

Evaluation of Poverty Reduction
Strategies in Latin America – 2005
Executive Summary

Budgeting the PRS in Honduras



Preface

The poverty reduction strategy responds to a legitimate concern for the problem of persistent and high poverty in many developing countries. The PRS process intends to reduce poverty through a participatory, long-term, and result-oriented strategy that seeks to bring together both government and civil society in finding solutions to the country's poverty problems. The commitment of the donors is to support the strategy with resources and debt relief.

The Swedish International Development Cooperation Agency, Sida, has requested the Institute of Social Studies (ISS) in The Hague, to monitor and evaluate the PRS processes in the three Latin America countries eligible for debt relief: Bolivia, Honduras and Nicaragua. The study will be carried out over a period of 5 years, beginning in 2003.

Each year five reports will be elaborated, including three country reports, one regional report and a thematic report. The country reports to be submitted in 2005 provide an update of the progress with the PRS process in terms of strategy definition and implementation. This year specific attention is paid to the budgeting process in relation to poverty reduction policies and the problems countries are facing in making the budget process more transparent and more results-oriented. The analysis of the country reports is supported by a detailed and systematic stakeholder analysis, including the stock taking of local actors through visits to several municipalities in the three countries. A comparative analysis of the experience in the three countries is presented in the regional report, highlighting lessons to be learned for governments, civil society and the donor community. The thematic report for 2005 focuses on the potential of result-oriented budgeting in the case of basic and secondary education.

The five reports aim to make a contribution to existing evaluations of the PRS process through the regional focus and an impartial assessment of the PRS, resulting from the ISS's complete independency in the process of design, implementation and financing of the strategies.

All reports can be downloaded from the following website: <http://www.iss.nl/prsp>.

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"Budgeting the PRS in Honduras"

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Executive Summary

Background

For the last five years, 45 low income countries have been implementing Poverty Reduction Strategies (PRS), introduced by the International Monetary Fund (IMF) and World Bank with the intention of reducing poverty through a participatory, long-term, and result-oriented strategy that seeks to bring together both government and civil society in finding solutions to the country's poverty problems. The Swedish International Development Cooperation Agency, Sida, has requested that the Institute of Social Studies (ISS) in The Hague monitor and evaluate the PRSP processes in the three Latin America countries eligible for debt relief: Bolivia, Honduras and Nicaragua. This is the third country report presented for Honduras. Learning by doing has been the rule in countries implementing PRSs. Honduras has made several adjustments to the strategy, and there are lessons to be learned from the experience to date.

The two previous reports highlighted the financial constraints faced by the strategies, the lack of prioritization consistent with the objectives of the strategy, internal limitations and the inflexibility of certain donors when dealing with new demands. Enhancing ownership remains an important challenge, which could be facilitated by broadening the participatory base and creating a balance between an incentive-driven (but not stifling) conditionality on the one hand and the fostering of national proposals, engagement and transparency on the other hand.

This year's study evaluates how the dynamic of the PRS in Honduras has affected poverty reduction, not only quantitatively, but also qualitatively by considering processes and behavioral patterns. The study will focus on the budget process and on understanding how the poverty reduction objectives have modified budgeting in order to comply with the objectives of the PRS.

Progress in the PRS

Honduras has made important progress in implementing public sector reforms and policies to achieve greater fiscal discipline (essentially by trying to control public sector wages) and economic growth. The growth rates of 2004 and 2005 are expected to be over 4% per annum, which has further helped the country stay on track with macroeconomic and fiscal targets. The reforms and the performance of the economy have enabled Honduras to reach the completion point under the HIPC (in April 2005) and to access funds from the Millennium Challenge Account

(in May 2005). The sounder economic environment has been favourable to the strengthening of the PRSP process, although structural changes to increase productivity and employment are still lagging. This positive economic growth has not yet been translated into poverty reduction and eradication of extreme poverty (Table 1), despite the fact that pro poor spending has increased since 2002.

Table 1. Honduras: Social Indicators

	2001	2002	2003	2004 p
Unemployment	4.2	3.8	5.1	5.9
Invisible underemployment	23.1	26.6	29.6	29.5
Poverty %	64.5	63.3	63.5	64.2
Extreme poverty %	47.4	45.2	44.7	44.6
Expenditure on ERP as % of GDP	8.8	7.5	7.7	8.3

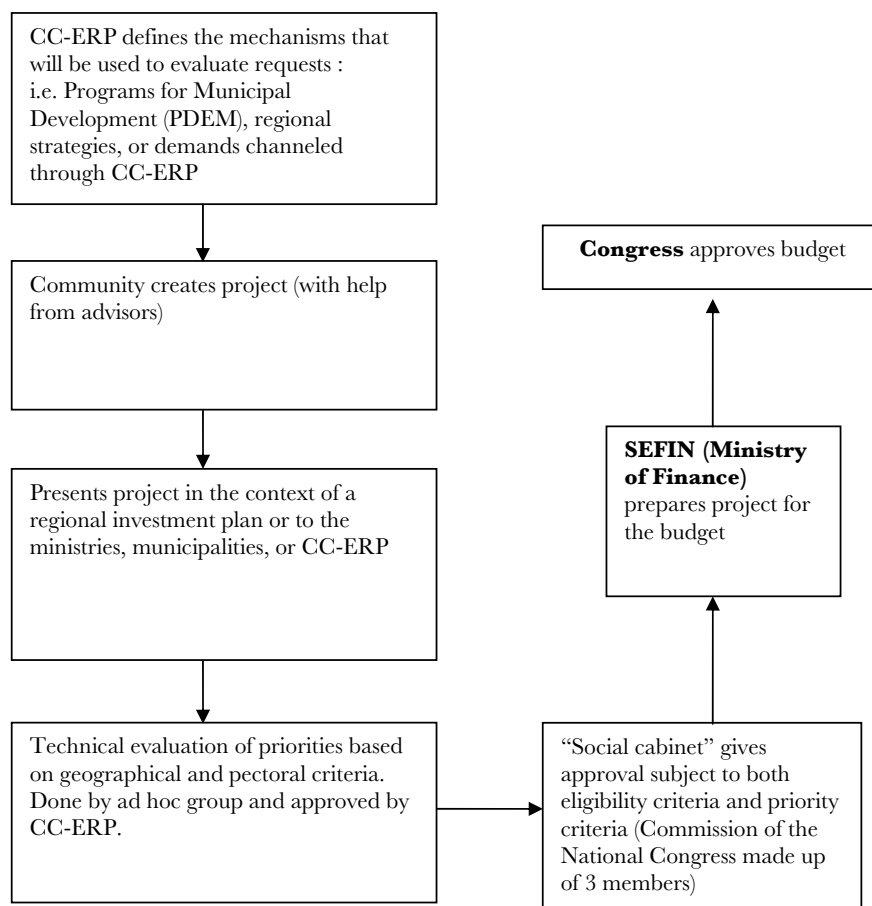
Source: SEFIN, INE. Expenditure on PRS includes both national and international resources. Statistics on unemployment and underemployment are from May 2004. p = preliminary / e= estimated.

The PRS process in Honduras involves a notion of horizontal planning in which mainly government and donors try to coordinate priorities with each other, while civil society is involved in the selection of programs and projects financed with HIPC resources. The PRS is not yet the overarching strategy it was originally intended to be, in which intersectoral linkages and crosscutting themes can easily be identified. Much of the attention in poverty-reduction efforts today goes to the financing of specific projects, as donor support is still mainly provided in the form of project aid. The sense of stakeholder ownership in the strategy is limited as participation of stakeholders does not take place on a level playing field. Enhancing trust among government, donors and civil society and more widespread capacity building are essential in fostering this partnership.

The PRS initiative has continued strengthening the organizational culture that became more apparent after Hurricane Mitch. The Consultative Council CC-ERP is working to support this effort, although the representativeness of some members of the council has been questioned, mainly due to a lack of consensus among civil society groups in the designation of certain representatives. Further development of communication channels and feedback mechanisms are still essential for disseminating information about the PRSP and the work of the council.

A demand-driven and regionally-based approach to the selection of projects was initially promoted by civil society and continues to be implemented (Figure 1). Nonetheless, mechanisms to evaluate performance at the regional level face constraints in terms of the definition of administrative responsibility and availability of information, and new financing schemes such as the Millennium Challenge Corporation continue to opt for traditional project financing and have not subscribed to the regional focus.

Figure 1. Participation in the Selection of HIPC Projects



Source: Methodology for using HIPC funds (August 2005) and FRP Law (Decree 76-2004)

Financial and time constraints generate risks for the implementation of the PRS. The extensive demands that the country faces and the time-frames for institutional and capacity building are not compatible, inhibiting the strategy from being comprehensive and rigorous and making it difficult for the government to comply with its commitments. Evaluations made by donors do not necessarily capture this complexity nor include policy impacts that could help understand the consequences of policy implementation in order to eventually compensate possible deviations from poverty reduction goals when needed. Reports recurrently mention fiscal uncertainty as the main risk for poverty reduction efforts, overshadowing other issues such as lack of productivity, widening of educational and technological gaps and unfair trade.

Donors have made efforts to reconcile their country strategies with the PRSP, through national and international meetings and workshops. There are, however, undoubtedly still major challenges in adapting traditional roles assumed by certain stakeholders in the PRS framework. For example, despite numerous calls for change, the macroeconomic conditions attached by the IMF and its role as macroeconomic supervisor, still occupy the central position in aid provision. The recent decision of the IMF to include in their assessments the performance of the MDGs and not only macroeconomic outcomes in Low-Income Countries shows a positive approach towards inclusiveness, but the implications are still to be evaluated. In the case of Honduras progress in implementing the PRSP has to be paired with a more defined strategy on

budget support and SWApS. Pool funding to support sector specific strategies, mainstreaming cross cutting issues, commitment in implementation, incentive schemes that reward performance and predictability of funding are only some of the conditions that would facilitate budget support.

The culmination point under HIPC in Honduras must be seen as the beginning of a challenging new process that seeks to avoid unsustainable debt levels in the future. In the pursuit of faster growth the fight against inequality should not be put aside; improving the climate for investments, employment and fair trade are key issues for the future of the PRS.

Budgeting for Poverty Reduction

The national budget under the PRS framework is seen as a facilitator of good governance and accountability that links policies, expenditures and goals set in national development plans or sector plans. The guidelines for annual budgeting require consistency with the availability of resources within a Medium Term Expenditure Framework (MTEF) and with the priorities set in the national development plan. It should be result oriented, ensuring that fiscal policy drives funding towards poverty reduction, assuring more effectiveness to budget implementation. SWApS and budget support are complementary financing options intended to give more flexibility and coordination to the budget framework. Under this framework, participation is made explicit at the different stages of the budget, beginning with the definition of the overall strategy and providing the appropriate checks and balances for monitoring and control of the appropriate budget allocation.

Honduras has taken steps to improve budget management and in making social spending (and thereby PRS-related spending) explicit into the national budget. Among the reforms introduced are a programmatic classification of expenditures that allows more transparency in social spending, the presentation of a three year multiannual programming to be adjusted annually, consistent with the National Development Plan, the inclusion of budgets from decentralized institutions and improvements in reporting grants. In practice, the budget is a top-down process involving mainly the Executive and Legislative powers, multiannual programming is still more a guideline incorporating policy intentions which in time should be enforced to become an effective targeting instrument. Moves towards SWApS are still limited and result-orientated budgeting is only a project. Participation has been gradually moving to the selection of projects with HIPC debt relief. A lot has to be done in improving the allocation of budget expenditure in line with a result oriented performance, beyond traditional adjustment approaches like inflation criteria.

A closer look at the budgeting of HIPC debt relief shows in more detail how a part of social expenditure is being budgeted. Government authorities have shown eagerness to encourage transparency in budgeting and, as mentioned, a broader participation in the selection of projects to be financed with HIPC funds and in defining priorities for an effective use of HIPC debt relief.¹ Management of HIPC resources could be considered a pilot program that involves a learning process in budget allocation that could be translated to national budgeting procedures

¹ Debt relief under the HIPC initiative in Honduras should amount to US\$ 1 billion (or US\$ 556 million in NPV terms estimated at the end of 1999). Total debt relief if other donors take part (multilateral donors and donors not included in the G-8) could imply a reduction in outstanding debt from US\$ 5 billion (in March 2005) to US\$ 2.5 billion according to estimates made by the Ministry of Finance.

depending on its effectiveness. Predictability and continuity in the flow of funding should be complementary to efforts to the reforms being implemented by the government.

While this framework is being consolidated, complementary approaches to facilitate the implementation of result oriented budgeting should be considered. Experiences with social auditing have proven fruitful at the local level and are important in developing a result-oriented culture that links policies with results, which in time could be translated into the general budget. Sectors such as health, education and agriculture offer, in a first stage, a better potential for measuring expenditure performance. Nevertheless the choice of indicators and the flexibility of each sector to introduce changes when results are unfavourable must be taken into account. Indicators and benchmarks make it possible to evaluate change over time and impose a sense of discipline. The monitoring of quantitative indicators alone, however, will not necessarily reveal the source of any problems. In this case social auditing could also be an important complement in evaluating results.

Many of the documents reviewed and interviews done for this report point to capacity building as a necessary requirement for formulating and implementing the budget. Institutions such as the Ministry of Finance directly involved with poverty expenditures have made important progress in gaining experience and strengthening the capacity of its staff through the PRSP-related budgeting experiences. The success of on-the-job learning depends on the stability of civil servants, on the quality of management, and on salary incentives based on performance.

Annual and medium term budget frameworks call for a better understanding of domestic political issues. The limited availability of resources in Honduras makes programming difficult as austerity is the rule leaving little margin to respond to the multiple priorities and to build on the political capital, which seems so important in the Latin American context and particularly in Honduras. Overoptimistic assumptions affect commitments which are recurrently broken affecting credibility and trust. Bad “track records” in turn affect the predictability of funding tied to conditionality. Therefore an important dose of realism and of flexibility is necessary for medium term programming.

Participation and transparency should be thoughtfully implemented. Participation does not imply that all decisions be submitted to public consultation as long as there are efforts made to improve transparency and internal and external controls that ensure an efficient allocation of resources.

Conclusions

Progress in the PRS is not uniform. Processes are being built, but greater efforts are still needed in translating policies into poverty reduction. Government transition remains a threat, particularly since the PRS has not been institutionalized. Government and donor support have been crucial in the last year in sustaining the process and as long as civil society does not assume ownership of the strategy, political cycles will be a concern for the sustainability of the PRS.

The budget process is currently being reformed in Honduras with the support of the international community and donors. In the last two years important budget reforms have been implemented and improvements have been made in managing poverty reduction expenditures. The experience and procedures that are being developed to strengthen the national budget require stability in the executing agencies and staff and predictability in financial support to assure efficiency in reducing poverty.

The incoming government and civil society organizations have the challenge to prove that Honduras was not only engaged in implementing the PRS as a condition to obtain HIPC debt relief, but seriously committed to reduce poverty. Although the PRS is definitely alive in Honduras, it is time for procedures to translate into actual poverty reduction.

Halving poverty by 2015 is one of the greatest challenges of our time, requiring cooperation and sustainability. The partner countries are responsible for their own development. Sida provides resources and develops knowledge and expertise, making the world a richer place.



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