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ILPES
Instituto Latinoamericano y
el Caribe de Planificación
Económica y Social



OEA
Organización de los
Estados Americanos

SOCIAL INVESTMENT IN GUATEMALA, EL SALVADOR
AND HONDURAS ^{*/}



PNUD
Programa de las Naciones
Unidas para el Desarrollo (PNUD)
Proyecto RLA/86/004

Banco Mundial



PREALC
Programa Regional del
Empleo para América
Latina y el Caribe



Grupo Esquel Chile

^{*/} Las opiniones que contiene este estudio no comprometen necesariamente a los organismos involucrados. Este documento no ha sido sometido a revisión editorial.

POVERTY ALLEVIATION, BASIC SOCIAL SERVICES AND
SOCIAL INVESTMENT IN GUATEMALA, EL SALVADOR AND HONDURAS

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PREFACE

Central America is beginning to emerge from a decade of crisis that has left a broad legacy of poverty in its wake. Newly elected governments in El Salvador, Honduras, Costa Rica, and Nicaragua show courage and determination in addressing widespread malnutrition, ill health, and illiteracy. Meeting recently in Antigua, Guatemala, government leaders from Central America and Panama declared their intention to develop more equitable and efficient public social programs of food security, primary health care and basic education that must reach marginal groups, especially those in rural areas, that for too long have been left with no exit from the crushing burden of poverty.

The World Bank supports economic adjustment in Central America and seeks means to provide complementary programs for public social spending that can alleviate poverty. With that object in mind, the Bank convened a workshop within the Consultative Group framework, June 28-30, 1990, that brought together representatives from Central American governments and the donor community to discuss plans for social programs and the needs for related technical and financial assistance. Three country programs, those of Guatemala, El Salvador, and Honduras, were given particular attention because of their innovative approaches to social program design that can be supported through social investment funds. These funds are expected to offer effective mechanisms to improve the efficiency of service delivery in population, health, education, and nutrition programs, and to intensify efforts to extend these services on an equitable basis to the poor.

We are pleased that this report to the Board appears in the same month as the Bank's World Development Report 1990, which emphasizes poverty alleviation by means of more effective public social service delivery. That report finds that poverty reduction is consistent with adjustment and growth because investments in human capital will contribute to long-term development. Nowhere is the need for balance between economic stabilization and human development more evident than in Central America, and the prospects for achieving balance are brighter now than they have been in more than a decade.

The report includes a report of discussions and background papers prepared by Bank staff. We are grateful to representatives of the governments of Central America for the excellent materials they brought to the meeting, to the Inter-American Development Bank for its active participation, and to other governments and agencies for their useful comments and suggestions.

R. B. Steckhan
Director, LA2

July 20, 1990

I. WORKSHOP ON POVERTY ALLEVIATION

BASIC SOCIAL SERVICES AND SOCIAL INVESTMENT FUNDS

AGENDA

Paris, June 28-29, 1990

Wednesday, June 27
3:00 pm to 6:00 pm

Informal Donors Meeting

Thursday, June 28

Session 1

9:00 am to 11:00 am

OVERVIEW OF INTERNATIONAL EXPERIENCE

20 minutes

Welcome and World Bank and IDB Perspective: Rainer B. Steckhan and IDB Representative

Open Discussion

Case Studies

Session 2

11:00 am to 1:30 pm

GUATEMALA - SOCIAL INVESTMENT FUND

10 minutes

Introductory Statement of Country Representative

10 minutes

World Bank Status of Social Investment Fund: Hans Binswanger

Open Discussion

1:30 pm to 3:00 pm

Lunch, Paris Office

Session 3

3:00 pm to 4:30 pm

EL SALVADOR - SOCIAL INVESTMENT PROGRAM

10 minutes

Introductory Statement of Country Representative

10 minutes

World Bank Assessment of Social Sector Situation and Needs: William McGreevey and IDB Representative

Open Discussion

5:00 pm to 6:00 pm

Open Discussion on Non-Governmental Organizations
Chairman: Hans Binswanger

Friday, June 29

Session 1

9:00 am to 11:00 am

HONDURAS - SOCIAL INVESTMENT PROGRAM

10 minutes

Introductory Statement of Country Representative

10 minutes

World Bank Assessment of Social Sector Situation and Needs: Hans Binswanger

Open Discussion

Session 2

11:30 am to 1:00 pm

Lessons - Concluding Remarks

Rainer B. Steckhan

CENTRAL AMERICA WORKSHOP ON
POVERTY ALLEVIATION, BASIC SOCIAL SERVICES AND SOCIAL INVESTMENT FUNDS

Paris, Thursday-Friday, June 28-29, 1990

LIST OF PARTICIPANTS

<u>WORLD BANK</u>	Mr. Rainer Steckhan Mr. Hans Binswanger Mr. Ulrich Lachler Mr. William McGreevey	Chairman
<u>CANADA</u>	Mr. John Robinson Vice President Americas Division Canadian International Development Agency Mr. Stephen Wallace Deputy Director Central America Division Canadian International Development Agency	Head of Delegation
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Central America Workshop
June 28-29, 1990

FRANCE

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Mr. Dieter Neuhaus
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Ms. Ana Patricia Peralta
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Dr. Rodolfo Paiz Andrade
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Ms. Marithza de Vielman
Fondo de Inversion Social de Guatemala

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Embajador
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Mr. Fernando Sesenna
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Central America Workshop
June 28-29, 1990

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Central America Workshop
 June 28-29, 1990

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EXECUTIVE
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 Executive Director*
 World Bank

Mr. Edgar Ayales
 Alternate Executive Director*
 World Bank

* For Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama,
 Spain, Venezuela

Central America Workshop
June 28-29, 1990

COMMISSION OF
THE EUROPEAN
COMMUNITIES
(CEC)

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Urban Development Specialist

INTERNATIONAL
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INTERNATIONAL
MONETARY FUND
(IMF)

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UNITED NATIONS
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WORLD FOOD
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Mr. Domingos A. Donida
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WORKSHOP ON POVERTY ALLEVIATION,
BASIC SOCIAL SERVICES AND SOCIAL INVESTMENT FUNDS
IN GUATEMALA, EL SALVADOR AND HONDURAS

(Paris, June 28-29, 1990)

I. SUMMARY OF THE DISCUSSIONS

A. Introduction

1. Social indicators in Guatemala, El Salvador and Honduras are among the worst in Latin America, reflecting deep seated structural problems that had been neglected in the past and that were compounded by the severe economic and political crisis that afflicted the Central American region during the last decade. In recent years, the governments of these countries have become more aware of the need to increase their efforts to alleviate poverty, both as a development goal in itself and as a means to achieve a lasting solution to the region's persistent political and social tensions. Accordingly, each government has initiated social sector reforms and is beginning to implement new mechanisms designed to improve the delivery of social services.

2. The Workshop on Poverty Alleviation, organized within a Consultative Group framework, provided the three Central American Governments with an opportunity to brief the international donor community about their new poverty reduction programs, and enabled an in-depth exchange of views and sharing of experiences among the workshop's participants on issues of poverty alleviation in Central America. For the first time, NGO representatives also were invited and attended the workshop. (The workshop agenda and list of participants are attached.) The Bank report on Social Investment in Guatemala, El Salvador and Honduras served as a general background document for the workshop. In addition, each of the three country delegations distributed separate sets of documents that described their governments' social sector strategies and plans for alleviating poverty.

B. General Focus of Discussions

3. A central focus of the discussions was the need for adopting a multi-pronged approach to the problem of poverty alleviation in Central America. This need arises from the recognition that there are different groupings of poor people with different characteristics and needs in each of the Central American countries. The discussions highlighted the distinction between the "structural poor", whose living standards had not risen with overall GDP growth in the past, and the "new poor", i.e., vulnerable groups that bear the brunt of economic adjustments when, for example, stabilization and structural adjustment measures are implemented. Another important distinction is that of the urban versus rural poor: in Guatemala, for example, structural poverty is largely a rural phenomenon, encompassing the indian peasant communities that are largely isolated from the more urban-centered market economy. In El Salvador, on the other hand, the rural-urban distinction appears less

compelling in view of the small size of the country and absence of strong ethnic divisions; the structural poor in this case are largely to be found in marginal urban areas. Another poverty stricken group that deserves separate attention, particularly in El Salvador, Honduras and Nicaragua, are the displaced persons impoverished by war and political violence.

4. For combatting structural poverty, the discussions emphasized the need for a long-term commitment on the part of governments to significantly improve the delivery of basic social services. Honoring that commitment, in turn, requires the allocation of more resources toward the social sectors (particularly in Guatemala and El Salvador), more efficient social service delivery systems, and better targetting mechanisms to reach the poorest members of society. For mitigating the impact of adjustment on the most vulnerable groups in society, the discussions emphasized the need for a more agile response capacity in the delivery of social services, together with improved targetting mechanisms to quickly identify those groups that are adversely affected by new economic developments. This latter need is most pressing in El Salvador and Honduras, which have recently initiated far-reaching stabilization and structural adjustment programs. Although these structural adjustment measures are expected to have a beneficial effect on overall poverty alleviation in the medium term, there is the fear that some already poor groups may bear a disproportionate share of the adjustment costs in the short term. Another fear is that the unequal distribution of adjustment costs could undermine the political support needed for carrying out the adjustment program.

5. A common shortcoming addressed in the discussions is the limited capacity of existing public sector institutions in delivering social services. This limitation is particularly severe in Guatemala and El Salvador, where tax revenues currently account for less than 8% of GDP; in Honduras, this ratio is substantially higher (14%). Another severe shortcoming common to all is the juridical and institutional rigidities that impede public sector management reforms and, thus, hinder the timely reallocation of public resources in response to new problems or changed spending priorities. As a result, this has raised interest in social investment funds, as alternative vehicles for achieving a better and speedier delivery of social services

6. Most participants stressed the need for simultaneously advancing on two fronts to improve the delivery of social services: i.e., reforming the line ministries and existing public sector institutions and exploring the creation of separate and independent mechanisms, such as social investment funds, to meet particular poverty alleviation needs. The focus of discussion during the country-specific workshop sessions nevertheless tended to gravitate more toward the subject of social investment/emergency funds, which are currently under preparation in each of the three countries discussed. This focus partly emerged from the need to achieve quick results, particularly in El Salvador and Honduras, which are currently experiencing rapid economic changes.

C. Social Investment Funds (SIFs)

7. During the discussions on social investment funds, many important issues and concerns were raised that relate to (i) the objectives motivating the creation of a SIF, (ii) the design of SIFs to meet those objectives, and (iii) the role of donor agencies and non-governmental organizations (NGOs). Individual country presentations provided examples on how to address these issues.

On the Objectives of SIFs

8. It is important to clarify whether a prospective SIF is intended as an emergency measure to mitigate the short term impact of other policy adjustments on the poor, or whether the aim is to alleviate structural poverty, independent of other economic policy measures. The focus of the SIF should depend on the specific country situation, with more emphasis on mitigating adjustment costs in countries with strong adjustment programs. Accordingly, in Honduras and El Salvador, which have embarked on major adjustment programs, the SIFs have been designed as social emergency funds based on the Bolivian model, while the Guatemalan SIF focuses on the alleviation of structural poverty in rural areas.

9. SIFs should not be too ambitious in their objectives. Experience in other countries indicates that SIFs can be successful instruments for financing, appraising and supervising projects, but in the view of participants they have no proven record in social program implementation, cost recoverability and project execution. For a SIF to focus on longer term poverty problems, it must develop the capacity to deliver social services, which should eventually revert to specialized line ministries.

10. There is a potential danger that the creation of SIFs leads to a proliferation of competing institutions and detracts attention and effort from implementing fundamental institutional reforms in the line ministries. This can be avoided by linking social fund programs to parallel and complementary institutional reform programs.

11. SIFs might play a useful role as "vanguard" institutions for social reform by providing examples and generating experience that can be incorporated in the redesign and restructuring of other public institutions. Indeed, experience with simplified procedures and targeted pilot projects that were carried out in conjunction with several of the Central American SIFs are providing some good examples for reforms in the line ministries.

Issues in SIF Design

12. An important issue in designing SIFs is to assure that the assistance provided truly reaches the neediest segments of society, especially if SIF assistance is demand-driven and recognizing that those neediest segments are often the least able to voice their demands. As

shown by Central American SIFs, this issue can be addressed through project selection criteria that include rules for targetting particular populations. For example, the Guatemalan and Honduras SIFs intend to target rural poverty areas, whereas the Salvadoran SIF mainly focuses on the urban poor.

13. Discussants emphasized the need to avoid the misuse of SIFs for short term political purposes by established interest groups. To address this problem, the new SIFs in Central America have been designed with boards of directors with great independence to insulate them from political pressures. Also, careful attention to maintain high professional standards is required, which involves, inter alia, securing a sufficient supply of adequately trained field staff. This has been addressed in the Central American SIFs through ongoing training programs during the preparation of the SIFs financed through external technical assistance.

14. Care must be taken to prevent violations of the overall fiscal budget constraint through the SIF. SIF expenditure levels should be considered within the total budget and increased only as less urgent expenditures are curtailed. This was clearly incorporated into the design of the Honduran SIF.

15. Whether SIFs are best introduced through executive decree or legislation depends on the priorities of the policymakers. Countries have chosen different ways to create SIFs. Creation by decree assures speed, while creation by law or parliament may assure more solid political support.

16. The mode of SIF finance is important, but should not influence the design of the SIF, which should primarily depend on country priorities. That is, a SIF should not be designed to focus only on productive projects, rather than as a vehicle for social welfare transfers, just because it is financed through loans rather than grants. Participants commented that grant finance is clearly the preferred financing mode, but some loan finance will usually have to be included. Also, any SIF financing plan that includes external funds should also include local counterpart commitments from the recipient country.

The Role of Donors and NGOs

17. A major purpose of the SIFs is to assure a better coordination of separate NGO activities than has been the case through existing public institutions. To see how succesful Central American SIFs will be in this respect requires more time.

18. It was questioned whether the monitoring ability of donors would be enhanced or reduced as their assistance is channelled through a SIF instead of directly through existing government institutions. The general impression emerging from the discussions is that coordinated monitoring through the SIF can be more powerful than individual donor monitoring.

19. Does the creation of SIFs warrant additional donor assistance, or does it merely entail a reshuffling of projects away from the line ministries to a more decentralized institution and, thus, only require a reallocation of assistance? In the countries considered at the meeting, the SIF projects are unlikely to substitute for programs of the line ministries, so that additional resources are warranted.

D. Summary of NGO Discussions

20. The Governments of Guatemala, El Salvador and Honduras were asked to invite at their discretion representatives from the NGOs to participate in the workshop; one donor delegation also included an NGO representative. Following the plenary sessions on July 18, 1990, a separate meeting was held to discuss specific issues pertaining to the NGOs.

21. A member of the Guatemalan delegation gave a summary of the main NGO groupings in Guatemala and discussed the deep divisions between them. The key concern of Guatemalan NGOs with the SIF is the potential loss of political independence. That is, they fear that the SIF rules may reduce their scope of action. To reduce that danger, they had initially demanded representation on the SIF Board, but later expressed a desire to be included in an advisory board comprising the country's four main NGO groupings.

22. The Salvadorean delegate presented the program of a specific NGO, which is mainly involved in obtaining and distributing medical supplies from donor countries and is becoming increasingly active in the delivery of services to poor groups. Divisions among the Salvadoran NGOs appeared to be less sharp than those in Guatemala.

23. European donors worried that NGOs had not been sufficiently consulted while the SIFs were being set up. The Guatemalan delegation contradicted this suggestion. A lively debate took place on the proper interaction between NGOs and the SIFs. It was pointed out that it would be inappropriate for NGOs to be represented on the SIF Boards, in view of the conflict of interest that arises when an NGO is simultaneously executing projects for the SIF and has a voice on the Board that approves such projects.

E. Concluding Remark

24. The donor and country delegations attending the meetings appeared very pleased with the results of the workshop. They praised the workshop as timely and informative, and stated that it served a highly useful function in the context of the Bank's overall aid coordination and development work. Follow up meetings were suggested.

II. SOCIAL INVESTMENT IN GUATEMALA, EL SALVADOR AND HONDURAS
BACKGROUND PAPER FOR WORKSHOP

BACKGROUND

1. After decades of neglect of health, education and nutrition in Guatemala, Honduras and El Salvador, the time is now ripe for change. There are several reasons for this. First, the political context has changed--elections have ushered in new governments in Honduras and El Salvador, and Guatemala will also go to the polls in a few months. Second, the new governments have acknowledged the need for remedying social deficiencies. Third, an adjustment program is being implemented in Honduras, which the World Bank may support with a loan, and another adjustment program is being prepared for El Salvador. The programs offer an opportunity to reform social spending, and the pains of adjustment need to be mitigated by interventions targeted at the poorest. Fourth, a number of lessons have been learned from the experience of developing countries in the 1980s on how to reform deficient social sectors and relieve the pains of adjustment. These lessons need to be incorporated in plans for change in Central America. Donor support will be needed on an expanded scale for the new strategies.

2. Guatemala, El Salvador and Honduras have some of the worst social indicators in Latin America (see charts ps. 12 and 13, and table on p. 15). The most telling way of illustrating this is to compare them with Haiti, which is generally regarded as the poorest country in the region with a weak implementation capacity. Haiti's per capita GNP is US\$380 per year, barely one-third that of the three countries. Yet on several counts Haiti actually comes out ahead of the three. The quality of statistics in the countries leaves much to be desired, but they suggest that Haiti spends more of its GNP on education (3.4%) than Guatemala (2%) or El Salvador (2%). Primary school enrollment is higher in Haiti (95%) than in Guatemala (79%) or El Salvador (77%). The proportion of malnourished children is lower in Haiti (30%) than in Honduras (35%), El Salvador (50%) or the Guatemalan highlands (59%). The percentage of births attended by medical staff is virtually as low in Guatemala (19%) as in Haiti (20%).

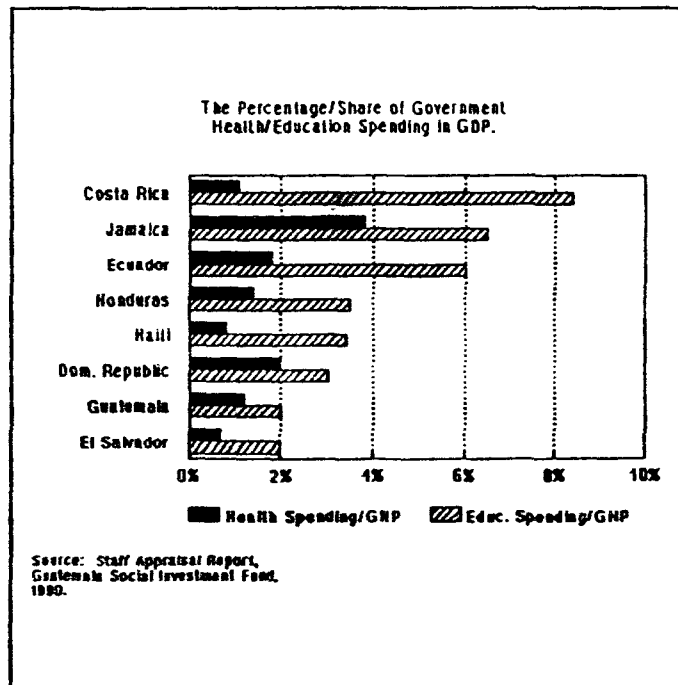


Chart 1

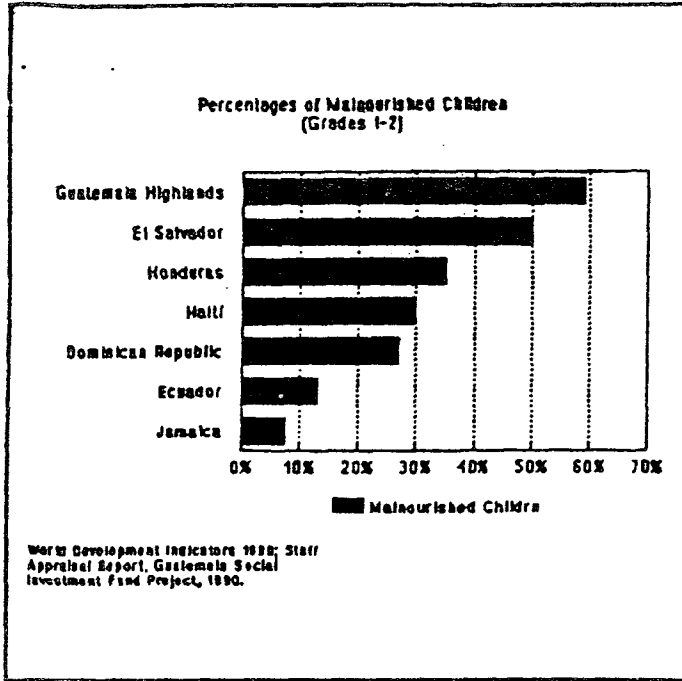


Chart 2

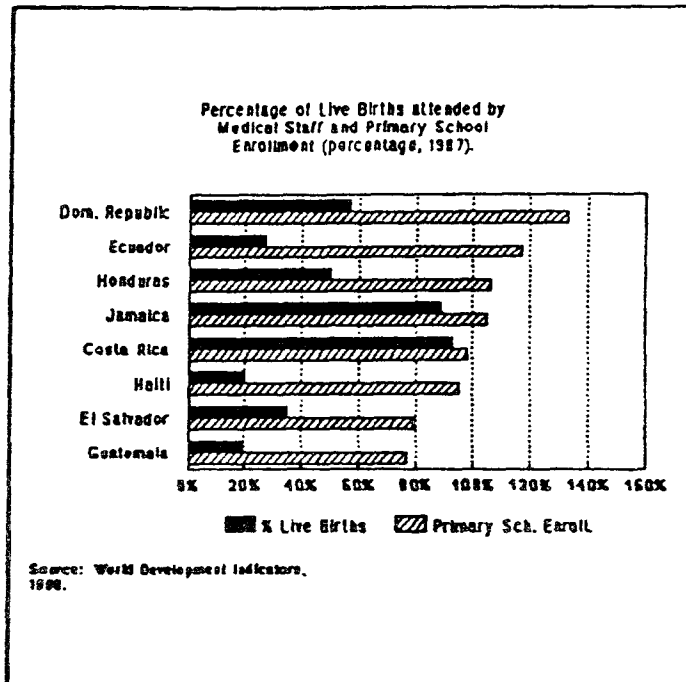


Chart 3

3. These figures are bad enough but the underlying realities are worse. Disparities between rural and urban areas are enormous, especially in Guatemala, and deprivation in the more remote areas is far worse than indicated by national averages. In Guatemala, primary school enrollment is 23 percentage points lower in rural areas than urban ones. In El Salvador the difference is 20 percentage points. Studies in El Salvador show a difference of 10 percentage points between rural and urban areas for people below the poverty line. Child malnutrition in Guatemala is 28.6% for the country as a whole, but more than twice as high (59.2%) in its highlands. At the national level half the population has access to safe drinking water, but only a quarter of the people in the highlands enjoy such access. Almost three-quarters of the highland Indians are below height-for-age norms, and illiteracy in some parts of the western highlands touches 60%.

4. The countries suffer from four chronic problems that have led to deep-seated neglect. (a) In Guatemala and El Salvador (but not Honduras), tax revenue as a percentage of GDP is too low. In Guatemala it was only 8.8% of GDP in 1988, in El Salvador 10.5%. It is important for these countries to make a much greater tax effort. (b) Of the limited government funds, too little is spent on social sectors. In El Salvador health expenditure is only 0.7% of GDP, one of the lowest rates in the world. It is more than five times as high in nearby Jamaica (3.8%). Education spending in Guatemala and El Salvador (2% of GDP each) is far lower than in Costa Rica (8.4%) or Jamaica (6.5%). (c) Of the limited funds available for social spending, too much is wasted in inefficiency. In Guatemala the administrative costs of a school feeding program came to 80% of the value of food distributed. The ratio for a similar program in Honduras was 28.7%. By contrast, the ratio in Jamaica was only 15.4%. Salaries swallow up 95% of education spending in El Salvador and over 85% in Guatemala, leaving little for school buildings, books or teaching aids. (d) Of what gets through to beneficiaries, there is too little for the rural poor in the form of primary education and preventive health, too much for the urban middle class in the form of higher education and curative medicine. In El Salvador hospitals account for 35% to 40% of health spending, against only 20% for primary health care. In Guatemala hospitals absorb four-fifths of all health spending.

5. Because of these problems, compounded by poor rural infrastructure, a large number of people in the poorest regions have been bypassed by development even in boom times like the 1960s and 1970s. They are the chronic poor, whose deep-seated structural problems reflect decades of neglect. These have been worsened in the case of Guatemala and El Salvador by civil strife which has led to a breakdown in rural services, while increased security spending has crowded out social spending. In El Salvador, social spending in 1978 was as much as 44.4% of the budget, four times as much as for security plus debt servicing (11.7%). But by 1989 the share of the latter two had shot up to 37.7%, and in consequence the share of social spending plummeted to 23.6%, almost half its share a decade earlier (see chart 4). In El Salvador real wages fell by half between 1978 and 1988, and the proportion of the urban population in extreme poverty rose from 21% in 1985 to 35% in 1988.

Social Indicators in Selected Latin American Countries

<u>Country</u>	<u>Year</u>	<u>GNP per capita</u>	<u>% GDP Health*</u>	<u>% GDP Educa- tion*</u>	<u>% Enroll. primary school**</u>	<u>% Pobl. extreme poverty</u>	<u>% malnourished children (Grades 1 & 2)***</u>	<u>% Live births attended by health staff***</u>
Guatemala	80	1,050	1.5	2.0	77		28.6	19
Highlands	85		1.2			63		
	86						59.2	
Haiti	80	230	0.8	3.4	95	72	30.0	20
Costa Rica	82	1,810	1.1	8.4	98	15	13.7	93
Honduras	80	550	1.4	3.5	106	61	35.0	50
Dominican Republic	80	1,030	2.0	3.0	133	44	27.0	57
Jamaica	80	1,110	3.8	6.5	105	49	7.6	89
Ecuador	80	1,110	1.8	6.0	117	32	13.3	27
Colombia	88	1,320	0.8	4.0	114	28	21.0	51
El Salvador	88	940	0.7	2.0	79	35	50.0	35

* It includes only central government expenditures.

** All figures relate to 1987.

*** All figures relate to 1985.

Sources: World Bank, Education Comparative Indicators; LAC Technical Department, Human Resources Division, Feeding Latin America's Children, IDP No.0049, 1989; and LAC Technical Department, Human Resources Division, "Government Expenditures on Social Sectors in Latin America and the Caribbean. Statistical Trends", September 1989; World Development Indicators 1990.

6. Faulty policies have led to economic distortions and unsustainably high budget and current account deficits in Honduras and El Salvador. In Honduras, the resulting macroeconomic disequilibria have required strong cuts in increases in controlled prices of fuels and basic foods. In Guatemala and El Salvador growth has slowed in the last quinquennium. Guatemala has postponed important adjustment measures and the government has been unable to make the necessary changes. In El Salvador social strife and the expansion of the defense budget led to a substantial reduction in living standards. Adjustment is inescapable since there is a point beyond which debt accumulation is no longer possible, and living standards will therefore fall. Adjustment is necessary to launch the basis of a sustainable growth path. Only through a vigorous process of growth can poverty be substantially eradicated in the long term. The enhancement of human capital is essential for that process. An equitable participation in the fruits of progress is a sine-qua-non for its sustainability. However, in the short term, some reforms may hurt the poor and offsetting measures are required.

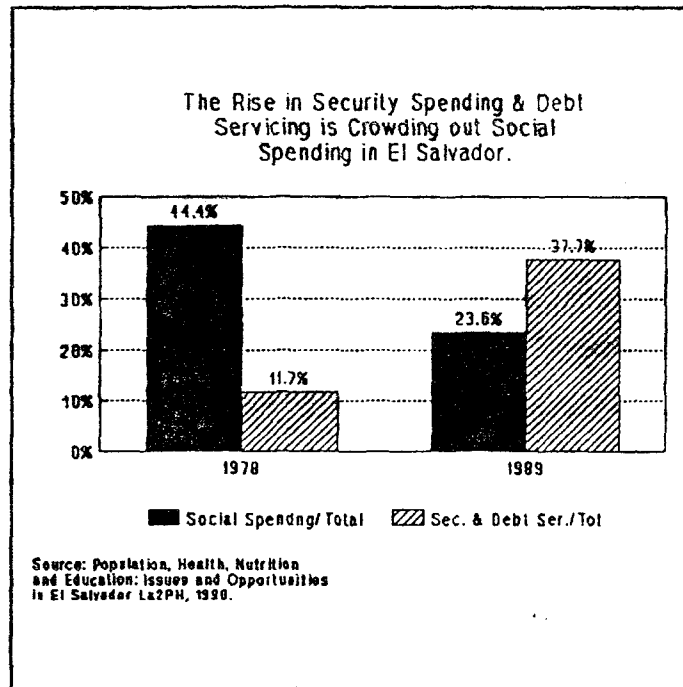


Chart 4

7. Adjustment programs backed by foreign assistance can mitigate but by no means eliminate the fall in living standards. There will be a temporary rise in prices and unemployment and fall in real wages. In Honduras, for example, a study suggests that unemployment may increase by up to 52,000, and prices have risen by perhaps 20% in the first two months of the adjustment program (principally on account of costlier food and transport). This will create a new sort of poverty in sectors hit most by adjustment, and the new poor will swell the ranks of the chronic poor. Emergency operations targeted at the needy can alleviate the temporary adjustment pains, and help both the chronic and new poor. Fairly soon, the adjustment program should begin to yield sustainable economic growth again.

8. Many countries now recognize that they have a problem of "social debt"--what they owe their own people. The real wealth of a country lies in the quality of its manpower, not in land or minerals. Japan, Korea and Singapore have shown that even in the absence of much land or minerals, a country can become prosperous rapidly by investing in its people, by making them healthy, educated and skilled. The neglect of human capital in Central America for decades is an important reason why it has been

overtaken by so many Asian countries. The social debt problem is in some ways analogous to the external debt problem. Structural adjustment on the social side is required to overcome the social debt, just as economic adjustment is required to overcome the external debt. Both kinds of adjustment will pay major dividends. Both kinds of adjustment will require financial and technical assistance from donors.

9. Redeeming the social debt will create wealth in ways that redeeming the external debt cannot. Repaying the social debt will build up the resources of the country, not drain them.

WHAT NEEDS TO BE DONE

1. A two-pronged attack on social sector deficiencies is needed. First, the countries need to reform government policies, procedures and delivery systems. This is essential to tackle the problem of the chronic poor, but will take time. Meanwhile--and this is the second prong of the strategy--the countries need to devise ways of getting emergency assistance to the new poor (those hit by adjustment programs) as well as the chronic poor. Social Investment Funds (SIFs), autonomous bodies with flexible procedures and rules, can act quickly to fund employment and social programs targeted at those who need it most.

2. Setting-up SIFs should not be a substitute for the reform of government programs and improvement of their administration. The Ministries are not only permanent bodies but they usually absorb the lion's share of the resources for the social sectors. Donor support is needed both for reform programs and for SIFs. Several measures could be used to effect a link between the two. First, reform of the social spending and institutional reform in the social sectors should be a pre-condition for setting-up SIFs. Those measures could be part of the adjustment packages implemented by the Governments. Second, the SIFs should be viewed as an alternative scheme for channeling funds to local governments, communities and NGOs and thus achieve decentralization and community participation from the state. The SIFs should avoid becoming an executing agency. That way they would not duplicate the functions of the line ministries. Third, collaboration should be sought between the SIF and the line agencies in order for the SIFs to provide feedback to the Ministries on quality of services and coordinating problems that arise as well as on new approaches to delivery of services. Fourth, processes which prove successful in the SIF should be integrated into the reformed line agencies. That integration could provide new mechanisms of planning and financing beneficiary groups with more flexibility and responsiveness than traditional bureaucratic systems.

3. Apart from undertaking social sector reforms, the three countries must find ways of improving the income and productivity of the chronic poor. Economic growth alone will not suffice (as was demonstrated in the 1960s and 1970s) thanks to gross inequalities and regional neglect. Ways must be found of enabling the chronic poor to be active participants in and beneficiaries of growth. Three things are needed simultaneously: better

economic policies that remove distortions and urban biases and facilitate growth; improvements in rural economic infrastructure (rural roads, agricultural extension) that will enable the poor to take advantage of incentive prices; and improvements in social services (health, education, nutrition) that will build human capital in areas that lack it most. Donors that finance structural adjustment programs should ensure that the reforms cover all these three elements in one package. In the past there has been a tendency to ignore social aspects when formulating reforms.

4. The three countries as well as donors can learn a number of lessons on improving social indicators from the worldwide experience of developing countries in the last two decades. It is useful to divide these into (a) lessons on reforming government policies and delivery systems, and (b) lessons on easing the pains of adjustment.

5. LESSONS ON REFORMING GOVERNMENT POLICIES AND DELIVERY SYSTEMS

(a) Even poor countries can have excellent social indicators. Sri Lanka and China have better social indicators than Brazil, whose per capita income is twenty times higher. Chile is only now returning to the per capita income level it enjoyed in the 1960s, but its social indicators have meanwhile improved immensely. This shows that major social progress is possible despite low incomes and slow growth.

(b) Even when adjustment forces budgetary cuts, governments can maintain or even expand social sector spending. The cuts can be levied on other sectors. In

I n d o n e s i a , development expenditure fell between 1982 and 1987 but the share of spending on human resources increased from 16% to 24% of total spending. Likewise in Chile total spending fell by 2.5% in 1983 and by another 3.8% the following year, but the share of social sectors rose from 54.7% in 1982 to 59.7% in 1984. In Korea, subsidized medical aid to the poor increased and other anti-poverty

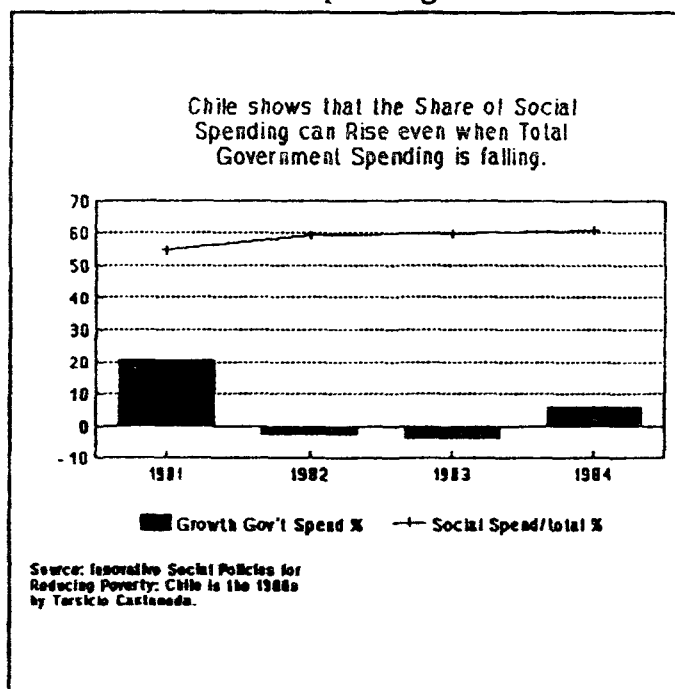


Chart 5

schemes were maintained during its adjustment program in the early 1980s.

- (c) Within the social services sector, it is possible to reallocate funds from higher education and curative health (used mainly by the urban middle class) to primary education and preventive medicine (Chile, Jamaica). However, Chile's experience shows that such reforms can generate enormous resistance from service providers (like unions of teachers and doctors) and beneficiaries of misallocation (the middle class). Sustained political will is needed to withstand such pressures.
- (d) User charges for those who can afford them can ease budget constraints and free money for those who need it most. Niger has successfully levied user charges on higher education and hospital care.
- (e) Social spending can be targeted much more accurately on the poor, reducing the total financial burden and directing it to those who need it most. Sri Lanka switched in 1979 from a universal rice subsidy to a subsidy for those earning less than Rs. 300 per month. In consequence, the fiscal burden of the subsidy fell from 6% of GNP to 2%. In Mexico, the new program of targeting food subsidies to the poor has cut its cost from 1.0% of GNP to less than 0.5%. In the state of Tamil Nadu, India, a nutrition program used geography and weighing scales as targeting devices. Food supplements were given to underweight children in six districts with the lowest calorie intake. The program was very effective, and even if extended to the whole state will absorb only one per cent of state government expenditure.
- (f) Decentralization works. Both money and responsibility should be delegated to organizations closer to the target beneficiaries. Municipalities, village communities, NGOs, financial intermediaries and private contractors can get things done much faster and cheaper than the central government can. Decentralization was at the heart of Bolivia's successful Emergency Social Fund and Chile's reforms. It not only cuts delays but leads to programs more in tune with the needs of local communities. Often the reach of the government is limited, and only village bodies and NGOs have functioning delivery systems in remote rural areas. NGOs can constitute good, low-cost delivery systems as shown in Colombia's Community Child Care and Nutrition Project. The Tamil Nadu nutrition project in India cut overheads by using women's groups. However, the absolute number of beneficiaries that can be reached by NGOs is limited, and local bodies can play a much bigger role.
- (g) Information systems are vital for revealing the dimensions of different problems and their response to different solutions. Cheap public housing for the poor was once considered essential in Ivory Coast. But then a study showed that not a single person

belonging to the ultra-poor was a tenant in public housing, and only 14% of tenants belonged to the more broadly-defined poverty group. So this form of intervention has been abandoned, and the public housing is being privatized. The Living Standards Measurement Survey (LSMS) of the World Bank is a cheap, quick way of getting household data based on small samples, and this has been used with success in Bolivia, Ghana, Ivory Coast, Jamaica and Peru.

- (h) Competition can be used to cut costs and improve quality in social sectors. Portugal and Nigeria have used a two-stage device to improve university quality. First, the universities are asked to implement a set of reforms (in curricula, staffing, fees, maintenance) to become eligible. Then the eligible universities compete in academic results, with the winners getting extra grants. In Chile the government makes payments based on actual services rendered to all providers of social services, regardless of whether they are in the public, municipal or private sectors.

6. LESSONS ON EASING ADJUSTMENT PAINS.

- (a) Adjustment programs can be designed to mitigate the impact on the poorest. They can incorporate fiscal changes which rely more on progressive direct taxes and less on indirect taxes on mass-consumption goods. Adjustment programs can include targeted schemes for the poorest even while cutting public expenditure (Korea, Indonesia). Finally, the effects of some new policies on poor farmers (like abolishing fertilizer subsidies in Mexico) can be offset by compensating changes (raising producer prices).
- (b) Emergency employment programs can put purchasing power in the hands of those hit by adjustment. Bolivia's Emergency Social Fund has been successful with this approach. Mauritania and Madagascar have introduced employment schemes too.
- (c) According to beneficiaries of the Emergency Social Fund in Bolivia, they were especially pleased with day-care centers, nutrition programs and school lunches. Day-care centers for babies enabled poor women to find work and nutrition provided food where it was most needed.
- (d) Compensatory packages can be developed for workers that lose their jobs, as shown by Gambia, Senegal and Guinea. This may or may not be combined with schemes for retraining displaced persons, which have been proposed in several African countries including Ghana, Guinea-Bissau, Gambia, Togo, Senegal and Madagascar. It is too early to judge which of these are most worthy of replication.
- (e) Local communities and NGOs can be much better than Ministries in identifying the most urgent needs and best solutions. Bolivia

has shown that communities not only demand relevant projects but also come up with cost-effective ways of executing these. Ghana has used the same approach as part of its package of 23 anti-poverty interventions called the Program of Action to Mitigate the Social Costs of Adjustment (PAMSCAD).

REFORMING OFFICIAL DELIVERY SYSTEMS

1. The special circumstances of Guatemala, El Salvador and Honduras need to be viewed together with lessons from other countries to devise a program for reforming government policies, procedures and delivery systems. Because of differences in the three countries, the solutions will not be identical.

2. Social investment must be stepped up from the very low levels prevailing today. With prospects of internal strife diminishing in Guatemala and El Salvador, it should be feasible to switch some spending from security to social sectors, reversing the trend of the last decade. Guatemala intends to increase the share of social spending in the budget from 24% to 30%. Other countries need to follow suit.

3. More money alone will not suffice. Even when funds are available, Ministries are sometimes unable to use them because of procedural delays and inefficiencies. For example, Bolivia which appears strapped for cash has almost one billion dollars of unutilized aid. In 1986, the Ministries of Health and Education in Guatemala could not spend more than a quarter of their budget, and a foreign-assisted program for oral rehydration of children spent only 25% of its funds in the planned period. Two steps are essential to improve this state of affairs-- decentralization and improved management techniques in the public sector.

4. It is now recognized by the three countries that some of their inefficiencies stem from gross over-centralization. In some cases there is only one person in the whole country who can change appointments or allocations. Guatemala has now made it mandatory for 8% of ordinary government revenue to be given to its 330 municipalities for capital investment. Honduras is also likely to enact a law giving new responsibilities and sources of finance to municipalities. The experience of the three countries shows that central Ministries are not efficient at implementing projects, and this is better left to local bodies and private contractors. The Ministries should lay down norms and regulations, provide the allocations, and then leave much of the detailed work and implementation to agencies that are closer to the target beneficiaries.

5. It is sometimes argued that municipalities have little managerial expertise. But this in turn is largely because they have not been given the chance to design or execute projects. Colombia has shown that moribund municipalities can come alive and be effective when they are actually given funds and responsibilities. Training schemes for municipal staff should usually accompany decentralization efforts.

6. By asking local communities to suggest programs, Ministries can often get a much improved picture of what people need most urgently. However, demand-driven programs of this sort have some limitations. They give an edge to the most articulate and vocal communities, and these are usually urban and better-educated ones--illiterate communities in remote areas are not good at articulating their demands. Besides, experience in India, Chile and other countries has shown that rural elites can hijack programs meant for the rural poor. This highlights the need for overall supervision (but not implementation) in the form of norms, guidelines, monitoring and audit by the Ministries to ensure that funds go to the neediest. NGOs can be used by the Ministries to help articulate the needs of the rural poor.

7. Targeting is needed to correct errors of exclusion (too many people in remote highlands are left out) as well as errors of inclusion (too many social benefits are appropriated by the urban middle class). Targeting can take several forms. (a) Countries can target the pattern of social spending to ensure that more resources are given to sectors which are used most by the poor. This means switching marginal spending from college education to primary and pre-primary education, from hospitals and curative medicine to rural health centers and preventive medicine, from urban areas to rural ones. (b) Countries can target areas known to suffer from the most deprivation--urban slums, remote rural areas, districts known to have the poorest nutrition. This can be very cost-effective. Alternative ways of identifying the target group, like income determination, can be expensive, time-consuming and vitiated by corruption. (c) Weighing and height measurement can be used to identify children below anthropomorphic norms who are clearly in urgent need of extra nutrition. (d) Supplementary food can be channelled through primary schools and primary health centers. (e) Surveys can identify target areas which need special attention, such as those suffering most from iodine or iron deficiencies, those with the greatest incidence of intestinal infection (indicating unsafe water), or those with an exceptionally low calorie intake.

8. Good information systems are vital, at both the national and project level. At present the three countries are often groping in the dark because they have little data on the extent of problems or effectiveness of different solutions. Building strong national information systems will not only delineate problems and target groups better but provide the means to monitor the impact of new policies and projects. A proposed Bank-financed Social Sector Restructuring project in El Salvador may include a Living Standards Measurement Survey (LSMS) using computerized field teams to gather and process field data on social indicators very quickly (in a couple of months instead of a couple of years). The proposed SIF in Guatemala also plans to have an LSMS. These surveys are likely to adopt innovative techniques in data collection which will provide good baseline data on social indicators and monitor changes in welfare levels over time.

9. The three countries need to improve the managerial capacities of their Ministries and specialized agencies. This will not be easy, given the low salaries and lack of motivation evident today. Nevertheless

training and incentive systems can improve matters. Governments need to create a political environment where strong managerial leadership in the public sector is possible, as in the Bolivian ESF. Training institutions can be used for upgrading managerial capacities--identifying what works and what doesn't, locating and filling gaps, following up successes and weeding out failed strategies, focussing on results rather than procedures, devising procedures that cut delays and improve efficiency. Institutions should turn out not only skilled managers but also skilled specialists in various disciplines, including health, education and nutrition. Management information systems should be created in the Ministries to help managers and specialists to keep track of the latest events and react accordingly.

10. The countries need to devise ways of ensuring that social sector employees deliver the goods, and do not simply collect pay for little work badly done. At present they usually cannot be fired, and get paid regardless of performance. This creates perverse incentives. For instance, a rural teacher overloaded with a class of 70 pupils has an incentive to encourage rather than discourage drop-outs. One possible reform is to make payments on the basis of the number of patients treated or children taught (although one should be careful to screen possible bogus claims). Another reform, tried with success in Chile, is to make the same level of payments to all providers of services, whether in the government, municipalities or private sector. This leads to competition and innovation. A third possible reform is the one tried in Portugal and Nigeria, to let educational institutions compete on the basis of performance for extra grants.

11. Donors can help with both funds and technical assistance for creating and supporting institutions to produce better managers, specialists and information systems. They also need to coordinate their aid programs to eliminate duplication and conflicting approaches.

SOCIAL INVESTMENT FUNDS

1. The reform of official delivery systems is vital, but will take time. Meanwhile, especially in countries affected by the pains of an adjustment program, urgent action is needed to get relief to those who need it most. This can be done by SIFs, autonomous bodies with statutory backing, which have flexible procedures and staffing patterns that enable them to act quickly. In Bolivia, the ESF proved very effective in giving short-term relief to the new poor.

2. The SIFs should be facilitators, not implementers. They should be financial intermediaries that screen, fund and monitor the progress of projects. Implementation should be left to local bodies, NGOs and private contractors.

3. Being autonomous and harnessing a more effective delivery system than Ministries, SIFs should be able to attract foreign assistance that traditional programs cannot. SIFs can also coordinate funds received from

different donors. Today there are examples of several donors trying to get into similar areas, leading to duplication and inefficiency.

4. Local communities have shown in the aftermath of earthquakes that they constitute an efficient delivery system in remote areas with little or no official machinery. By harnessing them, SIFs can expand the reach of programs, and in the bargain cut costs. In Bolivia the Fund proved that houses could be built for as little as US\$2000, and that road maintenance could be done very cheaply by local communities. Giving local people a say in the formulation and execution of projects creates a more participative and integrated society. It is both socially effective and cost-effective.

5. The first priority of emergency employment programs is to put purchasing power in the hands of the needy. Emphasizing a quick start may mean that emergency employment does not, to begin with, create assets that are very productive. But fairly soon such employment can be linked with the creation of social infrastructure. It should be aimed at repairing and rehabilitating schools, primary health centers, rural roads, water supply facilities and sanitary facilities. This approach will enable SIFs to cover rural as well as urban areas, and to give employment to the chronic poor as well as the new poor.

6. The experience of Bolivia has shown that management information systems using computers are vital for keeping track of hundreds of small projects. This also makes the system more transparent and honest. Audit and accountability become easier, the cheapest and most effective innovations can quickly be spotted, corruption and leakages can more easily be detected.

7. SIFs are useful for designing and testing pilot projects, for experimenting with new ideas.

8. Local communities and NGOs should from the beginning be associated with the planning and setting up of SIFs. This improves the structure of the SIFs and enables them to get into action quickly and efficiently.

9. Donors and Ministries should also be associated with the planning of SIFs. This will help donors coordinate their strategy. Ministries must be kept in the picture to reduce jealousies and resist the temptation to sabotage what may appear to them as rival bodies.

10. SIFs should ask local communities to cofinance projects. There are several reasons for this. (a) It ensures that the mostly urgently-needed projects are put forward. (b) It is a good way of screening executing agencies. (c) It mobilizes additional resources. (d) It gives communities an incentive to organize themselves and improve the process of democratization. (e) It gives the local people a sense of pride and ownership in new and rehabilitated facilities.

11. While SIFs can tackle short-term problems, they can have a long-term perspective too. There is a long-term rationale for Funds that deal directly with local communities and NGOs, that are flexible and can experiment with new ideas, that aim at helping the chronic poor as well as the new poor. In Bolivia, the Emergency Social Fund has evolved into a long-term SIF. In Guatemala and Honduras the SIFs will undertake both emergency operations and longer-term ones, though Honduras emphasizes the former and Guatemala the latter.

12. While their main task lies in social sectors, SIFs can also be used to support production activities like agriculture and small enterprises. This approach is being adopted in Guatemala. SIFs would be well advised to avoid credit schemes, since the recovery of loans can be time-consuming and require a lot of staff and litigation.

FOOD AID

1. Food aid is provided by donors for a variety of motives--political patronage, using up agricultural surpluses, providing disaster relief, alleviating poverty. For recipient countries food aid is less valuable than cash because of the transaction costs of the former, which can be extremely high when food is shipped all the way from Europe, stored in warehouses, and then sent for distribution to remote rural areas. Nevertheless food aid can be valuable, and both donors and recipients need to work on ways on making the best use of it. While some food aid programs work reasonably well today, others suffer from major deficiencies.

- (a) Only a small proportion of people benefit from food aid. In Guatemala, feeding programs reach only 14% of lactating mothers and children under 5. In Honduras, a feeding program gets to only 20-30% of the target group. Most of the food tends to go to people near ports and the capital, and the really needy people in remote areas get little or nothing because of logistical problems and a lack of motivation on the part of administrators. Better targeting and planning are needed.
- (b) Food aid programs are not coordinated, partly because of the different motives of different donors. As a result there is duplication and waste. In Guatemala some people get double rations from two separate programs while many of the neediest get nothing. Better coordination between donors is needed, and an integrated approach should be preferred to piecemeal aid programs.
- (c) Much food aid lies unutilized in docks and warehouses. This is because of bottlenecks in transport (not enough rural roads or trucks), in finance (some food-for-work schemes lie unimplemented for want of money for wages and materials, and so the food component cannot be used either) and in administration. One way out is for the government to simply sell the imported food and use the sale proceeds for poverty alleviation. However, this is

sometimes not acceptable to donors. Community participation in food transport and distribution can cut costs and speed up delivery.

- (d) Some of the food donated is inappropriate. Canned meat and fish make little sense for those lacking basic foods, and the solution here could be to sell the meat and use de proceeds for poverty alleviation.
 - (e) If care is not taken, some types of food aid can depress local production and prices. This will not happen if the food aid replaces commercial imports, but sometimes it substitutes domestic production. Surplus US milk donated to Guatemala rose to as much as 38% of domestic milk production in 1987, hitting the local dairy industry. Subsequently the US milk surplus and donations ended, creating supply problems for Guatemalan consumers.
2. Both donors and recipients need to work out ways to overcome problems associated with food aid. Recipient countries need to improve their capacity to evaluate, coordinate and insert food aid as an element on an overall poverty alleviation strategy. Donors need to coordinate their policies and programs better, and should ease constraints on food aid. This means, for example, permitting the recipient governments to sell the donated food and use the proceeds for targeted food assistance.

SPECIAL CHARACTERISTICS OF THE COUNTRIES

1. While all three countries have poor social indicators, their problems are not identical. Hence the solutions cannot be identical either.
2. In the past, Guatemala had not suffered to quite the same extent from economic distortions (in prices, controls) as El Salvador and Honduras, and hence had not needed adjustment on the same scale. So it is appropriate for Guatemala's SIF to pay more attention to long-term problems. Honduras and El Salvador on the other hand need to concentrate, to begin with, on easing the pains of adjustment, especially now that both countries have initiated far-reaching adjustment programs.
3. Since adjustment pains tend to be greatest in urban areas, an emergency operation (as in Bolivia or Honduras) tends to have all its staff in the capital. But in dealing with longer-term problems (as is the case with the Guatemalan SIF) it is appropriate to decentralize and appoint staff in regional offices, in close contact with rural beneficiaries.
4. Honduras raises almost twice as much revenue in relation to its GDP as the other two. Hence the need to improve tax revenue is more urgent in the latter two.

5. Guatemala has a special language problem. The Indians living in its highlands speak 23 local languages, whereas text-books and teachers are generally attuned to the Spanish medium. So educational reforms in Guatemala should attend to the language problem, something that is not essential in the other two countries.

6. Guatemala and El Salvador have been hit by internal strife for more than a decade, but not Honduras. So there is greater scope for switching security spending to social spending in the first two than in the third.

7. Local communities do not have equally strong traditions in all three countries. They are probably strongest and most capable in the Indian villages of Guatemala.

GUATEMALA

What the Government is Planning

1. Guatemala has long neglected the social and economic development of its highlands (where most of the indigenous population lives), leading to striking inequalities and poor social indicators. These problems were aggravated by civil strife and deteriorating external conditions in the first half of the 1980s. The economy recovered between 1986 and 1988 but then deteriorated again, with fiscal and trade deficits widening. In March 1989, the Government presented a two-pronged social investment strategy to the Consultative Group meeting in Paris. This called, first, for progress in decentralizing the Health and Education Ministries and improving the coordination and targeting of health and nutrition programs. This effort may be supported by a Health and Nutrition Sector Loan assisted by the Pan American Health Organization and the World Bank. Given that this is a long-term effort, the Government has proposed a second channel: an autonomous SIF which will get into action quickly and finance poverty alleviation schemes undertaken by village communities, municipalities, NGOs and the private sector. The SIF project has been prepared with the help of the World Bank, UNDP, IDB and USAID. In March 1990 the Bank negotiated a loan of US\$15 million with the government, which plans to present to Congress both the law creating the SIF and draft loan agreement for approval in June or July 1990. Meanwhile the government has implemented a constitutional provision transferring 8% of ordinary government revenue to 330 municipalities. This is a good start in decentralization and improving community participation.

The World Bank's View of these Plans

2. While agreeing with the overall direction of the proposed reforms, the Bank would like the government to identify more clearly the design and sequence of reforms. The Bank is working with the government on both the SIF and a Social Sector Restructuring project. While the former is well advanced, progress on the latter has been slower. To move ahead, there is a need to define health and nutrition policies more

clearly, especially in regard to the delivery systems for basic health care.

3. Decentralization should be accompanied by a strengthening of the municipalities' capacity to maintain, operate, design and implement projects. They need more powers to mobilize their own revenues for maintaining old facilities and cofinancing new ones. The government should foster an institutional strengthening plan, through training and technical assistance, to upgrade managerial capacity in both the Ministries and municipalities.

4. The SIF should complement the line Ministries and work in close collaboration with them. Its approach and successful experiments can be replicated by the Ministries themselves at a later stage.

What Donors can Do

5. The SIF has attracted some foreign assistance, but needs more soft loans and grants. IDB and KfW have already indicated their preliminary intention to support it. There is still a financing gap of about US\$10 million for which donor support will be welcome.

6. Donor support will also be needed for upgrading the managerial capacities of the Ministries and municipalities, and for future investment in the social sectors. The World Bank is helping prepare a Social Sector Restructuring project, focussing mainly on health and nutrition. It will provide for better targeting, decentralized delivery systems, and improved management techniques. Donors will be kept informed of the progress of project preparation, and will be requested to give and coordinate financial support when the project is clearly defined and financing needs are established.

EL SALVADOR

What the Government is Planning

1. Civil strife and rising foreign debt have led to serious economic decline in El Salvador. Real wages halved between 1978 and 1988, poverty worsened, and social spending plummeted. After falling 22% between 1978 and 1982, GDP has been rising, but not as fast as net population growth. Agriculture has suffered greatly, and emigration has taken away many talented people. Recognizing the need for reforms, the government has initiated major actions to restructure the economy and proposed an ambitious program for the social sectors. The main objectives of the Health and Education Ministries include the following shifts of emphasis: (a) promote primary health care emphasizing preventive steps; shift resources for education toward pre-primary and primary education for the rural population under 12 years of age; (b) decentralize the management of public health services and education to managers much closer to local communities; (c) coordinate and target food assistance to the most vulnerable groups (pregnant and lactating mothers and children 0-5) through integrated health and nutrition interventions and school meals; (d) finance

innovative schemes through greater cooperation with NGOs and the private sector, perhaps through a SIF.

The World Bank's Views on these Plans

2. The proposed reforms are generally highly desirable, but will take time to fully implement. Decentralization will have to be a gradual process reallocating personnel and budgets and strengthening the institutional capacity of local governments.

3. The Government needs to develop a calendar of reforms, identifying their sequence. A short-term strategy in the health sector could focus on: (a) maternal and child care, family planning, and nutrition assistance; (b) rehabilitating health posts, training and employing nurses and auxiliary personnel for the regions most in need; (c) targeting and coordinating existing food supplementation programs and improving their efficiency by contracting out food storage, packaging, transportation and distribution; (d) providing moderate price subsidies for selected food items consumed by the poor; and (e) focussing foreign assistance on priority areas.

4. In the education sector the Government could: (a) rehabilitate the existing primary school infrastructure and improve school supplies; (b) expand the school feeding program, targeting rural primary schools; and (c) expand pre-primary education with the support of NGOs and communities.

5. The key elements of a medium/long term strategy for the health sector could be decentralization of the Ministry of Health and better nutritional coverage of pregnant and lactating women and young children. In the education sector the Government could focus on: (a) decentralizing school administration and resources through the establishment of non-profit private corporations confederating the education sectors of several municipalities; (b) strengthening the Ministry of Education's technical capabilities; and (c) preparing a comprehensive program to improve the coverage and quality of pre-primary and primary education.

What the Donors can Do

6. Many donors such as USAID, UNDP, WFP, IDB and the World Bank are already active in El Salvador. Improving social sectors in the country implies (a) sectoral reforms and (b) emergency social programs through a fast disbursing and flexible mechanism. The Bank is already following the first approach by preparing a Social Sector Restructuring project, and the IDB is exploring the possibility of a SIF.

7. Donors will be informed of the progress of project preparation. When specific project proposals and cost estimates are available, donors will be informed of further financing needs.

HONDURASWhat the Government is Planning

1. Years of faulty policies resulted in 1989 in Honduras having a large current account deficit (7.3% of GDP) and budget deficit (9.2% of GDP), being unable to service its foreign debt, and suffering a fall in per capita income. To remedy matters the government in March 1990 announced a major economic reform program, adjusting its currency from L 2 - US\$1 to L 4 - US\$1 for most transactions, and cutting the budget deficit. To help alleviate the social costs of adjustment, it created the Honduras Social Investment Fund (FHIS) which started operations in March 1990. The UNDP, USAID, Holland, and Taiwan, China have already earmarked a total of US\$5.9 million to support the FHIS, and other donors such as IDB and the World Food Program have also shown some interest. Technical assistance is currently being provided by the UNDP and ILO.

2. Modelled largely on the Bolivian ESF, the FHIS focuses mainly on emergency employment. This is appropriate in the short run. However, longer-term reforms of social sectors need attention too. So it may be appropriate for the FHIS to broaden its scope and start decentralized operations addressing these issues as well. It has already started to move in that direction by preparing a voucher program to help single mothers with school-aged children. L 30 million has been budgeted for 1990 and the program is expected to benefit 100,000 single women.

The World Bank's Views on these Plans

3. The Bank has started a dialogue with the Government, keeping in mind the points raised in this paper. The following issues will be addressed: (a) clarifying the overall social sector strategy in the light of problems that have accumulated over the years and international experience in tackling such problems; (b) within that strategy, determining what sectors and programs should be supported by FHIS in the initial emergency phase and how the FHIS should later broaden its scope to include longer-term social sector projects; (c) determining what needs to be done to improve delivery of services by the social sector Ministries; (d) determining whether it is appropriate for the FHIS to execute projects itself or provide credit; (e) discussing how FHIS operations should relate to existing government programs; (f) determining how the FHIS should work through decentralized institutions such as municipalities and NGOs; and (g) discussing how to ensure the accountability of FHIS' operations.

What the Donors can Do

4. Donors (UNDP, USAID, Holland, and other donors) have already started to provide significant support to the FHIS. In collaboration with donors, the Bank will continue its dialogue with the government on how best to address poverty alleviation, through both the FHIS and line ministries. Donors will be kept informed of the progress made and of the external financing needed to support a comprehensive social investment program.

III. ANNEXESA. GUATEMALASOCIAL INVESTMENT STRATEGYA. Long-Term Social Problems

1. Concurrently with its efforts to stabilize the economy, the Guatemalan authorities have begun to focus on the problems of social neglect and extreme poverty. While these problems were aggravated by the economic decline of 1980-85, they are long-term structural problems rooted in the acute inequality of income and wealth, the cultural diversity of the society and the excessive centralization of political power, public administration and services as well as economic activity in Guatemala City and the areas of traditional export agriculture. Extreme poverty is concentrated in the rural areas, especially the Western Highlands which are heavily populated and where most of Guatemala's indigeneous population lives. There are also pockets of extreme poverty in the slum areas of Guatemala City and the larger secondary cities. For thousands of small communities, which are often of difficult access, the supply of social services is grossly inadequate. Seventy five percent of the Guatemalan rural population does not have ready access to public water supply. More than three quarters of roads serving villages are in an inadequate or deteriorated condition. The situation in the health, nutrition, and education sectors is even more difficult, as described below.

2. In view of the economic and social conditions in the above rural areas, Guatemala's health and nutrition indicators are among the worst of countries with similar per capita income in Latin America. Infant mortality (65 deaths per 1000 live births) and maternal mortality (1.2 per 1000 live births) are high when compared with other Latin American countries at a similar stage of development. Contagious diseases and diseases associated with poor hygiene are among the main causes of death. Mortality among children is also high (15 per 1000 children under five). Over 50% of deaths of children are related to intestinal and respiratory diseases brought on by the lack of potable water and sewerage facilities and poor housing conditions. Most deaths would be easily preventable through better sanitation and vaccination, and basic primary health care. Malnutrition appears to have worsened over the last 20 years, now affecting 60% of children under three years, and 75% of indigeneous preschool children suffer severe height deficits.

3. Guatemala also has a long way to go to meet the educational needs of its people. In 1986, 52% of the population over 15 years of age was illiterate, and in some of the poorest areas illiteracy exceeded 80%. Only about 60% of school age children attend school in poor rural areas and more than half of them have to repeat the first grade. The rate of repetition and desertion is high. Education faces special challenges given the ethnic complexity of the society, one of the most diverse in Latin America. About one half of the population are Indians,

descendants of the Mayans. They speak as many as 23 different languages, although most speak one of four major Indian languages. The majority of the Indian population continues to speak little Spanish which makes it difficult for them to take advantage of educational and health programs offered by line ministries.

B. Key Elements for a More Effective Social Investment Strategy

4. There will have to be a substantial increase in the resources allocated to the social sectors to repay what the present Government has called the "social debt", i.e. the failure over many years by the nation to invest adequately in the development of its human resources. Central Government expenditures are only about one half of the level in other countries with similar per capita income, and expenditures on health and education are only about one third as large as in these countries. The low level of public spending results in part from low resource mobilization--the country's tax burden remains one of the lowest in the world. If progress is to be made in paying the "social debt", investment in the social sectors should be increased from about 24% to at least 30% of total government investment, as a medium term goal, as recommended in the Public Sector Expenditure Review.

5. However, money in itself will not be sufficient to solve the problem. Key ministries need to improve their capacity to design programs and projects and carry them out efficiently and in a timely manner. This is perhaps the greatest challenge which the Guatemalan authorities face in trying to mount a broader and more effective effort to alleviate poverty. For example, in 1986, the Ministries of Health and Education were able to utilize only about a quarter of their budgeted investment resources. The major causes seem to be the excessive centralization of decision making, expenditure control and staffing authority; an overly legalistic, rigid and time consuming system of procurement; antiquated and unnecessarily complex bureaucratic procedures and the lack of well-trained and motivated staff and its excessive concentration in Guatemala City. Other contributing causes are poor project preparation, the proliferation of often over-lapping programs and projects because of poor donor coordination and ad hoc budgeting.

6. As a result, health services reach only 35% of the population, mostly in urban areas, and similar problems affect the Ministry of Education (MOE) which covers less than 60% of school age children in poor rural areas. The Guatemalan authorities have started efforts to decentralize the operations of these ministries and deserve the support of the donor community in this endeavour. The problem is difficult because it requires profound changes in the allocation of resources, personnel policy, budgeting, contracting and auditing procedures. At the same time, the cultural diversity, topography and settlement pattern of Guatemala's rural poverty areas are such that it is almost impossible to carry out many of the most important social programs effectively in these areas through central government departments.

7. One of the great strengths of Guatemalan society is the vigor of its community life at the grassroots level. While the municipal system and, indeed, the entire social fabric was gravely weakened as a result of the violent civic conflict of the early 1980s, the institutions of municipal government are being reconstructed and at the "aldea" (rural village) level a proliferation of local committees has reemerged. These committees, which have a formal structure (i.e., officers and the legal right to manage funds) arise in response to specific needs such as the desire for a new school, a better access road or an improved water system. These local groups constitute a vast, informal, decentralized, rural service delivery system. Often with the help of local promoters and technicians employed by public institutions or NGOs, they secure outside financing and services and carry out the projects. Most Government and virtually all NGO programs, that try to work with the rural poor, employ this organizational model.

8. A tangible decentralization effort of the government has been the transfer to the municipalities of 8% of ordinary government revenues. These resources are destined for investment in municipal infrastructure and public services. The transfers to the 330 Municipalities have reportedly amounted to a total of US\$153 million from 1986 to 1989. The eight percent transfer has helped increase income and short-term employment and has helped rebuild local institutions and the social fabric in the communities. It has strengthened the democratic process and increased community participation in decision-making. On balance, despite its restriction to the financing of capital investments, the experience seems to have been positive and the new mechanism constitutes a demand-driven funding chain which is fast-disbursing and responsive to the needs of the local communities.

9. NGOs constitute another demand-driven chain. With the advent of a democratic government in 1986, some of whose members had considerable experience in designing and managing NGO development projects in the period following the 1976 earthquake, NGOs have become more numerous and active than ever. There are over 200 such organization at present operating in Guatemala, of which 54 have annual investments ranging between US\$50,000 and US\$1.0 million. It is estimated that in 1989 these 54 spent a total of about US\$30 million on projects in health, education, infrastructure, agriculture, and micro-enterprise projects. Given their proven ability to work closely with municipal and village development committees, cooperatives, and other forms of associative organizations, the NGOs constitute an efficient vehicle to execute and supervise projects at the local level.

C. The Government's Social Investment Strategy

10. In March 1989, the Guatemalan authorities presented to the Consultative Group in Paris a social investment strategy to be implemented during the next three to five years. The key objectives of the strategy are: (i) to make significant progress in reducing the rates of infant and maternal mortality, malnutrition and illiteracy,

especially in the rural poverty areas; (ii) to expand and improve the social infrastructure and the provision of social services at the municipal, and above all, the rural village level; and (iii) to help raise the income and improve the employment opportunities of the rural poor. The strategy adopted is a two-pronged one where the two elements complement each other. First, given the time required to improve line ministries and the urgency of addressing poverty alleviation, the Social Investment Fund (SIF) was to be created to finance programs and projects undertaken by municipalities, community groups in the rural villages, and NGOs. Second, the strategy called for progress in decentralizing the Ministries of Health and Education and in improving the coordination and targeting of health and nutrition programs. This will be a longer term effort.

The First Component of the Social Strategy: the Social Investment Fund

11. Because line ministries and agencies have a limited capacity to serve the rural poverty areas, the government has explored various alternative channels to implement its social investment strategy. Providing additional financing through the eight percent transfer mechanism was explored at length, but this mechanism in itself is not an appropriate vehicle. If it were used directly, no health, nutrition, and education programs like maternal health care, growth-weight monitoring of children, or preprimary education, which are more of a "software" nature, could be carried out because transfers received by municipalities are limited by the Constitution to capital investments. Using NGOs as a vehicle to implement decentralized projects is also an interesting alternative because they operate relatively efficiently and have close contacts at the grassroots level, but NGOs have limitations in terms of institutional capacity and geographical coverage.

12. In view of these facts, the Government has decided to create an autonomous institution --the SIF -- which would use several demand-driven channels (municipalities, NGOs, government agencies, local committees) to help community groups in the rural poverty areas improve their health, nutrition and education, and increase their income and employment. In August 1989, the COSIF was created to prepare the law creating the SIF and to implement a pilot operation to test and fine-tune the targeting and selection criteria and operating procedures to be used by the SIF, through the financing of subprojects. The SIF draft law requests exemption from civil service law and simplified procurement procedures so that the SIF be able to attract a highly qualified staff and operate fast and flexibly, on a decentralized basis. The Fund will be a financing agency, but will not execute projects itself. It will focus its operations on the following sectors: water supply and sewerage, access roads, primary health care, nutrition, preprimary and primary education, and productive projects. It may emerge as a major vehicle for donor financing and coordination.

13. The SIF will require the full support of line ministries and will maintain close relationships with them through specific agreements defining clearly how and in which areas the SIF would complement the

work of the line ministries and will assist their process of decentralization. The SIF will also work closely with municipalities whose officials will receive training and technical assistance to improve project implementation.

14. The SIF will operate in accordance with an operational manual. The projects and programs will be proposed and implemented by the communities themselves with the support of municipalities, contractors, NGOs, or consultants whenever necessary. Most of the projects, to be financed by the SIF, will be quite small. For example, in the case of water supply, the average project cost would be about US\$37,000, of which the SIF would finance about US\$20,000.

15. All projects will have cost-sharing arrangements among potential project participants such as local committees, association groups, NGOs, line ministries, municipalities, and the SIF. To adjust demand, the SIF would use different proportions of financing among participants by type of project. Thus the SIF will provide incentives for those projects with the highest priority such as social projects and those which require a high degree of community participation such as primary health care and nutrition programs.

16. The Fund's operations will be audited quarterly by independent private external auditors to verify that subprojects are being carried out in accordance with the agreed upon technical and financial criteria and that acceptable procurement and accounting procedures are being used.

17. The donors and the Bank will conduct a comprehensive midterm review of the program based on the semi-annual reports, the impact evaluation surveys, and the annual financial statements of the SIF. In addition, the donors and the Bank will review progress towards achieving long-term objectives of decentralization of line ministries. As a result of the review, the donors and the Bank will make their recommendations, discuss them with the government and SIF's management and agreement would be reached on their implementation.

Initial Work Program and Financing Plan

18. During the first three and a half years, the total cost of projects to be financed by the SIF, as well as SIF's administrative expenses and institutional development are estimated at about US\$95.3 million, excluding taxes and duties. Under the cost-sharing mechanism, it is contemplated that the local communities, municipalities, and NGOs provide a total of US\$31.2 million, and that the SIF itself provide financing of US\$64.1 million. The tentative financing plan is summarized below.

TENTATIVE FINANCING PLAN

	<u>US\$ Million</u>
Government	10.0
Beneficiaries	11.9
Municipalities	15.1
NGOs and Others	4.2
IDB	15.0
KfW (German Government)	18.0
IBRD	15.0
Other Donors	6.1

Total	<u>95.3</u>

19. The Government has indicated its intention to put up US\$10.0 million for the project (and has already included US\$ 2.7 million for the SIF in the 1990 budget). The proposed Bank loan of US\$15.0 million would represent about 16% of total project cost. IDB is considering a tentative commitment to the Guatemalan authorities that it may provide soft loan funds. The Government of the Federal Republic of Germany intends to contribute US\$18.0 million on highly concessional terms, subject to an appraisal of the project. This would leave a gap of US\$6.1 million which would need to be mobilized from Japanese, Canadian, or European funds.

The Second Component of the Social Strategy: Improving the Delivery Systems of the Ministries of Health and Education

A. Ministry of Health

Policies and Objectives

20. The Government has given priority to primary and preventive health care. This is an important improvement over previous policies. Infant mortality has diminished partly as a result of recent increased immunization, but coverage for children under one year of age for all major diseases remains below 50%. The serious deterioration in iodine and vitamin deficiency has been halted. Training has improved, especially of paramedical and auxiliary health personnel. Finally, administrative regionalization plans and strategies have been drawn up.

21. However, the Ministry of Health (MOH) has so far remained a relatively passive participant in the nutrition area. Most nutrition programs have been designed and funded by external donors. They are largely restricted to untargeted maternal child health feeding programs carried out within public health centers but managed by NGOs. Currently, only one-third of the US\$27 million of food aid programmed in Guatemala is devoted to maternal and child feeding programs. The rest of food aid is distributed through food for work and school feeding, but still with low coverage programs. The synergy between health and nutrition problems makes it imperative to address both problems in a

coherent and coordinated manner. A standardized growth monitoring system to measure the impact of nutrition interventions would be a first step to improve the nutrition programs in the country.

22. In the short-term (to 1991) the Ministry of Health has set the following goals: (i) to eradicate polio and reduce significantly malaria, dengue and immunopreventable diseases; (ii) to reduce infant mortality by one-half from the 1988 level; (iii) to reduce maternal mortality to 1 per 1000 through increasing coverage and training of public health staff and voluntary workers, especially midwives; (iv) to increase access to potable water in rural areas through UNEPAR and DSM; (v) to reduce malnutrition significantly through better management of food aid in coordination with implementing agencies.

23. The Government believes that this short term strategy, will improve health indicators considerably, but ought to be complemented with more far-reaching actions over the longer term that will improve efficiency of the health system through: (i) decentralizing operations and financing by delegating more responsibility to the regions and to executing agencies; (ii) developing a strategy of growth monitoring as part of the primary health care strategy; (iii) rationalizing staffing patterns with preventive and curative health care goals at the primary and ambulatory level; and (iv) improving the operation of hospitals through better management, cost and inventory control, physical maintenance, and auditing. To accomplish these improvements, the MOH will need to define its strategy more fully and receive the full backing and commitment of the government to help ensure its implementation. Additional technical and financial assistance will also be necessary.

Ongoing Donor Support

24. Donors have given considerable support to the Ministry of Health and provided food aid in a variety of ways. The programs include credit from the IDB for aqueducts and sewers and AID support for immunization, Child Survival and Oral Rehydration (ORT) as well as improvement of the information system and institutional development. Technical assistance and resources from WHO/PAHO, UNICEF, and the bilateral donors (Germany, France, and Italy) are also included. Donor resources for the MOH programs, including credits for sanitation, total US\$57.8 million for the period 1989 to 1991. Existing programs have tended to support the primary health care and sanitation strategy of the Government and have had a considerable impact on immunopreventable diseases and the improvement and expansion of the health service infrastructure. Food Aid is expected to average about US\$60 million per year in 1990 and 1991. All food aid donors and implementing agencies will need to coordinate their program among themselves and with the Ministry to assure that food aid supports the primary health care strategy.

25. There are several problems which should be resolved by the donors and the government to improve the efficiency and impact of ongoing external assistance: (i) lack of coordination between donors and

government on national priorities and the recurrent cost implications of projects; (ii) lack of integration of projects in the administrative structure of the Ministry of Health and failure to strengthen this structure instead of increasing fragmentation and conflict; (iii) inadequate integration of national teams in the formulation, execution and supervision of donor projects and programs through in-service training; (iv) inadequate institutional support for badly needed projects with high software components; and (v) slow disbursement by donor agencies.

26. The major problems to be resolved by the Government are: (i) the complicated administrative structure, complex procedures, and excessive centralization in decision-making and execution of projects; (ii) lack of decision-making capacity and continuity in project management (iii) use of funds for activities not stipulated in the original agreements, which creates conflicts and delays (partly resulting from the narrow focus of projects which do not consider more comprehensive primary health care actions); (iv) lack of coordination among units responsible for programs within the Ministry and between the Ministry and executing agencies; and (v) commitment on the part of the MOH to effectively implement improved programs.

27. The Government has taken some actions to correct some of these problems. For example, the government is reorganizing the administrative unit in charge of the EPI/ORT project financed by AID and providing training in financial management to project staff, which should accelerate the implementation of the project. However, much needs to be done in effectively implementing the above strategies and in defining a coherent institutional framework to enhance implementation of programs.

Actions to be Taken by the Ministry of Health

28. The Government needs to review existing policies and plans and appoint a working group to prepare a strategy for an integrated health and nutrition program that would focus both on urgently needed actions to achieve short-term objectives and on ways to decentralize the Ministry and improve its operations. This working group should prepare a document including several elements: (i) an assessment of the need to train midwives, other voluntary workers, nurses, rural health technicians and high level health workers in order to increase preventive and curative health coverage; (ii) an evaluation of the needs for staff, goods and services of the existing health centers and health posts throughout the country, and a study of the possibility that the municipalities would gradually become responsible for the operation of these centers and posts; (iii) a plan to increase the capacity of the Department of Food Control to ensure food industry compliance with the food fortification laws; (iv) a proposal to increase the Ministry's resources for nutrition to support growth monitoring and nutrition screening; (v) a plan of action to achieve universal coverage of growth monitoring (weight-age) in the maternal child health program and to screen for entry and exit in food aid programs; (vi) an analysis of

financial aid received by the health and nutrition sectors, indicating the objectives of the multiple projects in execution, their complementarity or substitutability and ways to better target, rationalize and consolidate these projects to meet the Government's objective of primary health care; and (vii) implement the decentralization of budgetary resources.

29. On the basis of the above analysis, the group would be in a position to prepare a financial health and nutrition plan, including additional local and external resources required to achieve both the short-term and longer-term objectives of the Government's health care and nutrition strategy. This would allow the government to receive appropriate financial support, for example through a Bank financed sector adjustment operation, supported by a group of interested external financial institutions and donors.

B. Ministry of Education

Policy

30. The Ministry of Education's strategy assigns the highest priority to the improvement of primary and pre-primary education in the rural areas. Primary education is assigned high priority given its well known, high social rates of return and contribution to poverty alleviation. Pre-primary education holds the promise of greatly increasing the social rate of return of primary education by helping to reduce the very high rates of repetition and desertion of the two first grades of primary education.

Expanding Primary Education

31. In order to carry out this strategy the Ministry has started to implement the Basic Education Project (US\$60 million) financed by the World Bank, although very limited progress has been made to date given the lack of counterpart funds. This project will assist the Government to expand the coverage of primary education from 60% to 80%. Other external funds are available to finance the expansion of coverage and the improvement of primary education such as the PRODEPRIR project for basic education in rural areas, financed by the Inter-American Development Bank, and the Bilingual and Sector Management projects financed by USAID.

32. Some of the causes for slow project implementation of education projects are similar to those already mentioned in the case of health and nutrition, i.e. proliferation of project units, excessively complex and time-consuming bureaucratic procedures and delays in providing budgeted counterpart funds. If progress is made in correcting these shortcomings by both the Government and donors, already available funds should prove adequate to achieve the desired increase in the coverage of primary education over-all and in the rural poverty areas.

33. Expanding Pre-Primary Education. Financial assistance for pre-primary education has been quite limited up to now, even though the social rates of return may well be even higher than for primary education. This is especially the case in Guatemala in view of the cultural and linguistic diversity of the population. Moreover, pre-school children show the worst indicators of malnutrition and do not have access to the food assistance distributed through the school system. In order to expand pre-primary education, the MOE has already started to take some steps by working closely with the SIF project through its "Programa de Atencion Integral" (PAIN). This program will be undertaken by local communities to provide early stimulation, initial education, and health and nutrition assistance.

C. Conclusions and Recommendations

Actions to be Taken by the Government

34. The law creating the SIF, together with a draft negotiated loan agreement with the Bank and a letter from the IDB indicating the proposed terms of its financing, is expected to be presented to Congress in June 1990. Important next steps will be the appointment of the Directors and the General Manager, and the opening of a project account.

35. While the SIF project is well advanced, there has been slow progress in preparing a program in health and nutrition. To accelerate the process, the government needs to define more clearly its policies in health and nutrition policies, particularly basic health care delivery systems, decentralization of programs and budgets and the role and coordination of donors' aid programs in providing assistance to the public health sector. Once this overall strategy is established, preparation of a health and nutrition project could be accelerated since most basic information is already available.

36. In the area of education, primary education programs are relatively well funded from external financing sources. However, effective implementation will require a substantial increase in local government financing over the next few years. Pre-primary education through the SIF will be implemented primarily by parents and community groups at the grassroots level.

Suggested Support by the Donor Community

37. If the law creating the SIF is approved by the Guatemalan Congress in June 1990, the SIF could start its operations soon afterwards, initially with government funds. Then donors such as IDB, KfW (after an appraisal), and the Bank will consider financing. Any World Bank financing would require settlement by Guatemala of its arrears to the Bank. There is still a financing gap of about US\$6-10 million for which support from other donors would be welcome.

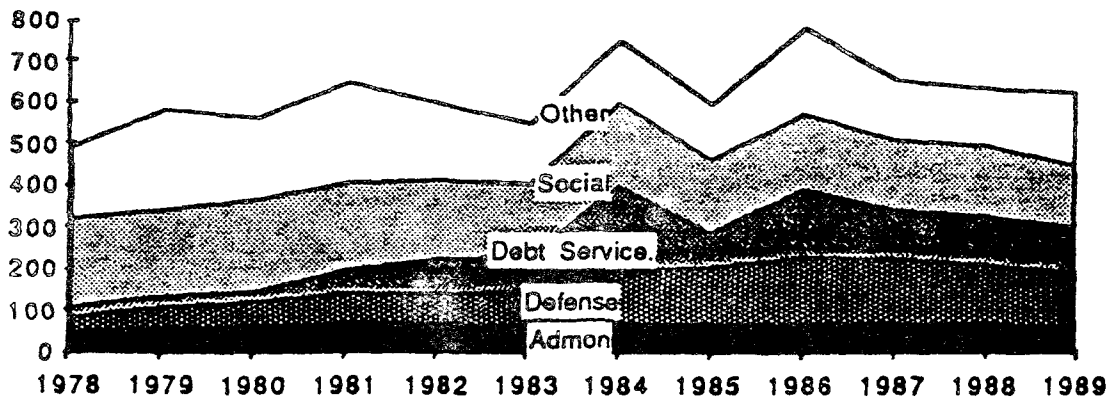
38. Donors are already helping the government prepare a strategy for an integrated health and nutrition program. The Japanese government

has already approved 67.7 million yen (about US\$450,000) to support preparation of a health and nutrition sector project. A group of AID financed consultants is also assisting the Ministry in a study of the decentralization of its operations. Other donors could also participate in these efforts, provided there is adequate coordination. The government would also wish to seek additional support from donors, once the preparation of a health and nutrition project has been completed.

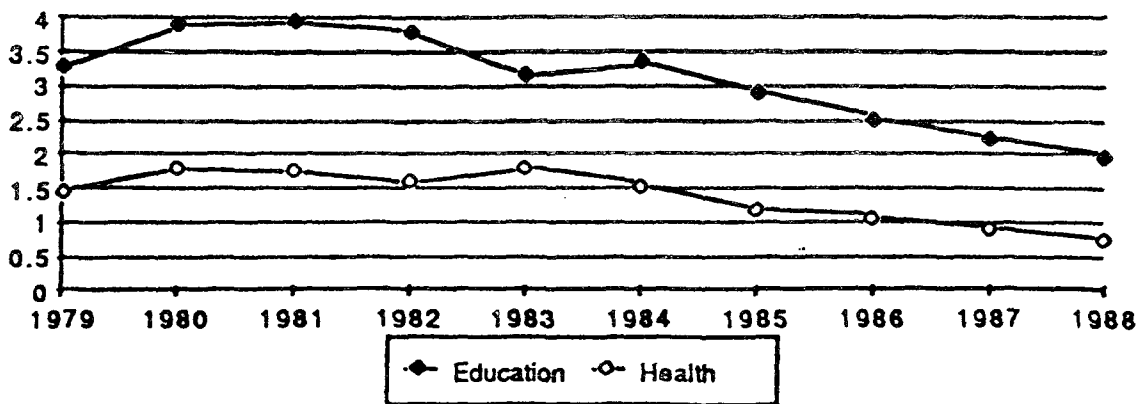
B. EL SALVADOR**POPULATION, HEALTH, NUTRITION AND EDUCATION**
ISSUES AND OPPORTUNITIES

1. El Salvador's civil conflict has had heavy economic and social costs. About 75,000 lives have been lost, causing major economic and human damage. The proportion of the budget devoted to national security (23% in 1988) is by far the highest in Latin America. In conjunction with interest payments, that spending has crowded out public social and economic spending. Whereas in 1977-78 defense and interest spending accounted for 11.7% of total public expenditures, by 1988-89 they took 37.7%. Over the same period, the share of spending on social programs fell from 44% to 24%, and real per-capita outlays on social welfare fell by over 42%. Spending on education and health has declined the most as a percentage of GDP--from about 3.3% on education and over 1.5% on health in 1978--to 2% on education and 0.7% on health in 1988 (see Figures 1 and 2 on the following page).
2. Per capita incomes have stabilized but at a low level. Between 1978 and 1982, GDP fell by 22%. While the decline was halted in 1983, economic growth has averaged only 1.7% a year since then, about the same as the rate of population growth less net emigration. The stock of human capital has fallen even more as the emigrants appear to have been more educated than the population as a whole, and school enrollment ratios have declined.
3. The economic decline has resulted in a significant increase in unemployment. Most dramatic, however, has been the decline in real wages--by about half--between 1978 and 1988. Public sector wages fell more than those in the private sector. As the highest cuts have been in the higher salary ranges, the wage differential within the public sector has shrunk dramatically. This combination of a compression in the wage ratio, and falling real wages, has affected the ability of the public sector to attract and retain qualified personnel, a major threat to the government's capacity to implement its programs and to the efficiency of the bureaucracy.
4. The agricultural sector, a key to food security and income generating opportunities for poor small producers and farm workers, has shared in the general fall in economic activity, except that in recent years it has fared worst than the rest of the economy. Conditions in the agricultural sector are closely related to trends in the nutrition indicators, a relationship that to a large extent explains the recent stagnation in nutrition.
5. Poverty is widespread, aggravated by the civil conflict. A recent study by the Foundation for the Development of El Salvador (FUSADES) found that extreme poverty, defined as people whose income (money and in-kind) is not sufficient to cover a basket of basic foods, rose from 26% in 1985 to 35% in 1988. Extreme poverty is highest in rural areas, where over 50% of the population still live.

**Figure 1. Central Government Expenditures
by Category, 1978-89
(Millions of 1962 Colones)**



**Figure 2. Expenditures on Health and Education
as a Percentage of GDP, 1979-88
(%)**



The Government's Economic Reform Program

6. To address the country's economic problems, a far-reaching structural adjustment program was initiated in July 1989 by the incoming administration. By January 1990, the Government had (i) devalued the exchange rate and transferred most private trade transactions to a flexible parallel exchange market, (ii) eliminated most price controls and raised public utility rates to reflect costs, (iii) raised nominal interest rates toward positive real levels, (iv) simplified the income tax structure, unified the sales tax and eliminated most tax exemptions, and (v) eliminated quantitative trade restrictions, reduced tariff levels from a range of 0%-120% to 5%-50% and reduced coffee export taxes. By June 1990, the exchange rate was unified and managed in a flexible manner, and the tariff ceiling had been reduced to 35%, giving El Salvador one of the least distorted trade regimes in Central America. These reform measures represent the first steps of an overall strategy aiming to reestablish a sounder economic and financial system, paving the way to a more market-oriented, private sector led economy.

7. Although the Government's structural reform program is expected to have, on average, a positive impact in terms of alleviating absolute poverty, some groups in society will be affected adversely, especially in the short run. Groups which may be vulnerable include the marginal urban poor who will feel the impact of agricultural price decontrol and urban workers in industries which previously enjoyed high protection. Social policy measures to protect the living standards of those vulnerable groups, particularly if they already belong in the lower income categories, therefore, will be vital, both to ensure a more equitable distribution of social adjustment costs and to assure that the continuation of the program retains enough political support. The Government has recognized the seriousness of this issue and, thus, also has initiated a short and medium term social sector reform program, including preparation of a social investment fund.

Population

8. El Salvador is the most densely populated country in Latin America, with an estimated population of about 5 million in 1988 and a total land area of 21,000 square kilometers (see Table 1). The rate of population growth, an estimated 1.7% per annum, after a 1% per annum rate of emigration.

Table 1. Population and Health Trends, 1975-88

Indicators	1980	1985	1988
Population (million)	4.5	4.8	5.0
Crude death rate (1,000)	11.6	10.8	n.a.
Crude birth rate		37	35
Infant mortality (1000 births)	73.7	65.0	50.0

Source: Population, health, nutrition and education: Issues and opportunities in El Salvador, World Bank Report, March 1990, p. 10.

9. The recent survey of undernutrition found that it was most prominent in rural areas and among children 12-24 months old (see Table 2). The only exception was acute undernutrition among infants, which is most prevalent in urban areas, probably because of the still high fertility rates and short birth spacing among poorer women, and mothers' participation in the labor market. Other groups at risk include pregnant and lactating women from rural or marginal urban areas and adolescents and young women of childbearing age. Only 35% of the estimated pregnant women register for prenatal care, and only 27% of total births take place in hospitals and are attended by physicians. Of the other births, only about 9% are attended by trained midwives. This inattention results in a high rate of maternal mortality (74 per 100,000 births), one of the highest of Latin America. Along with its many other problems, El Salvador must begin to address the adverse treatment and poor public services provided to women.

Table 2. Malnutrition, 1965-1988

Year	Degree of Malnutrition	
	Moderate	Severe
1965	22.8	7.3
1976	26.0	8.4
1978	15.0	2.9
1988	13.4	2.0

Source: Same as previous table.

Health and Nutrition

10. One of the most impressive features of El Salvador's social development in the last 10 years has been the continuing decline in infant mortality (it fell by a third between 1980 and 1988) and undernutrition (the share of children with moderate or severe malnutrition declined from 18% in 1978 to 15% in 1988). These improvements occurred despite the enormous drop in public spending on social programs and the attendant deterioration of health and nutrition services. Similar patterns have now been identified for the 1980s in other Latin American countries. The common explanation appears to be that funds were inefficiently spent on curative health care that had no impact on infant mortality or undernutrition, so that budget cuts did not affect these outcomes. Improvements occurred with the gradual spread of knowledge about virtually costless changes (washing hands by midwives, greater care in use of potable water, use of oral rehydration therapy, changed feeding practices during diarrheal episodes) that yielded positive results.

11. There are several additional reasons for the apparent progress in the health indicators in El Salvador. First, an increase in Ministry of Health service delivery--total medical services (including emergencies) rose from 93 to 116 per 100 people between 1982 and 1987, with the largest increases found in services by nurses, midwives, rural health workers, and volunteers. The implication is that the decline in expenditures has affected salaries, and probably the morale of workers, rather than the level of

services provided. Second, there was an increase in foreign aid, especially for immunization campaigns, medical supplies, equipment, repairs and other items, including money for recurrent expenditures of specific targeted programs, which do not appear in the ordinary budget figures. Third, services provided by the private sector and NGOs increased, after the earthquake of 1986, which heavily damaged the public sector infrastructure.

12. These advantages now having passed into history, major additional investments, especially from the Government of El Salvador's budget allocations for these sectors, will be needed to improve the indicators beyond the current level, which is still among the worst in Latin America. Well-baby care and nutrition monitoring programs of the Ministry of Health, which is supposed to cover the uninsured 85% of the population, are used by only 41% of the target population under 1 year of age, 32% of children 1 to 2 years old and 21% of children 2 to 4 years of age.

13. The Government of El Salvador has proposed an ambitious program to address these issues and restructure health services delivery:

- o Emphasize primary health care, nutrition interventions and sanitation;
- o Improve client responsiveness through decentralization within the context of a national health system, and
- o rationalize and coordinate food assistance to target the most vulnerable groups in extreme poverty areas.

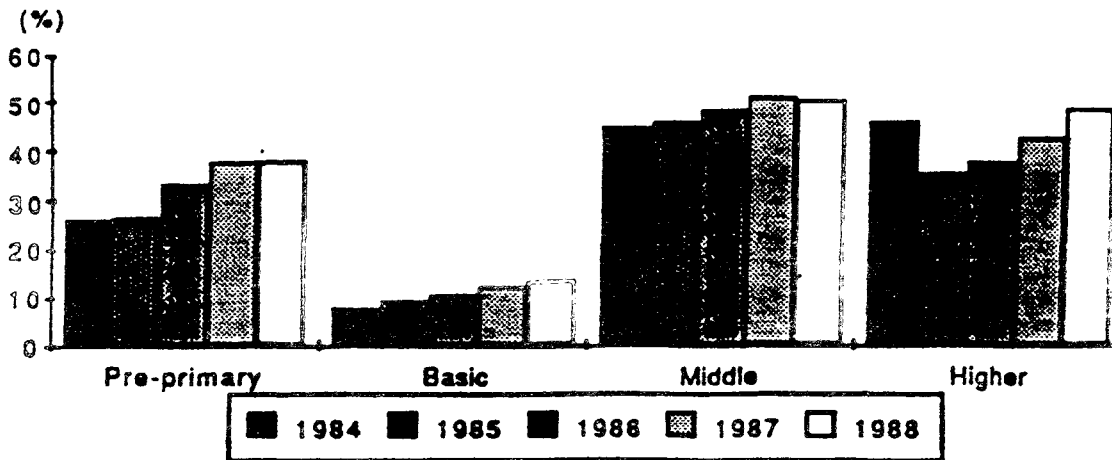
In the course of its review of the Government's strategy, the Bank staff concluded that it is sound but that implementation will be difficult given the major deficiencies at all levels of the health care delivery system. Health posts and units will need to improve operating practices and obtain additional resources. Moreover, the Government, through its Ministry of Health, could consider these additional steps: Integrate the nutrition program into maternal and child health care; increase staffing and training for health post personnel; provide the basic equipment for growth monitoring at all health posts; improve the logistics system for food distribution (NGOs or for profit groups can be contracted to package and distribute the food to health posts or even directly to the beneficiaries), and use mass media for health, nutrition and sanitary education.

Education

14. Even though the education indicators of El Salvador did not deteriorate during the severe economic crisis and civil war of the last 10 years, the education level remains one of the lowest in Latin America, particularly in rural areas, which account for 50% of the population. Over 30% of the adult population is illiterate, and the average school attainment of those who have ever attended school is only 4.5 years. The internal efficiency of the school system is low, as indicated by insufficient coverage and high rates of absenteeism, repetition and dropout.

15. A prominent feature of the 1980s has been the expansion of private schooling, which rose at an annual rate over six times that of public schooling in spite of falling per capita incomes. At the primary level, private schools accounted for 12.2% enrollments in 1987 up from 7.6% in 1983 (see Figure 3). There are several reasons for this trend. First, the public school system has suffered from falling resources and the destruction of facilities in the 1986 earthquake and the war (877 schools were closed in 1982 and in 1987 573 were still closed). Second, teachers' real salaries have experienced a steady and significant decline. The implication is that teachers may work part-time and have sought at least a second source of income, probably increasing the supply and reducing the cost of private schooling. Third, because of the lack of resources, the public school system has suffered from inadequate expenditures on textbooks and teaching materials, a situation that has fostered concern about the quality of public education.

Figure 3. Evolution in Enrollment In Private Sector Schools by Education level, 1984-1988 (%)



16. The main problems include: (i) a sharp reduction in real expenditures for the sector during the last 10 years; (ii) inefficient allocation of resources within the education sector; (iii) inefficient management of the Ministry of Education, with over 90% of the budget going to salaries; (iv) inequity in the allocation of resources nationally, with only a small share going to the poorest groups; (v) declining quality of the school system arising from the deterioration of the physical infrastructure, lack of

textbooks, teaching materials, and teacher training, and falling teacher wages; and (vi) a strong dependence of foreign aid for key operational components.

17. Basic education faces serious and lingering problems of inefficiency: Of the cohort entering school in 1979, only 22.5% has so far completed the nine years of basic education. USAID reports that it takes an average of 10.1 years to produce a sixth grade graduate. Part of the reason for the low completion rates, particularly in rural areas, is that most schools are incomplete. Figures for 1987 indicate that 66% of all schools offered less than six grades and 29% only offered between one and three grades. The situation was even more acute in rural areas: 82% of the schools offered less than six grades and 40% only had between one and three grades.

18. Repetition rates have not improved since the 1970s. Between grades 1 and 6 it was 11.5% for the period 1970-75 and 9% in 1986. School dropout rates have increased since the 1970s--from 10.6% for the period 1970-75 to 15.1% in 1986. In rural areas, the figure was substantially higher: about 23% of the students dropped out of school before the 6th grade. The highest dropout rate occurred in the 1st grade, where about 21% of children left school. FUSADES estimated that repetition and dropout at all levels cost the country about 74 millions Colones (US\$12.3 million) annually.

19. As an illustration of why rural children learn little and drop out, consider the incentives facing teachers. The salary structure is biased toward urban areas and higher grades. The teachers' salary scale relates wages to certificates, grade taught and seniority, with no linkage to performance. To climb the salary ladder requires teaching higher grades. As such, the salary structure encourages teachers to transfer from schools in rural areas (where most schools have only lower grades) to urban schools; it does not provide teachers with incentives to keep children in school, and it allocates new, less experienced teachers to rural schools. Schools do not have positions; instead, teachers once appointed carry the slots with them, leaving the ministry little control over the allocation of the teaching force.

20. External assistance has kept bad from getting worse as it included a significant proportion of foreign technical assistance. USAID contributed to school reconstruction represented about 8.6% of the Ministry of Education's recurrent expenditures in one recent year. The Bank's Fourth Education Project supported school construction, textbooks and teacher training, and the earthquake reconstruction project will support school rehabilitation. The World Food Program participated with a school feeding program for basic schools in rural areas.

21. Since the poor can hardly afford the foregone income of their children while in school, let alone school fees at private institutions, publicly-funded schooling will continue to have a major role to play in El Salvador. Nonetheless, the Government is seeking modes of service delivery that can enhance the efficiency, as well as the equity, of schooling opportunities. Significant changes will be essential.

22. These considerations obviously pose serious challenges to a Government intent on improving social conditions. The major objectives the Government has set for the sector are as follows:

- o Increase the coverage of pre-primary and primary education;
- o Improve the educational attainments of the adult population through literacy, technical, and vocational training programs;
- o Reform the Ministry of Education and the legal framework for the education sector.

In May 1990, the Salvadoran Congress approved a major educational reform law that addresses many of the Government's objectives.

23. In the course of its review of the Government's strategy, Bank staff concluded that it is sound but that implementation will be difficult given the financial, institutional and human resource constraints to education reform. The Government needs to define specific programs with clear, measurable progress indicators for the short, medium, and long term. The sequencing of change would be facilitated by taking the following steps: (i) Shifting resources to favor pre-primary and primary education by making cuts in other areas; (ii) reforming the Ministry's administrative structure, and (iii) opening channels of communication for the participation of local governments, the private sector, and NGOs in the delivery of education. The Government of El Salvador is seeking technical assistance now to identify specific changes that can improve the delivery of education services.

24. It might consider concentrating efforts on expanding and improving pre-primary and primary education (first six grades), targeting its resources to the population in extreme poverty, and reforming the education sector as a priority for the medium to long term.

25. Specific steps, particularly those requiring action in the near term, are spelled out below; they could have a significant impact on the education system and on public opinion in the short-term while paving the way for later structural change in the Ministry of Education:

- o Improve School Infrastructure and Supplies. These improvements are scheduled for inclusion in an amendment to a World Bank earthquake reconstruction loan and proposed to provide for a school rehabilitation and repair program for 2,000 rural and basic classrooms;
- o Target an Expanded School Feeding Program on the Rural Poor. The current meal (700 calories) appears to be appropriate; expansion of the program should focus on 232,000 children in rural schools (annual cost per child, approximately US\$24, an additional US\$3.1 million per year);
- o Expand Pre-primary education for disadvantaged children. Focus first on 5 year-olds; the daycare component of the Emergency Plan of CONARA could be used as a pilot project to train community mothers in early stimulation, nutrition, and growth monitoring.

These near-term steps could then be followed by the restructuring of educational services and the Ministry of Education in the medium term,

including decentralization of operations and financing, with emphasis on an expanded role for local governments in hiring and managing the teaching staffs. Further improvements in pre-primary and primary education could then be achieved within a new framework of responsiveness to client and community needs.

26. USAID and the Ministry of Education are preparing a rural basic education project for the period 1990-1994. This exercise could be used as the basis for the design of an overall program to improve school quality. The experience of the escuela activa (same as Colombian escuela nueva) pilot schools may offer a model worth emulating. The escuela activa model incorporates four basic components: teacher training, curriculum, classroom and school management, and community participation and focuses on allowing children to advance in the system at their own pace. Reading, mathematics, social and natural science curricula are adapted to local conditions and divided into short units. There are 47 schools and over 10,000 children participating in this program in El Salvador today, supported by the Ministry of Education, UNICEF and, Save the Children. They offer a promising avenue for rural basic education in El Salvador.

Issues in Social Program Design

The Bank's review of proposed social programs concluded that objectives are clear but that sector problems, outlined above, are too grave to be solved quickly. Thus a sequencing of (i) rehabilitation of basic infrastructure, (ii) reforms of some specific programs, and (iii) overall restructuring of the social sector ministries, needs to be considered. The Government of El Salvador is now in the midst of these actions. It is receiving active support from bilateral and multilateral financing agencies and technical assistance from private foundations as well. The Inter-American Development Bank recently approved a loan for US\$14 million to support vocational education and sent a mission to El Salvador to review the design of a Social Investment Fund. The World Bank hopes to assist in promoting school rehabilitation through the earthquake reconstruction project. A mission is in the field now to examine prospect for an operation that would assist program reform in selected areas and take the first steps in restructuring the social sector ministries to make them more responsive to client demand and the needs of the poor.

Domestic resources need to be channeled into social programs targeted on poor and vulnerable groups. Insofar as the Government of El Salvador is able to achieve reallocation of its own resources, to concentrate more on needy groups, international support for these efforts should grow. In that regard, support to a social investment fund, if viewed as a mechanism to speed the reform and restructuring process, might offer bilateral donors an effective means to target support on poor and vulnerable groups in El Salvador during the country's transition from war to peace.

C. HONDURAS

Background

Recent Economic Developments

1. Honduras' economic performance in 1989 reflected the fundamental structural weaknesses in the economy that made long-term growth unsustainable unless a major economic program were implemented. Real GDP growth declined from 4.7% in 1988 to 2.1% in 1989, a rate below population growth. Gross domestic investment fell to less than 13% of GDP, and national savings reached only 5.8% of GDP. The current account deficit remained high at about 7.3% of GDP and was financed through the accumulation of arrears on external debt as medium and long-term capital inflows declined from US\$98 million in 1988 to a negative US\$46 million in 1989. Public sector savings deteriorated from 0.9% in 1988 to 2.0% of GDP in 1989. The overall public sector deficit remained high at 9.2% of GDP and was financed mainly through the accumulation of external arrears (4.7% of GDP) and the commercial banking system (4.3% of GDP). This put upward pressure on the parallel market exchange rate that reached above Lempira 4 per US\$1, compared to an official rate of L2 per US\$1. As a result, the rate of domestic inflation increased from 10% in 1988 to about 20% in 1989.

The Economic Reform Program

2. On March 2, 1990, the Government of Honduras (GOH) presented a package of sweeping reforms to improve the exchange and tariff regimes, and to reduce the public sector deficit. The currency was adjusted for most transactions from 2 lempiras = US\$1 to 4 lempiras = US\$1 and the Bank of Honduras has adopted a crawling peg system of currency valuation. All imports will be financed through the foreign exchange transactions carried out at the new rate, ending the implicit subsidy of petroleum, basic grains, industrial and other key inputs. The new exchange regime will have a positive impact on the trade balance.

3. The tariff reform will lead to major reductions in the dispersion and average effective protection rates between now and 1992. Under the new law, the nominal tariff structure will vary between 2% and 40%, and the dispersion will be further reduced over time, with nominal rates expected to be between 5% and 20% at the end of 1992. Traditional tariff exemptions of the public sector have been eliminated. By 1992, the effective protection rate could be around 40%, i.e., less than half the rate of 95% estimated in a 1988 study. This reduction in protection will most likely have a strong negative effect on import-competing industrial production.

4. To reduce the budget deficit, the government would take fiscal measures to increase central government revenues from 16% to 21% of GDP over the medium term, and limit current expenditures to about 21% of GDP. This would reduce the overall public sector deficit to 6.9% of GDP.

despite the effect of the currency adjustment on public sector debt which is estimated at 2% of GDP.

Extent of Poverty in Honduras

5. Honduras is one of the poorest countries in the Western Hemisphere. Its per capita income of US\$740 (which needs to be adjusted to reflect the new exchange mechanism), is higher only than that of Bolivia, Haiti and Nicaragua. Extreme poverty affects over 50% of the population nationally and nearly 80% of the rural population. The rural population is 57% of the total population. The poverty problem is aggravated by the rapid population growth of 2.8% per year, one of the highest in the Western Hemisphere.

6. Although social indicators have improved over the last 20 years, they still have a long way to go to be satisfactory. The health and nutrition indicators reflect acute problems in lack of prevention of simple illness, lack of sanitation, inadequate diets, and deficient coverage of the primary health care system. Infant mortality is over 70 per 1000 live births, according to the last epidemiological and family health survey (1987). According to the 1987 nutrition survey, undernutrition (weight-for-age, all three degrees) affects 37% of the children younger than 5 years of age. (See Table 1). The undernutrition rate for rural areas is 42% and over 55% in some of the poorest areas.

7. The primary cause of death and morbidity is diarrhea, indicating a severe sanitation problem. The frequent number of episodes of diarrhea estimated at 3 per year severely limits the possibilities of nutrition recuperation. According to the 1987 nutrition survey, the lack of potable water and sanitation facilities is dramatic in some health regions. For instance, less than 5% of households in the health regions 7, 4 and 1 reported to have in-house connections to potable water. Over 44% of households at the national level reported to have no appropriate excreta disposal, and in some regions the situation is critical.

8. The education indicators show good access to public schools by the population. The gross enrollment rate has been estimated at 106% (the net is about 90%) the largest in Central America, except Panama. However, the internal efficiency is very low. In 1987, it was estimated that only 46% of those who entered the first grade reached the sixth grade.^{1/} The problem is especially acute in rural areas where only 23% of those who entered the first grade continued until the sixth grade. The drop-out rates are the highest for children in the first three grades.

9. One of the most pressing problem is a shortage of classrooms and deterioration of existing classrooms. The Ministry of Education

1/ USAID, Evaluacion del Subsector de la Educacion Primaria en Honduras. Tegucigalpa, December 1989.

(MOE) has constructed only about 250 classrooms per year when the total needs are estimated at about 800 classrooms. Little maintenance has been done by the MOE or the communities.

Who will be most Affected by the Adjustment?

10. The adjustment program will ultimately increase growth, employment and real incomes, but will lead to temporary social costs. Real wages of the urban poor and small subsistence farmers who are net consumers of food are being reduced. Following the exchange rate adjustment and elimination of exemptions, there have been major price increases in basic foods and most consumer goods in March and April 1990. Although no reliable statistics yet exist, preliminary indications show the consumer price index rising at an annualized rate of over 25% in the first two months of the year.

11. The economic reform is also expected to have negative employment effects. Unemployment may increase to about 17% of the labor force (compared to 13% in 1988). According to an informal study prepared by a private consulting firm, the loss of jobs resulting from the stabilization and adjustment process would range between 26,000 and 52,000, as the adjustment measures take their toll in the public sector (10 to 20,000), highly protected industries (4 to 8,000), construction (7 to 14,000), and other sectors (5 to 10,000). There is thus an urgent need in the short run to mitigate the social costs of economic adjustment. One appropriate instrument to help implement this short-term strategy is the recently created Honduras Social Investment Fund (FHIS).

12. At the same time, the economic adjustment will most probably have a negative impact on health and nutrition indicators, reversing a trend of continued improvements over the last 20 years. In some of the poorest regions of Honduras, nutrition indicators are among the worst in the Western Hemisphere.

Effects on Health and Nutrition Indicators

13. On the supply side, the Ministry of Health (MOH) covers only about 60% of its target population with primary health care. The MOH is, however, the only affordable alternative for poor people with no money for private attention and basic medicines. In normal times, poor people often pay pharmacists and local health providers for their health care and medicines. The current program of food distribution through the health system supported by CARE, the World Food Program (WFP), the European Economic Community (CEE) and other donors, covers only about 11% of pregnant and lactating women and children 0-5 years old. The MOH urgently needs to expand its coverage and to establish a monitoring system that would signal worsening of nutrition and health indicators, and inform it about the number of pregnant mothers not attending health centers. Thus appropriate corrective measures could be taken, as discussed later.

14. On the demand side, pregnant and lactating mothers and children under 5 years of age need to be protected from reduction in consumption of basic foods and the consequent increase in malnutrition and death rates. Because the current food distribution program suffers from severe logistical problems, it can not be used quickly and efficiently to protect vulnerable groups from the drop in consumption. Its coverage is limited. A program of food coupons through the health system (including only a limited number of staple items to simplify the logistics) needs to be implemented in the very short term, as discussed later.

15. The population of children 2-5 years old is most likely to be affected as the mothers and older brothers and sisters will increase their labor force participation during the adjustment program. This group of children is only minimally covered with child care in conventional preschool programs of the Junta de Bienestar de la Familia. It will be most helpful during the adjustment as many mothers will have to work and leave their children at home, in most cases without proper care.

Effects on Education Indicators

16. On the supply side, the lower teacher salaries will affect morale and the amount of teaching time, as there will most likely be an increase in moonlighting by teachers. There will be also a reduction in budget for basic supplies (e.g. textbooks and equipment, desks and other), as well as per-diem for supervisors. The MOE reports that the majority of schools, especially in rural areas, are in a bad state of disrepair and that there is a significant shortage of classrooms and school supplies, primarily desks and chairs for students.

17. On the demand side, poor parents (and single mothers especially) will tend to withdraw children from school to put them to work. Thus, the opportunity cost of school time will increase and compensatory measures should to be put in place to reduce drop-out and repetition. Drop-out rates in Honduras are extremely high already, especially in rural areas.

Government Strategy

18. Although the Government has yet to work out a detailed social sector development strategy, the Government is well aware of the expected social cost of adjustment and has already taken a number of initial steps to address the problem. The government's approach focuses on employment creation (utilizing the newly created Honduran Social Investment Fund) to increase incomes and demand for social services; social fiscal spending (health, education, water and sewerage and welfare) to increase the supply of basic services; and direct transfers of purchasing power (through vouchers, food coupons or other means) to the most vulnerable and destitute groups of the population to compensate for price increases and prevent sharp declines in the consumption of basic foods and higher levels of malnutrition.

19. One of the first measures of the Callejas administration was to create the Honduran Social Investment Fund (FHIS) as a new vehicle for combating poverty. Other actions already taken include allocations in the FY90 budget to (i) help single mothers with dependent school-aged children; (ii) subsidize diesel fuel in order to prevent increases in transportation fares); and (iii) price subsidies on selected basic food items. As can be seen from the table below the total budget allocations for these programs is about US\$25 million.

FY90 Budget Resources that may be used by the FHIS
and Promised or Approved Aid by Donors (US\$ million)

<u>Program</u>	<u>National Funds (in 90 budget)</u>	<u>External Funds (for the FHIS) a/</u>
<u>FHIS</u>		
- Emergency Employ.	2.5	
- Productive & Social Inf.	3.0	2.5 (USAID)
- Administration	0.8	1.0 (Taiwan, China)
Subsidies through FHIS		2.0 (Holland)
- SMDC	7.5	0.3 (PNUD)
- Land Titling	2.5	
Other Subsidies		
- Diesel Consumption	6.2	
- Price Subsidies	2.0	
Total in 1990 budget	24.5	

a/ Argentina has promised 3,600 tons of food. Other donors such as IDB and the World Food Program have shown great interest in helping the Government's social program.

Source: Consideraciones sobre el FHIS, April 23, 1990

20. What has been done on the FHIS. In March 1990, the Government created the FHIS through a law allowing it to operate flexibly and fast. The FHIS General Manager comes from the private sector and has the rank of Minister. He is dynamic and well-respected and has hired a staff of 10 highly qualified people. The FHIS, which is broadly modelled after the Bolivia ESF, has already approved a number of projects costing US\$750,000, to give employment to 2900 people in Tegucigalpa and San

Pedro. The FHIS is currently studying 180 projects that would employ 15,000 more people. For selection of projects, the FHIS is receiving technical assistance of UNDP and ILO consultants. The FHIS now operates as an executing agency and does subproject preparation, and appraisal itself. Currently, the FHIS has resources from the national budget as indicated in the text table, and a total of US\$5.9 million from USAID, Holland, UNDP, and Taiwan, China. Other donors such as IDB and the World Food Program have also shown interest in helping the FHIS.

21. The current FHIS program for FY90 includes the financing of: (i) labor-intensive social infrastructure projects such as water and sewerage, basic rural and urban housing, small irrigation, flood control in poor areas (80% of funds), (ii) productive activities (micro-enterprises, small industry, cooperatives) through credit and training (8% of funds), and (iii) basic needs and subsidies. At the present time, the FHIS program has a clear emphasis on infrastructure.

22. Key Elements of the Strategy. The GOH basically has three instruments to mitigate the social cost of adjustment: (i) it can improve the efficiency of social spending on health, education, water and sewerage and thereby improve the supply of social services; (ii) it can increase the demand or intake of food by direct transfers of purchasing power (through vouchers, food coupons or other means) to the most vulnerable groups; and (iii) it can increase the demand for food and social services through employment creation. Each of these means will be further discussed below. At the present time social spending is primarily through centralized line ministries. Increasing its efficiency will require stronger participation of municipalities, and the steps already taken and further plans are discussed below. Employment generation is envisaged primarily through the FHIS. However, as discussed below, the FHIS could also play a role in improving the efficiency of social services. These possibilities are summarized in the section on broadening the FHIS.

I. Improving Efficiency of Social Spending

23. The GOH has been spending a relatively high share of its GDP and total government spending on public health and education in the last 10 years (see Figure 1). The share of GDP in health and education combined has averaged 6.8%, which is higher than that of most Latin American countries.

24. The problem of the low coverage of the health and primary education system is mainly the result of inefficient use of resources and inappropriate allocation in the budget with an increase in financing of recurrent costs and a dramatic decrease in investment in capital assets and supplies. For instance, the budget for wages and salaries increased from 39% of total expenditures (excluding transfers) to 63% from 1980 to 1989, in health, and from 80% to 90% of total expenditures, in education.

25. The expenditures that need to be protected from further decline in real terms are those for goods and services and investments for health primary health care, sanitation and vector control in the MOH, and rehabilitation of primary schools and basic equipment and supplies, especially in rural areas, in the MOE. These expenditures have decreased by 14% between 1980 and 1989 in health and by 21% in education. They need to be increased again and sharply targeted.

How to Channel Additional Funds for Health and Education

26. The first alternative is to give the funds to the ministries. This alternative has as limitation that complex and time consuming processes limit the speed of executing the works. For instance, the MOE estimates that it can rehabilitate at most 1,000 classrooms directly in a two-year period. The Ministry estimates that if in addition the communities are used, the rehabilitation program can be expanded to 3,000 classrooms in the same period, generating, in addition, substantial local employment. The MOE expects that the FHIS with its flexible law can overcome legal constraints that the small contractors face in far away areas. Among these constraints are the need to register in a great number of places (a process that can take several months) before contracts can be awarded by the public sector. With these constraints, only large well established contractors in the cities are likely to get the contracts.

27. In areas where implementation capacity is limited the government could transfer additional funds to the FHIS under an agreement with the MOH and MOE in which the FHIS, with its more flexible law, would finance social projects to be executed by communities, patronatos, NGOs or private agents. The guidelines would be specified by the Ministries, but rely on local communities to establish and prioritize the needs. (Similar agreements can be established with the Water Company, the Junta Nacional, etc).

Type of Project/Programs

28. The following are ideas of projects that the MOH and MOE would like to implement if funds were available. These projects could be developed at the local level.

29. The MOH is planning to build 400 new health centers in a two-year period that will increase its coverage of the population from 60% to about 90%. The MOH needs to be prepared to cover the increases in personnel and other recurrent expenditures. The MOH also plans to upgrade 40 health center (CESARs), that now attend populations of over 4,500 people, which are populations that call for a more complete service provided by a CESAMO. The CESAMOs are health centers in urban and peri-urbans areas with a physician and nurse.

30. The MOH plans to build and upgrade these centers with community personnel and local contractors using local materials such as "adobe". The cost of the two-year program has been estimated at L 18

million or about US\$4.5 million. (The figure of L 9 million per year is about the average per year the MOH spent on investment in the last 4 years). In addition to construction costs, the FHIS could provide the money for basic equipment for new and old health posts, training of personnel and other basic supplies for health personnel. This program would provide significant employment opportunities for people in the more remote and poor rural areas where the health posts would be built or upgraded.

31. The MOE is preparing a program containing two main components. The first is a program of school rehabilitation and repair of 3,000 classrooms (aulas) mainly in rural areas. The MOE reports that the majority of schools, especially in rural areas, are in poor condition and that there is significant shortage of classrooms. The second is a program to supply badly needed basic equipment and supplies, primary desks and chairs for students.

32. The MOE plans to do the construction and the procurement of supplies using the local level including patronatos, communities and municipalities who would be required to contribute with labor or other means to the program. The communities, especially parents associations and local authorities, would be used to identify the works to be done and to establish priorities. The MOE has estimated the cost of this program at about L35 million (US\$8.7 million) for 2 years to rehabilitate and equip about 3,000 classrooms. (The figure of L 17.5 million per year is about the same spent on goods and services and investments in 1989, assuming an inflation of 20% for 1990).

II. Direct Support to Purchasing Power to Buy Food

33. Even with a well designed emergency employment program some of the poor will have too little income to buy an adequate quantity of food. Sharply targeted transfers of purchasing power must be provided. Where the mechanism for such transfers are weak they need strengthening, where they do not exist, they need to be developed.

Pregnant and Lactating Mothers and Children under 5 Years of Age

34. Pregnant and lactating mothers and children under 5 years of age need to be protected from reduction in consumption of basic foods and the consequent increase in malnutrition and death rates. The current program of food distribution through the health system supported by CARE, the World Food Program (WFP), the European Economic Community (CEE) and other donors, covers only about 11% of pregnant and lactating women and children 0-5 years old and suffers from severe logistical problems that affect regular distribution to beneficiaries. These logistical problems can not be solved quickly and cheaply.

35. The Government needs to protect the above groups in a way which is fast and does not require complicated logistics and transportation costs. One way is to experiment with a food coupon that initially may include only two foods (maize and beans) to be distributed

for all children attending health checkup in health posts and centers in specified geographical areas. Among the most vulnerable groups are the children older than 6 months that are in the weaning period. A food which has been developed is the maize-bean mix that could be used for small children, and that has been supported by UNICEF, INCAP and PAHO. (Recommendations on how this coupon can be implemented are in a separate report). As the program develops the number of different foods which can be purchased with the coupons could be increased.

36. The cost of a program to cover the most vulnerable: children under 5 years old and pregnant and lactating women in extreme poverty areas can be estimated at about US\$6.3 million per year. These calculations are based on a number of 187,700 beneficiaries in the health regions with the highest malnutrition rates and some areas in the periphery of Tegucigalpa and San Pedro Sula (Table 3). The coupon per child is assumed to be L 10 to buy about 7 pounds of maize and bean, per month.^{2/} Other foods that can be tried, depending on local availability and possibility for local production, is alfalfa, which is having a great nutrition impact in experimental projects in Mexico.

Preschool Programs for Children 2-5 Years Old

37. The population of children 2-5 years old is only minimally covered in conventional preschool programs of the Junta de Proteccion de la Familia. The program is very expensive and has little possibility of being expanded. Recently people from the Junta visited Venezuela and liked the program of Hogares de Cuidado Diario implemented there. The Junta plans to implement a similar program in Honduras and has found a very good name for it "programa de madres empresarias".

38. The FHIS could provide money for pilot projects in the poorest areas, training of personnel and to pay for visits to the projects being implemented in Venezuela and Colombia. The Colombian Instituto de Bienestar Familiar can provide technical assistance to the Junta. A program like the one being tried in Honduras has been supported by the World Bank in Colombia and Venezuela. It combines food and nutrition intervention, growth monitoring of children and preventive health care, and community participation and useful work for community mother. It will be most helpful during the adjustment as many mothers will have to work and leave their children at home, in most cases, without proper care.

39. The Junta de Proteccion has estimated that starting up a "empresa maternal" and operating it for a year costs about US\$2,500, providing full-time child care for about 15 children with all meals included. The mothers of the children would also contribute to help pay expenses. The Junta has now three experimental empresas. It is estimated that if the Junta obtains some technical assistance, it could

^{2/} The total cost includes a 15% administrative cost that is estimated for well run programs.

expand the program to about 100 at least in a year. The total cost of a program of 100 empresas (especially in Tegucigalpa and San Pedro Sula where women's participation in the labor market is the highest) would be about US\$35,000 (including US\$10,000 for technical assistance and travel).

Children in Primary School

40. Strengthening the demand for education has to come through income support to pay for the opportunity cost of children attending school. The GOH has already allocated 30 million lenps. (US\$7.5 million) for a money income transfer in a voucher (bono o beca) to help about 100,000 single mothers with children in pre-primary (preparatoria) and the first three grades of primary school, for fiscal 1990. The government has started a pilot program to cover about 35 schools (or 4,000 beneficiary children) on May 13, Mother's Day in Honduras.

41. The coupon is a check to be used by the mother to buy food, clothes and medicines and is expected to be accepted by local retailers affiliated with the program. A national census of beneficiaries is to be completely shortly. The logistics envisioned is, in theory, simple. The pilot project is designed to test institutional arrangements and the design of the coupon.

42. There are some problems with the identification and targeting of the beneficiary population. The government plans to identify the single mothers in the schools, but there are indications of insufficient coverage of the school system for these children 4-10 years old. Following the current criteria specified by the government (single mothers in extreme poverty with children in the grades mentioned above) the subsidy program through the schools could cover only between 15,000 and 20,000 single mothers. In addition, it appears that the total number of potential beneficiaries may be much lower than the figure originally given by the government.

43. To reach a higher coverage and reduce costs of targeting beneficiaries, the government should: (i) select the poorest areas (and not individuals) and extend the benefits to all mothers with children 4-10 years old; (ii) use other means, in addition to schools, to identify beneficiary mothers with children not attending school (patronatos, communities, churches, municipalities); and (iii) simplify the coupon and the logistics.

44. The pilot program just started should be used to test not only coupon design (the current coupon has too much information), but logistics, identification systems of beneficiaries. An evaluation system needs to be in place as soon as possible to evaluate the program before it starts on a larger scale in September 1990.

45. The Government needs to decide who will be the responsible agency and undertake a more precise estimate of the number of potential beneficiaries, so that the excess money can be allocated to other

programs immediately. This program also needs an adequate administrative structure and staff. The current limited number of staff is not sufficient to the program. The cost of the program is in Table 8.

III. Employment Generation

46. As currently planned the FHIS will generate employment both with an emergency employment component as well as by financing social and productive infrastructure. A total of US\$8 million are available for these purposes.

47. Rapid generation of employment on a substantial scale is essential to protect the poor from the effects of adjustment. It is not just a matter of preventing political unrest in the cities, but of preventing nutritional damage in a population already at high nutritional risk. Initially the focus will be mainly on urban areas as the urban poor are likely to suffer more from the price rises of the adjustment program than the rural poor. Rural areas may benefit from expanded agricultural production on account of better rural/urban terms of trade brought about by the adjustment program.

48. In order to generate a sufficiently large number of jobs, the employment programs may have to finance activities and projects such as maintenance and repair which will have little lasting impact on productivity. Over time it will be possible to orient the employment generation program towards projects which make a lasting contribution to development. Over time the program can gradually be shifted to rural areas as well.

IV. Increasing the Participation of Municipalities

49. In principle, municipalities should play a major role in the implementation of emergency employment programs, as well as in expanded social services on a longer term basis. Only by involving the municipalities will these services eventually reach all of the areas of the country. However, at the present time, implementation capacity of municipalities is very limited.

50. Municipalities are currently very weak administrative bodies. This is the result, in part, from the old (1921) organic law that constrained municipal responsibilities, staff, and sources of funding and, in part, from the growth of national agencies that took over responsibilities for basic services. Municipalities do not share in national revenues in a systematic or formula-based way. The central government provides occasional "subsidies" to municipalities to help pay for a minimum of municipal staff. Some municipalities have not received a subsidy since 1988. The amount of the subsidy varies irregularly by municipal size and is very small varying from about US\$750 to US\$55,000 per year. This later amount was received by relatively rich municipalities such as Puerto Cortes which has export revenues.

51. A new municipal law is most likely to be approved by Congress that will give new responsibilities to municipalities and new sources of funding. The new sources of funding, however, will take time to develop. This provides the FHIS with an excellent opportunity to provide funds (bridge financing) for the transition period, so that municipalities can take on the new responsibilities as soon as the law is approved. Each municipality could have a fund for specified projects and under certain conditions.

52. The new law provides for non-discretionary transfer from the central government (based on a formula, yet to be specified) and gives powers to municipalities to raise their own revenue, and approve and execute their own budget. Municipal autonomy is established by a proposal of free popular elections of mayors and other municipal officers.

53. The FHIS could be an instrument to help in the implementation of the new law if approved. A way to implement an emergency program through the municipalities could be: (i) the FHIS could establish a ceiling by category of municipality of, say US\$40,000 per year for municipalities in category A, US\$30,000 for municipalities in B, and US\$20,000 for municipalities in C, for fiscal years 1991 and 1992 (Table 2). A more precise amount would need to be established based on capacity to execute projects; (ii) the FHIS would indicate that financing is for emergency programs as specified by FHIS and that are identified by the community. (A menu of projects elaborated by the FHIS among which the mayor and the community could choose projects could be helpful).

54. The FHIS would authorize quarterly disbursements or tranches conditional on progress on physical and financial execution as certified by auditing private companies. A set of rules and auditing procedures would be designed to minimize misuse of resources.

55. The execution of projects could be contracted out by the municipality or executed by the community directly. Some of the information systems used in Bolivia Fund could be adapted and installed in a number of municipalities as a pilot project.

V. Broadening the FHIS

56. As the previous sections have shown, the flexible financing mechanisms of the FHIS could be used not only for the objective of employment generation but also to contribute to improving the efficiency of social spending.

57. If some of the recommendations above were adopted, the FHIS would broaden its role as follows: Under the guidelines of the Ministries of Health, Education, and the Junta Nacional it would finance an expanded program in health and education to be executed by a broad range of agencies such as communities, patronatos and NGOs. It would

also finance an expanded employment generation program to be executed by groups as well as by rural and urban municipalities.

58. To operate efficiently, the FHIS should use funds from other international donors and the National Treasury, to contribute, on a grant basis, to sub-projects proposed and implemented by local communities, municipalities, and NGOs under the technical supervision of appropriate agencies. This would be an efficient way for the FHIS to operate as these decentralized agents have a comparative advantage over the public sector in project implementation.

59. Cost sharing by the beneficiaries and other cofinanciers of subprojects (such as municipalities, NGOs, or Ministries) is recommended because (a) it detects effective demand for investments, (b) it is a good method to screen executing agencies, (c) it mobilizes additional resources, (d) it gives incentives to communities to organize themselves thus improving the democratization process, and (e) it allows the FHIS to fine tune its targeting (e.g., if there were a relative excess demand in one type of project, the FHIS could lower its financing percentage. Conversely, to foster demand in certain types of projects considered of high priority, the Fund could increase its cofinancing share. These percentages would be readjusted in the light of experience.

60. The FHIS program should also include (i) improvement of the FHIS management information system and sharpening of operating procedures, and (ii) setting up of a monitoring and studies program to assess program impact. In a second stage, for example after a mid-term review, being able to show clearly the impact of the FHIS projects on the social sectors is the best element to convince donors when they are approached for further funding.

61. The FHIS should be audited by private independent external auditors. The auditors would undertake frequent (e.g quarterly) audits of the FHIS' operations combining financial revision with physical inspection of works in the field. They would examine a sample of subprojects (e.g all large projects and 50% of small projects in year 1), review the individual contracts, ascertain whether the terms of these contracts are complied with, inspect the progress of works, would reconcile the physical progress with the financial expenses incurred, and would state whether procurement guidelines are being respected. These audits are most costly than annual audits. Depending on frequency and size of sample, they could cost up to about US\$250,000 per annum which is considered money well spent.

VI. Benefits, Costs and Donor Support

62. Benefits. By transferring resources to poor urban and rural communities, the program outlined would help to: (i) create employment and income largely among those who would have otherwise been underemployed or unemployed as a result of the economic adjustment program; (ii) improve the social infrastructure in health, education, water supply, sanitation and perhaps access roads; (iii) reduce the

rates of mortality, malnutrition, and illiteracy, particularly among women and children; and (iv) provide the government with an opportunity to test decentralized mechanisms for delivering social services to local communities and mobilizing grassroots efforts.

63. Risks. The risks associated with excessive speed of response are that funds would be poorly used and diverted to uses not envisaged in the project. The consequence of too slow a response would be that the sought-for alleviation of the social impact of adjustment would not be achieved, thereby intensifying social pressures that might endanger the economic reform program. This risk would be reduced substantially through a good information system, quarterly audits (both financial and physical) of a significant sample of subprojects, and close supervision.

64. Financing Needs for the Program. The summary of cost of the program suggested is shown in Table 4. It includes: (i) support for social projects under the guidelines of the MOH and MOE; (ii) employment projects contracted out and supervised by FHIS directly; and (iii) municipal strengthening program.

Suggested Support from Donors

65. As mentioned earlier, the donors have already started to provide significant support to the FHIS. In close collaboration with donors, the Bank will continue its dialogue with the government on how best to address poverty alleviation in Honduras both through the FHIS and through the line ministries. Donors will be kept informed of the progress made and of the total financial support needed to implement a comprehensive social investment program.

66. Meanwhile, the donor community should provide technical and financial assistance for the further preparation of the social investment program.

Table 1. Nutritional and Socio-Economic Characteristics of Urban and Rural Households in Honduras, 1989

Indicator	National	Urban	Rural
Child Malnutrition ³			
Weight for Age ^{2 3}	38.0	13.5	42.0
Height for Age ^{2 3}	47.7	23.4	48.2
Weight for Height ^{2 3}	3.9	0.1	4.5
% of Families with inadequate diets ^{1 3}	62.7	59.8	64.5
% With Poor Access to Health services ^{1 3}	34.3	9.2	38.4
% Of women headed households ⁴	21.5	26.9	18.7
% With illiterate heads of household ⁴	33.8	15.8	43.1
Average Household size ⁴	5.5	5.2	5.6

1 Urban corresponds to the Metropolitan Health Area; Rural corresponds to "rest of the country".

2 Corrected indicator of the Z scores.

3 Encuesta Nacional de Nutricion, 1987

4 Encuesta de Hogares Para Propositos Multiples, 1989

Table 2. Example of a Municipal Strengthening Program Per Year (US\$)

Type of Municipality	Number	Amount per municipality	Total Cost
Category A	8	40,000	320,000
Category B	14	30,000	420,000
Category C	267	20,000	5,340,000
Total	289		6,080,000

Table 3. Estimate of Beneficiary Population for the Food Coupon Assistance (Thousands)/a

<u>Region</u>	<u>Malnutr. rate</u>	<u>0-5 Years Old</u>	<u>Benefi</u>	<u>% Children in control</u>	<u>% Pregnant not in control</u>
5	55.2	89.2	49.2	91.5	54.8
4	45.0	92.3	41.5	84.9	63.8
7	43.9	46.7	20.5	75.6	61.9
1	40.7	65.2	26.5	85.3	45.2
Tegucigalpa			30.0		
Other areas			20.0		
Total			187.7		

/a: The nutrition indicator is weight-for-age (acute and chronic malnutrition) for children 0-5 years old and includes all three degrees of malnutrition.

Source: Encuesta Nacional de Nutrición, 1987, Table No. 22, Ministry of Health

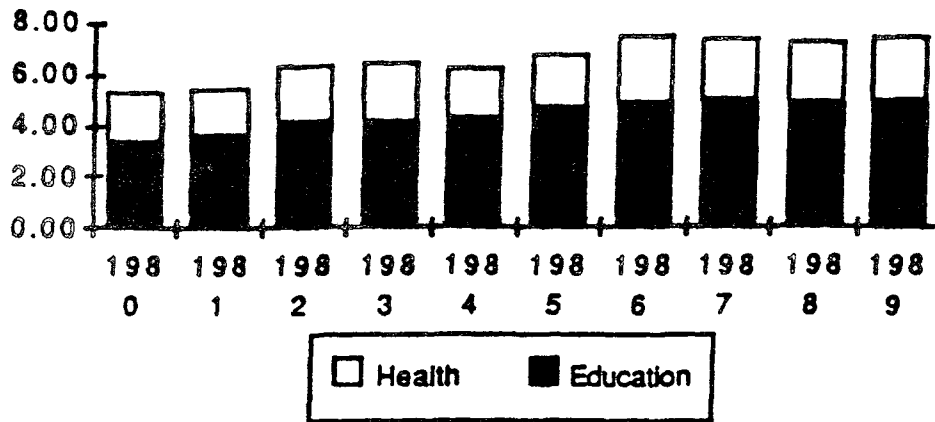
Table 4. Preliminary Estimates of A Two-Year Social Emergency Program (Million US\$)

	<u>Costs For 2 Years</u>	<u>Responsible Agency</u>	<u>Financing Agency</u>	<u>Monitoring & Supervision</u>
<u>MOH</u>				
-Constr. & Rehab.	4.5	MOH	FHIS	MOH/FHIS
-Food Coupon	12.6	MOH/?	FHIS	MOH/?
<u>MOE</u>				
-Const. & Rehab.	8.7	MOE	FHIS	MOE
-Food Coupon	5.2	MOE/?	FHIS	MOE/?
<u>Junta Nacional</u>				
Pre-School Children	0.7	Junta Nacional	FHIS	JN/?
<u>FHIS Own Programs</u>		FHIS	FHIS	FHIS
-Emergency empl.	4.0			
-Social infrastruct./a	10.0			
-Other (productive)	2.0			
<u>Municipalities</u>	12.2			
-Munic. Program		Municipalities	FHIS	FHIS/?
Total Cost	59.2			

/a: Estimate is very preliminary. A review of how much is being spent on water and sanitation by a great number of donors including IDB, USAID, CEE, UNICEF, CARE and a multitude of NGOs such as Save the Children, Agua del Pueblo and a number of governments, is urgently needed to assess additional needs.

/? : Means that needs to be defined.

**Figure 1 Expenditures on Health and Education B
GDP, 1980-89 (%)**



/a: The figures are the result of dividing nominal expenditures by nominal GDP.

/b: The expenditures on health excludes the Seguro Social and the value of food transfers in the maternal-child and school feeding programs.

Source: Table 5A in the Statistical Annex

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