission's **cooperation** under the previous CSP, which is still being implemented. **Priority 1, Support to the PRS:** direct support for **education** has given mixed results. A conventional project to support secondary and technical education has been quite successful, but a regional project and a basket fund (under thematic funding) supporting primary education have had limited results due to lack of capacity and teachers' pay increases absorbing most of the funds available. **Health** has shown deterioration in some indicators such as maternal mortality and prevalence of vector- and water-borne disease and the Government is committed to improving these. But absorption capacity in both these sectors is limited. **Decentralisation**, supported by the Budget Support Programme PROADES and by the environmental projects FORCUENCAS and PROCORREDOR, has progressed slowly, which has made it difficult for local authorities to access PRS funds. **Priority Sector 2, Natural resources**, can draw on experience with FORCUENCAS and PROCORREDOR under the previous CSP. These show that actions are better integrated into the structure of ministries. A new legal framework for forest management is being supported by these and the new MOSEF project, which is ready for a Commission decision in early 2010, provides direct support to the Forestry Conservation Institute ICF. **Priority Sector 3, Justice and security**, remains an essential focus (PASS Programme), as the crime rate discourages investment, destabilises the country and makes it impossible to police illegal logging, the drug trade, etc. This project has provided an object lesson in collaboration between different state authorities as well as consultation of civil society and close donor coordination.

The National Indicative Programme 2011-2013 (NIP2), with adjustment, will continue to focus on the three main priorities: 1. **Poverty reduction**, 2. **Natural resources** and 3. **Security and justice**. As Honduras is still one of poorest countries in Central America, these areas will remain long-term priorities. The country is likely to continue being a net ODA beneficiary, not only to tackle these crucial problems but also to implement the necessary institutional, administrative and economic reforms. It is proposed that poverty reduction include additional activities such as **employment generation**, having particular regard to **support to SMMEs and strengthening quality systems** as well as **water and sanitation**. For the natural resources sector it is recommended that support to this sector be expanded by launching actions related to **renewable energy sources and energy efficiency to slow climate change** and at the same time contribute to poverty reduction.

I THE MID-TERM REVIEW

1. Analysis of the main political, economic, social and environmental developments in the country

1.1. Political situation

The **political situation** in Honduras, which remained relatively stable in 2007 and the first half of 2008, has become tense since the second half of 2008 with the country's accession to ALBA and the primary elections that took place in November 2008. Since early 2009 the political agenda started revolving around an undefined constitutional reform proposed by President Zelaya, which resulted in his removal on 28 June 2009 and the nomination by the Congress of Roberto Micheletti as interim President, leading a *de facto* government, which was not recognised by the international community.

The election of President Lobo in November 2009 and his programme of national reconciliation have brought institutional stability and, considering the steps implemented by the new Government of national unity, the EU decided on a progressive normalisation of relations in line with the position of the international community.

As a result of the political crisis, progress towards democratisation and decentralisation, in promoting transparency in public affairs and in fighting corruption and poverty has slowed down significantly, while the required social and economic reforms and the necessary modernisation of the country's governance, already considerably behind schedule, have ground to a halt. This is going to have a longer-term impact on the development of Honduras. For the first time, it seems that a popular movement, representing the interests of the poor and supported by a significant part of the population, will demand social and political reforms in the short term, including a reform of the constitution.

1.2. Economic developments

Although Honduran administrations followed a prudent, market-oriented **economic policy** until mid-2008, several internal and external factors have contributed to the worsening of the **economic situation**. The sharp increase in oil prices during mid-2008, accompanied by food price fluctuations, placed an extra burden on the budget. The Government responded with a cut in the rate of energy subsidies, targeting only those in serious need. In addition, since mid-2008 the government introduced some measures to improve the living standards of certain groups without considering important fundamentals of the economics and consequences on the Honduran economy. The 60% increase in the minimum salary, triggering automatic salary increases in the public sector, resulted in almost 90% of government spending going on current expenditure. The minimum wage increase has already affected employment, shifting the workforce from formal taxable employment into the informal sector, with a negative impact on government revenues.

The **global economic and financial crisis**, and from mid-2009 the political crisis, has also seriously affected the Honduran economy. The GDP growth rate is expected to slow down from 6.3 % in 2007 and 4.0 % in 2008 to -4.4 % in 2009. The public sector deficit is rising and could reach 6 % of GDP. Export earnings, mostly from exports of traditional *maquila* products and agricultural goods (the latter having suffered due to the severe floods in October and November 2008) to the US, the country's main market, have decreased by about 13 %. Improvement of the budget deficit situation was helped by a sharp decrease in imports (27 %) which exceeded the drop in exports. **Investment** plummeted by 15 % in 2009 due to contracting export markets and the global credit crunch as well as the political crisis. A drying-up of accessible credit facilities, resulting from rising interest rates and stricter domestic and international borrowing conditions, has affected especially small and medium-sized enterprises, limiting their potential to make use of the opportunities offered by regional integration, the trade agreements with the US and the EU GSP+ regime. **Remittances** from Hondurans living mainly in the US, reaching almost 25 % of GDP in 2008, dropped by 14 % in 2009. **Domestic consumption** has shrunk by around 3-5 % due to the significant drop in income. Recession has also been deepened by the substantial cuts decided by the *de facto* government in July after finally approving the budget for 2009, which meant reductions of 10 % for central government spending and 20 % for independent state institutions. More cuts are foreseen due to the suspension of financing by both international donors and financial institutions, affecting especially social spending.

The drop in imports, at around 27 %, has reduced the **trade deficit** significantly. The over-valuation of the lempira has also contributed to the recession, especially given that the **inflation** rate peaked at 14 % by the late summer of 2008 due to increased food and oil prices. Solid economic growth and recovery require the implementation of the necessary reforms, which Honduras has failed to address since 2008. In order to support such reforms, the IMF signed a *Stand-By Agreement* with Honduras in March 2008, the terms of which were never complied with by the Government. Even if it was considered by various sectors of Honduran society as an important indicator of economic stability and therefore as an incentive for investors, it was not renewed and new agreements will only be possible once the political crisis is solved and the new government defines its economic and social policy. In addition, the *Anti-Crisis Plan* initiated early in 2009 by the Government has not only remained shelved because of the political crisis but seemed not to have provided necessary responses to help the country overcome the economic and financial crisis. Since July the *de facto* authorities have followed a more conservative economic line based primarily on expenditure cuts. The future government will have to implement serious fiscal reforms, tackle the constant rise in public payrolls and improve management of public utilities, in order to secure the resumption of international financing, make room for social anti-poverty spending and investment, and design a growth-stimulating economic policy based on a comprehensive development policy which should be approved around mid-2010.

Although the US remains the most important trading and economic partner and Hondurans living there are the main source of remittances, the government of Manuel Zelaya took steps to diversify its foreign relations. In addition to participating in the negotiations for the Association Agreement with Europe, the country had been strengthening relations with Venezuela and Cuba and joined Petrocaribe in 2007 and ALBA in 2008, from which it withdrew in late 2009.

1.3. Social developments

Honduras has one of the highest rates of poverty and inequality in the Western Hemisphere while at the same time having the highest population growth rate in Latin America, with the population doubling every 25 years. Although Honduran governments made some efforts, drew up a **Poverty Reduction Strategy (PRS)** and achieved debt relief, real progress in social development has been limited. While the poverty rate of 63.7% in 2005 dropped to 59.2% in 2008, and the extreme poverty rate fell from 46% in 2005 to 36.2% according to government statistics, it started increasing during the last two years as a result of the increase in oil and food prices as well as the global economic and financial crisis. Inequality in income between the richest and poorest also decreased until 2008 and started to increase thereafter. The richest twenty per cent of Hondurans earn over 20 times more than the poorest twenty per cent. Food prices increased by over 20% and the cost of food in the expenditure of Honduran households increased from 22% to over 30%. As a result, it is estimated that poverty increased by 7.9% and extreme poverty by 13.9%. Poverty¹ is extremely high in the countryside, where 68.9% of the population lives; national extreme poverty² now represents 45.8%. Nevertheless, the increase in food prices affected mostly the urban poor, whose numbers have increased as a result of migration from the countryside due to the lack of jobs in the agricultural economy, still dominated by giant estates and peasant-owned mini-farms. The current economic crisis has hit mostly the poorest but also the thin middle class. It has hit young people especially hard. At national level 30% of the working population lacks any job at all. The closure of *maquilas* as a result of the economic crisis but also the sharp increase in minimum wages since 2008 has affected over 30 000 people, who received little or no severance pay as there is no unemployment compensation. **Child labour** is still a great concern as about 300 000 children are engaged in some income-generating activity, and 69% of the labourers in the *maquilas* are young **women**. Despite being a signatory of most ILO Conventions (a prerequisite to benefit from the EC's GSP+ system), the implementation of the conventions aimed at improving employment conditions has been very weak in Honduras. Access to **water and sanitation** is still limited for a large part of the population and rural development is affected by the slow progress on regulating land ownership. According to a [Habitat for Humanity Report](#), about two thirds of Hondurans are living in inadequate **housing**. Based on the statistics of the World Food Programme, one out of four Honduran children under 5 years old suffers from chronic malnutrition. In some rural communities in the west of the country, chronic malnutrition can reach 48.5%. The health and education situation has improved somewhat as a result of increased spending, but qualitative improvements are still badly needed. Although it is claimed that, as a result of the abolition of school fees by the Zelaya government, 450 000 more children have been able to attend elementary school, the average number of **school** years completed in Honduras is still rather low at 6.2 years and still 20% of adults are unable to read. The rate of growth of **HIV/AIDS** has slowed, but it has not been possible to reverse its upward trend. Rising unemployment and unimproved living conditions are the main reasons why around 1.5 millions Hondurans, about 20% of the population, have decided to leave the country and social tensions have been on the rise. In addition to migration, poor living conditions force even more Hondurans to look to the rapidly growing illegal **narcotics trade** for income. The **crime rate** is at an all-time high and the rapidly **growing drug trade** is threatening the bases of state institutions. According to the United Nations Development Programme (UNDP), the number of homicides across the country shot up by 35.7% in the first nine months of 2008, to 3 262. Consequently, it is estimated that the

¹ Percentage of population having incomes amounting to less than twice the cost of a basic food basket; includes the indigent (ECLAC, 2008).

² Percentage of population having incomes amounting to less than the cost of a basic food basket (ECLAC, 2008).

Honduran murder rate is currently around an all-time high of 60 per 100 000 persons. Now about 60% of homicides are related to drug traffic and organised crime. Repressive anti-crime policies have failed to improve the situation. The state seems impotent to fight this wave of violence and impunity rates are alarming, given the authorities' lack of personnel, training, appropriate equipment and adequate security policies. **Violence and insecurity** has become the main factor deterring foreign investment in the country and is still estimated to cost over 10% of GDP. Since the removal of President Zelaya, the **human rights** situation has worsened.

1.4. Environmental developments and energy issues

Honduras remains **one of the most vulnerable countries to natural disasters**. Prolonged floods in the autumn of 2008 not only affected the poor and the economy of the country but also demonstrated that the response capacity of Honduras is still inadequate. During the last few years, **environmental problems have been further aggravated** by the impact of the relatively high recent economic growth until 2008. One of the main environmental concerns, the rapid **deforestation**, continued at a rate of 3.6% annually and biodiversity rapidly declined. Illegal logging is considered as a major reason for deforestation, and as much as 85% of timber production in the country is illegal. The **illicit timber trade** has contributed significantly to endemic **corruption**. In addition, the current **demographic trends** exert severe pressure on all natural resources, resulting in expansion into new areas with the ensuing degradation of soil, forest and water resources. 75% of protected areas lack administration and protection, which is compounded by legal insecurity on land tenure, low investment and lack of capacity in the State Forest Administration to manage forest resources sustainably. Many of these areas are located in departments and municipalities with higher poverty rates and lower human development indices as well as areas inhabited by minorities. Their limited access³ to the forest resource is one of the causes of forests and protected wild areas neither having contributed significantly to mitigating rural poverty nor generating economic and social development opportunities.

Environmental challenges have been closely linked to **energy issues**. Although Honduras is self-sufficient in electricity, it has been heavily dependent on imports of oil, which, with the oil price rise in the summer of 2008, resulted in a huge financial burden for the country. In Honduras, there is significant potential for **renewable energy** resources, which currently make up about 33% of total energy production, mainly coming from hydro plants, while biomass is growing in importance. Such resources, including wind, solar and some geothermal energy, could be developed at competitive prices, and it is considered that they could make a greater contribution to sustainable development as well as limiting environmental damage and the negative effects of climate change. Currently the government is backing the development of renewable energy, with the approval of the law on incentives for the production of renewable energy and recently with the launch of a tender for 250 MW of energy from renewable sources, which already represents a change from the traditional tenders that relied on energy generation from oil.

³ Only 3.4% of the population that live in the forests have benefited from social forestry programmes, an insignificant figure if it is considered that 74 per cent of the poor and 86 per cent of the extremely poor live in rural areas.

2. New EC/EU policy objectives and commitments

2.1. Relevance of new EC/EU policy objectives

Honduras has been allocated €223 million for cooperation in the current CSP period, being the largest recipient of Community aid in Central America. The Commission cooperation strategy has been conceived and implemented in line with the EU policy objectives, considering especially the commitments adopted in the **2008 Lima Declaration**, such as the eradication of poverty, inequality and exclusion, sustainable development, food security, the environment, climate change and energy, trade and regional integration and migration. Mitigation of the impact of the current crisis and support to recover from it has also been an objective of EC/EU policy. As the analysis of the previous chapter indicates, all these policy objectives remain relevant for Honduras. Several issues such as drugs, climate change and migration, which are assumed to be better dealt with at regional level, are the focus of CA regional programmes and projects and will be incorporated under the relevant components of the EU-CA Association Agreement. In addition, these issues will be integrated into actions of the current CSP as **cross-cutting issues** as follows:

- **Support to the Poverty Reduction Strategy social sectors** (Health and Education): fostering environment and risk awareness in education programmes, improving gender equality in education and also fostering both in water resources/renewable energy programmes.
- **Environmental response:** especially in the forestry sector, promoting sustainable management of natural resources, disaster preparedness, promoting women's rights and activities in forestry and equal participation in benefits, promoting the recognition of ethnic groups' rights.
- **Justice and public security:** human, especially children's, rights, socially at-risk young people and women.

2.2. Aid effectiveness agenda

Transfer of responsibilities to the regionalised Delegation in Tegucigalpa has facilitated contacts with the Government, local authorities, donors and non-state actors.

Donor coordination has increased and, since 1999, the **G16** donors group has proved to be an effective tool, both at political and technical levels, in diverse areas such as joint programming, harmonising actions, rationalisation of resources and effective sector concentrations. Donors have aligned their programming especially with the Poverty Reduction Strategy, and in some basket funds, in particular the *Education For All Initiative*, to which the Commission has contributed, there is close collaboration between G16 members. In the justice and security sector, the PASS programme was designed to build on the work undertaken by the IDB project *Justicia 2* and other G16 members also exchange information with the Commission in this sector. The **Budget Support Group**, one of the G16's donor round tables, has provided an especially useful discussion forum in which the World Bank, the Inter-American Development Bank, Germany, Sweden, Spain and the European Commission have worked together closely assessing the eligibility of the country for budget support. In 2008 a joint matrix of sectoral and macro-economic indicators for budget support was negotiated between the donors, including the Commission, and the Government.

Despite the progress following the post-Mitch period, since 2008 the political situation and difficulties in the dialogue with the Zelaya Government have slowed down and in some fields reversed the process of **cooperation with the authorities**. The initiatives have all been donor-driven, as the aid effectiveness agenda has lacked strong political support from government and the efforts made by some donors have been thwarted by the political instability and institutional weaknesses.

Nevertheless, donor coordination has continued throughout the political crisis despite the suspension of contacts with the *de facto* government in July 2009. The resumption of ongoing programmes and the future of Budget Support programmes will depend on the political will of the new Government. The commitment of Honduras to a coherent National Development Plan/Poverty Reduction Strategy, with improved management of public finances and a stable macroeconomic policy, must first be assessed before a resumption of the situation previous to the political crisis. The Budget Support Group is currently working on a minimum agenda for dialogue with the new authorities. The World Bank, IDB, IMF and European Commission will be the lead donors steering this effort, which has maximum political priority.

The current presence of donors and division of sectors in Honduras indicate that there is no overcrowding of donors in the country. **Collaboration between the Commission and the few Member States** (Italy, Spain, France and Germany) present in the country has also been strong. Sweden has decided to pull out of Honduras, although the EC will take over some of the work done by SIDA in the fields of Security and Justice.

2.3. Non-state actors, local authorities and national parliament

Civil society has become a very important partner in formulation of the strategies, especially the Poverty Reduction Strategy, through participating in the consultative forum concerning the PRS, and has been regularly consulted during the identification phase of our programming. **Local authorities** also participate in consultative forums and are usually represented by the *Association of Municipalities of Honduras* (AMHON). This is a non-profit national civil organisation. It brings together 298 mayors, representing the 298 local authorities. It advocates municipal autonomy and promotes decentralisation and national reconstruction processes. It is the sole mouthpiece for municipal interests and demands. Until the crisis, the Delegation regularly consulted the **National Congress**, including on formulation of this mid-term review.

2.4. Aid delivery methods

Budget support was chosen as the preferential aid delivery method in Honduras. While it accounted for some 22% (still only 40% disbursed) of the 2002-2006 CSP, it was planned to amount to 50-85% of the current CSP and most of the current *Food Security Budget Line Programme*. Nevertheless, the use of this channel has encountered serious difficulties over the last two years due to the deficiencies in macroeconomic performance and fiscal and monetary issues that have created great imbalances and a deteriorated Public Finance Management system. In addition, the Zelaya government never released the definitive version of the revised Poverty Reduction Strategy, which accounted for the country's National Development Policy. The existence of a National Development Policy was announced repeatedly, but its links with the Poverty Reduction Strategy and the Sector Strategies currently in place were never

clarified, adding to the confusion that paralysed budget support programmes in late 2008. As a result Germany, Sweden, the World Bank and the IDB suspended their budget support programmes at the end of 2008. This non-compliance with the conditions for Budget Support, followed by the political crisis, delayed the signature of the APERP Programme (Budget Support to the Poverty Reduction Strategy). However, there is reason for optimism, as the new government will have to confront a bleak economic situation and budget support will be badly needed. The members of the Budget Support Group are optimistic that, with the proper political dialogue, the Poverty Reduction Strategy, the Public Finance Management improvement programme and a proper stability-oriented macroeconomic policy could be reactivated in the short term and budget support resumed. Nevertheless, if this proves not to be possible, prudence suggests that conventional projects should be the main approach until there is evidence of greater financial rectitude and macroeconomic stability.

3. Results, performance and lessons learnt

3.1. Country performance

The original framework for the Honduras development agenda was the **Poverty Reduction Strategy**, which aims to attain all Millennium Development Goals (MDGs) with the exception of HIV/AIDs targets. Efforts made by Honduras to achieve various Goals during 1990-2005 show progress in: (a) reduction of poverty in relative terms; (b) reduction of the percentage of the population who live on less than a dollar a day; (c) a decrease in the rate of infant malnutrition; (d) growth in the rate of youth literacy; (e) an increase in the number of children who have access to primary education; (f) reduction of infant and maternal mortality; (g) a fall in the rate of prevalence of malaria and HIV/AIDs; and (h) an increase in people's access to sources of safe drinking water and sanitation. However, according to UNDP estimates it is uncertain to what extent the country will achieve most of the goals by 2015. Only the reduction of infant and maternal mortality is likely to be achieved and universal primary education and gender equality seem to be on the right track, although requiring additional efforts. Despite the insufficient data, it is probable that other objectives, such as a relative poverty rate of 42 % and an extreme poverty rate of 19 %, will not be met.

3.2. Cooperation performance: evaluation of the implementation of NIP 2007-2010

For the first National Indicative Programme (NIP1) €127.5 million were earmarked, of which €65.5 million was allocated for the Sector of **Fight against poverty**, €21 million for **Natural resources** and €44 million for the sector of Justice and security. It is difficult to evaluate the results and performance of the projects under NIP1, as projects started with a delay due to the late approval of the 2007-2013 CSP, slow negotiations with the Government, institutional deficiencies, macroeconomic instability and the relatively early kick-in of the electoral process, and the political crisis that has paralysed cooperation. Nevertheless, experience with projects started before the current CSP and which have made progress can provide useful lessons for future actions.

3.2.1. Sectors: Fight against poverty

Although the **Poverty Reduction Strategy** is still regarded by donors as an important tool, its definitive version was never officially released. Neither did the Government publish its **National Development Plan**, which is claimed to incorporate the PRS as a key element. The Poverty Reduction Strategy is currently not being implemented. However, a relatively up-to-date draft exists, which had been prepared after extensive consultations with civil society and donors and only minor modifications would be necessary to restart its implementation. With appropriate donor coordination and sufficient political will, the PRS could be operational again by mid-2010.

Although poverty spending has grown⁴, especially on health and education, only a few indicators have improved. In the **education sector**, one of the main reasons was that most of the new funds have been absorbed by salary rises for teachers and have thus not had the desired effect of improving the performance of the education sector. Currently Honduran public teachers earn 50% more than their Costa Rican counterparts, with far worse performance. Even if reaching the MDG for primary education is apparently on track, with 89% completion of primary education according to official government figures, this represents very little change on previous years despite considerable investment. Our previous programmes in the **education sector** have also shown mixed results. As of September 2008, the closing date of the project, the secondary school support programme (**PRAEMHO**) contributed to training 1472 teachers in professional and technical education, benefited 1100 students with grants to guarantee their access to training and entry into the workforce, built and equipped 40 workshops and 62 labs in 19 secondary schools and strengthened the Ministry of Education's administrative capacity. The EC has thus been able to position itself as the largest donor in the sub-sector and has been very much appreciated by the authorities. On the other hand, the *Primary Education Support Programme* (**EFA**), in cooperation with other donors, has shown weak performance and impact largely due to institutional weaknesses, especially regarding tendering procedures and financial control. This has led to limited advances in the specific EFA targets such as reduction of the dropout rate and improvement of the level of learning of Spanish and Maths.

The **health sector** is at a critical point. As a result of the limited physical and human capacity in place and its fragmentation, access to services in the sector is limited and badly needs improvement. The Ministry of Health has pursued different strategies in response to the problems that affect its sector. Nevertheless, the increasing number of early pregnancies in young women has turned into a severe problem that has led the Ministry of Health to prioritise the maternal and infant mortality rates. According to the Ministry's *Maternal Mortality Surveillance System*, in 2007 there was a 17% increase in deaths compared to 2006. As a result, in 2008 the Honduran Government launched a long-term strategy to achieve an accelerated reduction of maternal and infant mortality, in accordance with the PRS goals and the National Health Policy objectives. In addition, there is increased prevalence of vector- and water-borne disease, exacerbated by poor sanitation and lack of safe drinking water. While previously (2002-2006) the Commission specifically supported the health sector through the CA regional project *Strengthening of the Health and Education Sectors in Honduras* (**PRRAC Health and Education**), the 2007-2013 CSP aims to provide for further support in this sector through the Poverty Reduction Budget Support Programme.

⁴ The 2008 budget contemplated a significant increase in PRS spending, from HNL 22 183 million (€64m) to HNL 27 963 million (€64m), and the share of PRS spending remained steady at around 46% of the total budget. However, with the budget for 2009 only approved by the *de facto* government, the PRS document was never updated by the Zelaya Government.

In addition to the specific problems with health and education, it must be underlined that there has been slow progress with the **decentralisation policy** that has prevented many local governments from accessing Poverty Reduction Strategy funds. This strategy has been supported by the **PROADES** programme of budget support (with technical assistance to the Interior Ministry) under the 2002-2006 CSP and the environmental projects **FORCUENCAS** (which supports the empowerment of local authorities and some services related to governability) and **PROCORREDOR** (under the previous CSP), which have major decentralisation components.

The existing CSP plans to provide for the main support to the PRS to be through Budget Support (APERP). However, the problems of macro-economic stability and public finance management, referred to above, as well as the absence of an updated PRS document, despite much consultation on the update, in addition to the political crisis, delayed signature of the financing agreement and the remainder of the €111 million for this priority may need to be reoriented to conventional projects. Furthermore, the €60.5 million APERP, once it starts, is likely to last until near the end of the CSP.

The execution of the PRS will be supported by a **technical cooperation programme**, called **PAAPIR**, which, in addition to supporting this priority, includes support to the non-focal sector of regional integration. The preparation of the programme of Support to the Poverty Reduction Strategy (APERP) has been a successful example of how to mobilise support from civil society, political parties and unions and promote public debate on combating poverty in Honduras. The programme was designed in close coordination with the IMF, World Bank and IDB, through joint efforts channelled through the Budget Support Group. **PAAPIR** can support the collection of statistics on indicators in the health and education sectors, which are at present unreliable. This will enable figures to be put on the indicators in future. The Zelaya Government has showed interest in indicators, with its *System of Management by Results*, although this has been largely input-oriented. However, it provides a precedent for the Government taking ownership of a system of indicators.

Some PRS indicators are also being improved through the Food Security programme, such as the percentage of GDP invested in poverty, the poverty and extreme poverty rates, the Human Development Index (HDI), the Gender Index and the number of protected areas with management plans.

3.2.2. Priority Sector 2: Natural resources

In February 2008, the Honduran Congress passed the *Forest, Protected Areas and Wildlife Law*, after almost a decade of discussion. This is strategically important for the environmental and economic stability of the country, employment generation, the supply of water for all uses, the development of tourism and energy self-sufficiency. The Law is a first step towards better management of the country's forest resources. However, the process of transition from the old institution, AFE-COHDEFOR, to the National Institute for the Conservation and Development of Forests, Protected areas and Wildlife Conservation (ICF) is slow. The ICF needs to be able to count on increased participation of, and cooperation with, municipalities and local authorities and organisations covering the main part of the country, especially rural and semirural areas, as well as state institutions, including ministries. This consolidation is supported by the **MOSEF project**. The MOSEF project represents an excellent opportunity for **donor coordination**, as several donors (WB, IDB, GTZ) are taking additional

complementary actions such as strengthening Independent Forest Monitoring and Social Audits.

The previous EC projects, FORCUENCAS and PROCORREDOR, could serve as a good example of cooperation with authorities and other donors and provide useful lessons for the MOSEF project. **FORCUENCAS** provides lessons in how the local authorities can coordinate with local communities and central government and in the positive effects of allowing the beneficiaries to manage their own project so they have a higher degree of ownership. The difficulties of FORCUENCAS are that most of the partners in the project still need strong technical assistance to ensure the best use of the funds for institutional strengthening and to guarantee a strategic effect of the project and that FORCUENCAS activities have been so widely distributed that it has difficulties in building a consolidated, effective and integrated outcome. **PROCORREDOR**, building on the lessons learned from **FORCUENCAS**, has experienced greater success through establishing the project in the local offices of the Ministry and in municipal offices, to ensure better coordination and institutional continuity of the actions promoted by the project.

3.2.3. Priority Sector 3: Justice and security

The first phase of the **Programme of Support to the Security Sector (PASS)** was launched in 2008 and has recently started its activities. Reduction in crime, while removing the culture of impunity, would be a key factor in improving the governability and stability of the country and would improve the quality of life, increase social cohesion and reduce poverty by improving the climate for investment as many potential investors in Honduras are deterred by the physical insecurity and lack of legal certainty. The project also aims to support other sectors, such as the environment, by reducing crimes which damage the environment and contribute to climate change such as illegal logging. With all three phases of the project totalling €44m, this has made the Commission the leading donor in this sector in Honduras, with close cooperation arrangements with the US, IADB, UNDP, Spain and other significant donors, and could reinforce the image of the EU as a key partner of the country. In the first phase, activities include developing specific rehabilitation and prevention programmes, institutional restructuring plans, investment plans and a medium-term expenditure framework, which are important elements to reinforce justice and security in the country. In the second phase, greater emphasis will be placed on implementation of prevention and rehabilitation programmes, including improvements to the prison system and strengthening police training structures. It has been clear from the intensive planning process ongoing with the three main actors, the Security Ministry, the Supreme Court and the Public Prosecutor's Office, that the priority given in the first phase to strengthening especially the investigative capacity of the police is paramount, as this will enable a higher proportion of crimes to be brought to justice and help to combat the culture of impunity. A campaign to inform the public about the actual role of the security and justice institutions, which are more efficient than perceived by the general public, is necessary. The **sustainability** of the project requires finance to be secured for further investment in technical equipment and training and a commitment to continue the project. In addition, prevention and rehabilitation are still not perceived as priorities compared to maintenance of public order, either by the Government or by the population, for which an awareness campaign would be appropriate. **Consultations** have been held on the security and justice policy in various Honduran **civil society** forums, and they will have an important role

in the project's implementation, with special reference to rehabilitation and prevention. It can be concluded that agreement of the most representative political organisations in the country is crucial as is the Government's leadership and inter-institutional coordination. The current **donor coordination** coverage of this sector by international cooperation is at an early stage. However, the G16 group of **donors** in the security sector provides a good platform and the Commission, USAID, IDB and UNDP could be key partners, as each has major projects that could complement one another. Consultation and coordination with Member States will continue, especially with Spain and Sweden, as they also have security and justice projects. **Cross-cutting issues** such as good governance and human rights, including the fight against any kind of discrimination, are also key objectives of the programme. Women would certainly benefit from the project considering the current lack of guarantees of their rights, together with a high level of violence against women, and their presence in the institutions involved will be also an important issue.

3.2.4. Additional EC operations

Thematic projects as well as RSP programmes can also provide some useful lessons. **Renewable energy** and energy efficiency have increasingly become a priority in Honduras. Energy efficiency as well as energy conservation in both public and private sectors have been supported through the project **Autonomous Generation and Rational Use of Electric Power — GAUREE 2** (€5m), targeting isolated rural areas not connected to the national electricity network, allowing people in these regions to develop productive activities as well as improving social conditions. In the regional context, the EC has been supporting this priority through several projects. The **EURO-SOLAR project** is financing 68 systems in rural areas of Honduras, providing electrical power for education and health in selected rural communities. There are many applicants who have not been able to benefit from this project and new operations under the CSP in this sector would therefore complement it. Between these projects, the Commission has taken up an eminent position among donors in the sector, and the evaluation so far of GAUREE indicates good impact of the energy conservation component of the project.

Food security has become an important issue, not only due to the recent food crises, but also due to the low level of production of non export-oriented agricultural products despite the favourable geographical conditions for agriculture in Honduras. The country's National Food Security Policy with its implementation strategy has been supported by the EC through the **Food Security Budget Support Programme (PASAH — €14m)**. In parallel, complementary actions will be undertaken in the framework of the '€1 billion Food Facility' programme, one with the World Food Programme (WFP) on basic grain production and market enhancement for small holders/low-income farmers (€4.5 million) and another with the FAO providing technical input supplies for food security for vulnerable populations (€5.4 million). Three NGO projects are to be financed under the AAP 2008 Soaring Food Prices decision (€2 million allocated to Honduras). These initiatives will support the production of small-scale rural producers. Food security has been considered as a cross-cutting issue as well as a programme component of the PRS and municipal actions in this field are funded under the Municipal Development Plans.

Coordination and communication between ECHO and the Honduras EC Delegation have enabled complementarities to be established between **ECHO and DIPECHO actions** and the actions under the Natural Resources priority of the CSP. It is recognised that these

coordinated actions have had an impact on the reduction of physical, social, economic and environmental vulnerability.

4. Conclusion of the Mid-Term Review

On the basis of the previous analysis it can be established that the NIP1 priorities of the CSP 2007-2013 are still valid and the programmes and projects of this period are addressing real needs of the country development agenda. During this period the poverty situation in Honduras has not improved, a large part of the population is still not guaranteed access to basic social services and the country has not managed to tackle the growing violence and crime. Honduras has to face serious environmental challenges and the negative effects of climate change. Progress in social development has been especially aggravated by the increase of food prices, the global economic and financial crisis and, since, 2009 the political crisis. Honduras has made only very limited progress towards meeting the MDGs by 2015 and the Poverty Reduction Strategy, which should have supported achievement of these goals, has not been implemented, limiting aid effectiveness and cooperation with the well organised donor community. The lack of stable macroeconomic conditions and deteriorating fiscal and monetary policies have made it difficult to use budget support as an aid delivery method, although conditions are expected to improve when the political crisis is over. As the implementation of the programmes and projects of NIP1 has suffered delays it is difficult to draw conclusions; nevertheless, it is expected that the objectives will be met.

II. NATIONAL INDICATIVE PROGRAMME: 2011-2013 (NIP2)

Based on the findings of the MTR regarding the political, economic, social and environmental developments in Honduras, NIP2 of 2011-2013, with adjustment, will continue to focus on the three main priorities: 1. **Poverty reduction**, 2. **Natural resources** and 3. **Security and justice**. €95.5 million is allocated for its implementation. As Honduras is still one of poorest countries in Central America, these areas will remain long-term priorities. The country is likely to continue being a net ODA beneficiary, not only to tackle these crucial problems but also to implement the necessary institutional, administrative and economic reforms. It is proposed that Poverty reduction include additional activities such as **employment generation**, with particular regard to **support to SMMEs and strengthening quality systems** as well as **water and sanitation**. It is recommended that the Sector of Natural resources be strengthened by launching actions related to **renewable energy sources and energy efficiency to slow climate change** and at the same time contribute to poverty reduction.

Effective **donor coordination** by the G16 will remain a key element for joint programming and harmonisation of donor actions in Honduras, especially for monitoring the **viability of budget support**. **Civil society** will continue to play a significant role through consultative bodies and through the ongoing dialogue and consultation with the Delegation. **Cooperation with the government** definitely needs improvement to increase aid effectiveness. The main **risks** that could jeopardise successful implementation of the projects under the CSP 2007-2013 are the global economic and financial crisis, political instability and the growing social crisis if the main problems are not addressed. Heavy dependency on oil and the US economy

makes Honduras very vulnerable to outside influence and could once again unbalance the Honduran economy. Institutional weaknesses could also affect project implementation.

Table 1. Proposed changes to CSP 2007-2013 (€million)

PRIORITY	TOTAL AMOUNT 2007-2013 CSP	NIP I		NIP II		
		PROGRAMME	AMOUNT	Original amount same sector 2011-2013	PROGRAMME	PROPOSED AMOUNT
Priority 1. Support to the PRS	111	APERP	60.5		Strengthening of Quality Systems and Support to SMMEs (Employment/Social Cohesion)	20
		PAAPIR	5		Water and Sanitation	25.5
TOTAL PRIORITY 1			65.5	45.5		45.5
Priority 2. Natural resources	68	MOSEF	21	42	Sustainable Management of Natural Resources, including renewable energy and energy efficiency focused on climate change	47
Priority 3. Security and justice	44	PASS PHASES I & II	41	8	PASS PHASE III	3
TOTAL CSP	223		127.5	95.5		95.5

1. Priority Sector 1: Poverty reduction

Due to the worsening poverty situation, poverty reduction remains a **core priority**. To make the fight against poverty more effective, especially considering the current economic and financial crisis, it is considered crucial to launch two main additional actions in NIP2 focusing on 1. **SMMEs and strengthening quality systems** and 2. **Water and sanitation**. The activities of the key social sectors of education and health supported by the APERP will continue during NIP2. However, it can be concluded from the lessons learnt from the past support to these sectors that their absorption capacity is limited, so funds under NIP1 are sufficient for the time being. In addition to APERP, several other donors such as the WB, IDB, AECID, GTZ have strong health and education support programmes. Thus the funds allocated for the Poverty Reduction Strategy in NIP2 would contribute more to reducing poverty if they were used instead in support of SMMEs and quality systems, which would

enable more employment to be generated, and the sub-sectors of water and sanitation, which influence health in a more cost-effective way than curative actions, especially for the vector- and water-borne diseases mentioned above.

1.1. Strengthening of quality systems and support to SMMEs

Promoting equitable economic growth, employment- and income-generating productive sectors, access to new markets, bolstering competitiveness and supporting Honduras in the regional integration process under the EU-CA Association Agreement are key aspects of the effort to reduce poverty and strengthen social cohesion. This could be best done through **strengthening SMMEs**, especially providing help to **generate employment and to improve their** (and the Government's) **quality support systems**, and also through developing or stimulating export potential. This is fully in line with the Millennium Development Goals, the European Consensus on Development and the Paris Declaration. EC support for this action is important as other donors are heavily committed to direct social actions with little interest in supporting productive sectors that would strongly contribute to poverty reduction. Support, through improving the business climate and training and small grants to small, medium-sized and micro enterprises (SMMEs), would benefit the 700 000 or more people employed in small business, helping them to enter the formal sector, become more competitive, with emphasis on quality systems, and thus benefit from the opportunities offered by trade, including the EU-CA Association Agreement. The *Trade Sustainability Impact Assessment of the Association Agreement (AA)* under negotiation between the EU and Central America⁵ found that with the AA the small, medium-sized and micro enterprise (SMME) sector is likely to be the most affected by ongoing economic liberalisation and structural reform of the economy. In Honduras, this sector forms a significant part of formal and informal employment and thus of people's livelihoods, so attention should be paid to SMMEs and especially to vulnerable groups throughout the various policy initiatives.

The specific objectives of the action will include enhancing the positive effect of regional integration on employment by improving the investment and business climate for SMMEs through better regulation and by providing technical assistance for capacity building, including with reference to sanitary and phytosanitary (SPS) measures and overcoming technical barriers to trade (TBTs), and by helping SMMEs to comply with international labour and environmental standards.

2. Priority Sector 2: Sustainable management of natural resources, including renewable energy and energy efficiency focused on climate change

Forestry will continue to be the main priority in the sector during NIP2. The objective will be to build upon the results of the **MOSEF** project and implement actions in order to foster reforestation and sustainable use of forest products, create employment, introduce best practices for managing forest fires and promote renewable energy sources and energy efficiency to reduce carbon dioxide emissions. In addition, it is recommended that scope be allowed for actions related to **renewable energy sources** and **energy efficiency**, as an important complementary aspect of sustainable management of natural resources, because the

⁵ ECORYS, 18 September 2009.

energy provided by biomass represents nearly 60% of the energy matrix of the country and these issues have a major impact on forest resources. This reinforces the mitigation of climate change and of natural disasters. Supporting the promotion of clean energy is also an effective and comprehensive response to the problem of the country's high dependence on privately run, highly polluting fossil energy and would help rural development by providing access to energy in areas that are unlikely to be linked to the national energy network. The integrated availability of energy alternatives for forest dwellers is a very important need of the forest community. This renewable energy and energy efficiency action will draw on the experience of ongoing energy-related projects such as GAUREE and EUROSOLAR. These actions would have such important **results** for the environmental sector and climate change as the reduction of carbon dioxide emissions in rural areas, introduction of best practice in forest management, and reduction of the impact of natural disasters. The sector has a strong **cross-cutting dimension** as it could also strengthen the agri-food sector, promote tourism and contribute to the generation of opportunities for disadvantaged groups such as ethnic minorities, women and youth in rural areas. Securing the government's political support and financial resources as well as a long-term strategy are crucial to the **sustainability** of the Commission's action in this sector.

3. Priority Sector 3: Security and justice

Security and justice will remain a key priority and activities will continue throughout NIP2. An additional amount of €3 million remains for allocation during this period, to be executed in synergy with the first two phases, which are both planned to be committed during NIP1. The objective of the third phase of the PASS programme will be to build on the previous two phases, with stronger emphasis on preventive actions in the country's penitentiary system. The proposed action aims to support implementation of the prevention and rehabilitation programmes contemplated in the new Penitentiary Law, with the objective of running reinsertion programmes for inmates willing to learn a trade and abandon crime as a way of life.

Annex

List of acronyms

AA	Association Agreement
AFE-COHDEFOR	<i>Administración Forestal del Estado, Corporación Hondureña del Desarrollo Forestal</i> (State Forestry Administration, Honduran Forest Development Corporation)
ALBA	<i>Alternativa Bolivariana para las Américas</i> (Bolivarian Alternative for the Americas)
AMHON	Association of Municipalities in Honduras
APERP	<i>Apoyo Presupuestario a la Estrategia de Reducción de Pobreza</i> (Programme of Budget Support to the Poverty Reduction Strategy)
CA	Central America
CSP	Country Strategy Paper
EC	European Commission
ECLAC	Economic Commission for Latin America and the Caribbean (of the UN)
ECHO	European Community Humanitarian Office
EFA	Primary Education Support Programme
EU	European Union
DIPECHO	Disaster Preparedness, European Community Humanitarian Office
FAO	United Nations Food and Agriculture Organisation
FORCUENCAS	<i>Programa de Apoyo a la Gestión Local en las Cuencas de los Rios Patuca, Choluteca y Negro</i> (Programme of Support to Local Management in the Patuca, Choluteca and Rio Negro River Basins)
GAUREE	<i>Generación Autónoma y Uso Racional de Energía Eléctrica</i> (Autonomous Generation and Rational Use of Electrical Energy)
GDP	Gross domestic product
GSP	Generalised System of Preferences
GTZ	<i>Gesellschaft für technische Zusammenarbeit</i> (German Cooperation Agency)
HDI	Human Development Index
ICF	<i>Instituto de Conservación Forestal</i> (National Institute for the Conservation and Development of Forests, Protected Areas and Wildlife)
IDB (or IADB)	Inter-American Development Bank
IMF	International Monetary Fund

ILO	International Labour Organisation
MDGs	Millennium Development Goals
MOSEF	<i>Modernización del Sector Forestal</i> (Modernisation of the Forestry Sector)
MTR	Mid-Term Review
NGO	Non-governmental organisation
NIP	National Indicative Programme
ODA	Official development aid
PAAPIR	<i>Programa de Apoyo a la Administración Pública y a la Integración Regional</i> (Programme of Support to the Public Administration and Regional Integration)
PASAH	<i>Programa de Apoyo a la Seguridad Alimentaria en Honduras</i> (Food Security Budget Support Programme)
PASS	<i>Programa de Apoyo al Sector Seguridad</i> (Programme of Support to the Security Sector)
PRRAC	<i>Programa regional de Reconstrucción en América Central</i> (Regional Programme for Reconstruction in Central America)
PRAEMHO	<i>Programa de Apoyo a la Educación Media en Honduras</i> (Secondary and Technical Education Support Programme)
PREVDA	<i>Programa Regional de Reducción de la Vulnerabilidad y Degradación Ambiental</i> (Regional Programme for the Reduction of Vulnerability and Environmental Degradation)
PROADES	<i>Programa de Apoyo a la Descentralización</i> ((Budget Support) Programme of Support to Decentralisation)
PROCORREDOR	<i>Proyecto de Gestión Sostenible de Recursos Naturales y Cuencas del Corredor Biológico Mesoamericano en el Atlántico Hondureño</i> (Project for Sustainable Management of Natural Resources and River Basins in the Honduran Caribbean)
PRRAC	<i>Programa Regional de Reconstrucción en América Central</i> (Regional Programme of Reconstruction in Central America)
PRS	Poverty Reduction Strategy
SIDA	Swedish International Development Agency
SMMEs	Small, medium-sized and micro enterprises
UNDP	United Nations Development Programme
USAID	United States International Development
WB	World Bank
WFP	UN World Food Programme