President’s report

Proposed loan to the Republic of Honduras for the

Project for Enhancing the Rural Economic Competitiveness of Yoro

For: Approval
Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

To make the best use of time available at Executive Board sessions, Directors are invited to contact the following focal point with any technical questions about this document before the session:

Ladislao Rubio  
Country Programme Manager  
telephone: +39 06 5459 2575  
e-mail: l.rubio@ifad.org

Queries regarding the dispatch of documentation for this session should be addressed to:

Deirdre McGrenra  
Governing Bodies Officer  
telephone: +39 06 5459 2374  
e-mail: d.mcgrenra@ifad.org
Contents

Abbreviations and acronyms  ii
Recommendation for approval iii
Map of the project area iv
Loan summary v

I. The project 1
   A. Main development opportunity addressed by the project 1
   B. Proposed financing 1
   C. Target group and participation 2
   D. Development objectives 2
   E. Harmonization and alignment 3
   F. Components and expenditure categories 3
   G. Management, implementation responsibilities and partnerships 3
   H. Benefits and economic and financial justification 4
   I. Knowledge management, innovation and scaling up 4
   J. Main risks 5
   K. Sustainability 5

II. Legal instruments and authority 5

III. Recommendation 5

Annex
Important assurances included in the negotiated project loan agreement 6

Appendices
I. Key reference documents
II. Logical framework
**Abbreviations and acronyms**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CABEI</td>
<td>Central American Bank for Economic Integration</td>
</tr>
<tr>
<td>COMRURAL</td>
<td>Rural Competitiveness Programme</td>
</tr>
<tr>
<td>IDB</td>
<td>Inter-American Development Bank</td>
</tr>
<tr>
<td>INA</td>
<td>National Agrarian Institute</td>
</tr>
<tr>
<td>PCU</td>
<td>project coordinating unit</td>
</tr>
<tr>
<td>PRONADEL</td>
<td>National Programme for Local Development</td>
</tr>
<tr>
<td>RUTA</td>
<td>Regional Unit for Technical Assistance</td>
</tr>
<tr>
<td>SAG</td>
<td>Ministry of Agriculture and Livestock</td>
</tr>
<tr>
<td>SDC</td>
<td>Swiss Agency for Development and Cooperation</td>
</tr>
<tr>
<td>SIAFI</td>
<td>Integrated Financial Management System</td>
</tr>
</tbody>
</table>
Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed loan to the Republic of Honduras for the Project for Enhancing the Rural Economic Competitiveness of Yoro, as contained in paragraph 35.
The Republic of Honduras

Project for Enhancing the Rural Economic Competitiveness of Yoro

Loan summary

Initiating institution: IFAD
Borrower: Republic of Honduras
Executing agency: Ministry of Agriculture and Livestock (SAG)
Total project cost: US$13.88 million
Amount of IFAD loan: SDR 4.55 million (equivalent to approximately US$7.13 million)
Terms of IFAD loan: 40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum
Cofinancier(s): Central American Bank for Economic Integration (CABEI)
Amount of cofinancing: CABEI: US$4 million
Contribution of borrower: US$1.05 million
Contribution of beneficiaries: US$1.69 million
Appraising institution: IFAD
Cooperating institution: CABEI
Proposed loan to the Republic of Honduras for the Project for Enhancing the Rural Economic Competitiveness of Yoro

I. The project

A. Main development opportunity addressed by the project

1. There are two main development opportunities present in the selected project area, the department of Yoro in central Honduras. The first addresses the need to increase the competitiveness of the country’s economy in general and rural competitiveness in particular. The second calls for an IFAD intervention to contribute to reducing poverty levels of an indigenous group: the Tolupan tribes, who are among the poorest segments of the population in the project area. There is an opportunity to assist the Tolupanes to better manage their territories, clarify their land rights and initiate economic activities that may help in reducing their poverty.

B. Proposed financing

Terms and conditions

2. It is proposed that IFAD provide a loan to the Republic of Honduras in the amount of SDR 4.55 million (equivalent to approximately US$7.13 million) on highly concessional terms to help finance the Project for Enhancing the Rural Economic Competitiveness of Yoro. The loan will have a term of 40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum.

Relationship to the IFAD performance-based allocation system (PBAS)

3. The allocation defined for the Republic of Honduras under the PBAS is US$7.13 million over the 2007-2009 allocation cycle.

Country debt burden and absorptive capacity of the State

4. The most recent debt sustainability analysis by the International Monetary Fund (IMF) in December 2006 indicates that under a baseline scenario, Honduras’ external debt should be sustainable. Robust growth in exports of goods and services compensates for the increase in the cost of financing, allowing for a slight reduction in the net present value of the debt-to-export ratio. While full delivery of debt relief from remaining bilateral donors would help lower the debt stock and make the debt less vulnerable, reducing the country’s risk of experiencing debt distress in the medium and long term will continue to require sound macroeconomic policies, most notably fiscal discipline.

Flow of funds

5. IFAD loan proceeds will be channelled through a special account to be opened in the Central Bank. The Minister for Finance, or the person who is legally authorized to represent him, will operate the special account. The project resources will be channelled through the Government’s Integrated Financial Management System (SIAFI) of the Ministry of Finance.

Supervision arrangements

6. The project will be supervised by the Central American Bank for Economic Integration (CABEI) as cooperating institution. CABEI has supervised the existing projects and has a long-standing agreement with IFAD for project supervision and cofinancing in Central America.

Exceptions to IFAD General Conditions for Agricultural Development Financing and operational policies

7. No exceptions are foreseen.
Governance
8. The following measures are planned to enhance the governance aspects of the IFAD loan: (i) use of private auditing firms and full adherence to IFAD Guidelines on Project Audits; and (ii) support to enhance PCU capacity for financial management and procurement in accordance with SIAFI.

C. Target group and participation

Target group
9. The project’s target group includes small-scale farmers and their organizations in rural areas of Yoro as well as women, youths, landless peasants and an indigenous group. In selecting the project’s target group, due account was paid to the characterization of poverty in Honduras and in particular in Yoro department, which indicates that the extreme poor and indigenous groups are essentially rural and that most of the poor work in agriculture.

Targeting approach
10. The project’s targeting strategy has been based on IFAD’s targeting strategy and includes geographic targeting with attention paid to municipalities in the forested areas of the department showing higher levels of poverty. Self-targeting will also be used as beneficiaries will make proposals for project funding based on the identified weaknesses of their organizations and their wish to be strengthened and supported. The project will directly target resources exclusively in favour of Tolupan indigenous tribes.

Participation
11. The full participation of small-scale farmer organizations and indigenous Tolupan tribes is paramount for achieving project results. Cooperation with government agencies such as the National Agrarian Institute (INA) and the newly established National Forestry and Protected Areas Institute will be sought, as well as participation by other projects and NGOs working in support of indigenous groups and the rural poor.

D. Development objectives

Key project objectives
12. The development objective of the project is to significantly reduce poverty conditions affecting the rural population of Yoro department. Its purpose is to improve organizational capacity and territorial management practices as well as market positioning of the products of the rural poor and indigenous groups. As a result of project implementation, rural organizations will be strengthened, sustainable territorial management will be achieved and small-scale farmers will be better served by technical assistance providers and financial institutions.

Policy and institutional objectives
13. The project will pursue three main policy and institutional objectives: (i) increasing competitiveness in line with the country’s poverty reduction strategy, the strategic and operational plan for the sector and overall policy guidance to be provided by a steering committee established for a rural competitiveness programme; (ii) furthering economic growth by involving the rural poor in activities that are profitable and sustainable, leading to improved income; and (iii) addressing the needs of the most vulnerable groups such as women and indigenous populations and recognizing their contribution to overall development.

IFAD policy and strategy alignment
14. The project is consistent with IFAD’s country strategic opportunities programme for Honduras, which calls for: (i) improving income-generating opportunities for the rural poor by helping them integrate into the market economy, facilitating their access to technologies and investments for agricultural and non-agricultural activities; and providing linkages between the dynamic and non-dynamic sectors of
the economy; (ii) strengthening the organizational capacities and bargaining power of the organizations of the rural poor, building capacity to negotiate and establish alliances with other private-sector actors and benefit from trade agreements; and (iii) assisting indigenous communities in articulating their specific concerns with public and private entities and building their social, human and physical capital.

E. Harmonization and alignment
   Alignment with national priorities
15. The project is aligned with the country’s poverty reduction strategy and strategic and operational plan for the agricultural sector, which include activities to expand employment, support microenterprises and small and medium-sized enterprises and address the business environment in rural areas, providing opportunities for integrating the agricultural sector in supply and value chains. In the social protection area, the Government will rationalize existing programmes and concentrate efforts on one of two programmes, such as Red Solidaria (Solidarity Network), oriented towards the most vulnerable groups.

   Harmonization with development partners
16. In addition to leveraging additional funding from CABEI, this IFAD intervention will be harmonized with the World Bank-financed Rural Competitiveness Programme (COMRURAL) and with a rural businesses project to be implemented by the Ministry of Agriculture and Livestock (SAG) with Inter-American Development Bank (IDB) funding. The project will also be harmonized with initiatives being funded by the Swiss Agency for Development and Cooperation (SDC), including direct support for the Rural Competitiveness Programme and a project aimed at strengthening rural financial intermediaries.

F. Components and expenditure categories
   Main components
17. The project has two components: (i) organizational development and territorial management; and (ii) market insertion and positioning.

   Expenditure categories
18. The IFAD loan will finance, net of tax expenditure, the following categories in the financing percentages indicated: (i) vehicles and equipment (100 per cent); (ii) contracted services (60 per cent); (iii) commercial initiatives fund (50 per cent); (iv) salaries (100 per cent); and (v) operating costs (100 per cent).

G. Management, implementation responsibilities and partnerships
   Key implementing partners
19. The main implementing partners for this project, in addition to SAG, will include the World Bank, SDC, CABEI, INA, the National Forestry and Protected Areas Institute and the Ministry of Natural Resources and Environment. Partnerships for implementation will also be sought with such regional programmes as the Dominican Republic–Central America–United States Free Trade Agreement and the Regional Unit for Technical Assistance (RUTA).

   Implementation responsibilities
20. SAG will be responsible for project implementation, and a PCU will be established in the city of Yoro. Overall guidance for project implementation will be provided by the steering committee. Implementation of project activities will be the direct responsibility of beneficiary organizations including indigenous Tolupan tribes. Responsibility for allocating project resources will rest with a resource allocation committee composed of representatives of local governments, beneficiary organizations and other civil society stakeholders.
Role of technical assistance
21. Technical assistance will play a significant role in fulfilling project objectives, since most of the funds allocated for supporting beneficiary initiatives are intended for contracting technical assistance providers for a wide range of services, including organizational and administrative matters. Technical assistance will also be provided to service providers. Advisory services will enhance the capacity of indigenous groups in territorial planning and conflict resolution.

Status of key implementation agreements
22. During appraisal, agreements were reached in terms of the institutional setting for the project within SAG. Government agencies including the Ministry of Finance, the Ministry of the Presidency, INA and the National Forestry and Protected Areas Institute concurred on establishing a committee to guide implementation of a national rural competitiveness programme. The Government will monitor the CABEI cofinancing agreement.

Key financing partners and amounts committed
23. The total project cost is US$13.88 million over seven years. The sources of financing are IFAD (51 per cent), CABEI (29 per cent), the Government (8 per cent) and beneficiaries (12 per cent).

H. Benefits and economic and financial justification

Main categories of benefits generated
24. The project will directly benefit 9,000 small-scale producers (45,000 rural inhabitants), including 2,000 indigenous households. It will create 7,000 jobs and will contribute to a more dynamic economy, indirectly benefiting about 35,000 rural inhabitants.

Economic and financial viability
25. An economic analysis shows an internal rate of return of 18.2 per cent and a net present value of US$3.34 million. The financial analysis shows an internal rate of return of 15.7 per cent and a net present value of US$1.62 million.

I. Knowledge management, innovation and scaling up

Knowledge management arrangements
26. The project design addresses support for knowledge management and knowledge sharing by including the preparation of studies on project initiatives such as establishing alliances with commercial entrepreneurs, financial intermediaries and others. Knowledge acquired in the course of participatory mapping of indigenous land, provision of legal support for conflict resolution and economic initiatives of indigenous groups will be documented. Knowledge management arrangements will include deepening collaboration with organizations such as the Zamorano Agricultural School and IFAD regional programmes such as RUTA and FIDAMERICA.

Development innovations that the project will promote
27. The project will promote two main innovations. The first is inherent in the development of productive alliances to access markets and potential value chains. This has been tried in various settings in Honduras in connection with higher value commodities and is being pursued by the Millennium Development Account programme in the horticultural value chain. The second will be the use of participatory mapping by indigenous groups to set the boundaries of territories and indigenous lands. Finally, the provision of legal services for resolving conflicts with mobile advisory and counsel services will test the validity of this approach.

Scaling-up approach
28. There is considerable potential for scaling up the project approach at the national level since the much larger COMRURAL project funded by the World Bank and SDC will cover seven other departments in Honduras simultaneously. Additionally, an
IDB-funded Pronegocios project now being formulated to institute a national rural competitiveness approach taking advantage of new trading possibilities will open up further possibilities.

**J. Main risks**

**Main risks and mitigation measures**

29. The project faces three main risks, relating to: (i) the ability of small-scale farmers to respond promptly to market demands and changes. This can be mitigated by promoting alliances between more dynamic and well-organized producers with service providers, processing and marketing enterprises and financial intermediaries operating in the project area; (ii) an adequate supply of business advisory services. This would be minimized by taking advantage of technical assistance offered by processing and marketing enterprises and by supporting existing providers in gaining the required knowledge; (iii) the capacity of indigenous groups to participate fully in project activities. The project will provide considerable assistance for the creation of mechanisms to involve these groups and assist them in resolving conflicts and initiating productive initiatives.

**Environmental classification**

30. Pursuant to IFAD’s environmental assessment procedures, the project has been classified as a Category B operation in that it is not likely to have any significant negative environmental impact.

**K. Sustainability**

31. The project’s sustainability strategy includes a concerted plan of activities including actions aimed at ensuring ownership by beneficiaries of the initiatives funded during the life of the project. The strategy will cover the sustainability of human capital generated, alliances established between producers and processing and marketing enterprises, and business ventures undertaken. The sustainability of managing natural resources based on solidly acquired land rights would also be important. Knowledge acquired by indigenous groups will ensure that territorial management is sustainable providing an appropriate legal framework exists.

**II. Legal instruments and authority**

32. A project loan agreement between the Republic of Honduras and IFAD will constitute the legal instrument for extending the proposed loan to the borrower. Important assurances included in the negotiated agreement are attached as an annex.

33. The Republic of Honduras is empowered under its laws to borrow from IFAD.

34. I am satisfied that the proposed loan will comply with the Agreement Establishing IFAD.

**III. Recommendation**

35. I recommend that the Executive Board approve the proposed loan in terms of the following resolution:

RESOLVED: that the Fund shall make a loan to the Republic of Honduras in various currencies in an amount equivalent to four million five hundred and fifty thousand special drawing rights (SDR 4,550,000) to mature on or prior to 15 November 2047 and to bear a service charge of three fourths of one per cent (0.75 per cent) per annum, and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Lennart Båge
President
Important assurances included in the negotiated project loan agreement

(Negotiations concluded on 19 November 2007)

**Pest management practices**
1. The Government of Honduras (the “Government”) will ensure that pesticides procured under the project do not include any pesticides banned by the Food and Agriculture Organization of the United Nations (FAO), or classified as extremely hazardous by the World Health Organization (WHO).

**Gender**
2. All project activities will be carried out in such a way as to favour primarily participation by women, in order to achieve gender equity.

**Tax waiver**
3. Taxes, levies and other tax charges will be waived for all goods and services procured and/or financed under the project. The amount of such waivers will be credited as part of the Government’s obligation to furnish counterpart funds for the project.

**Insurance of personnel**
4. The Ministry of Agriculture will insure project personnel against health and accident risks in a manner consistent with national legislation.

**Resource protection**
5. The Government will take all reasonable steps to ensure that the prevailing legal norms on the safeguarding of water, forests and wildlife are adhered to in the project area. The Government will further make every possible effort to ensure project sustainability without any adverse impact on the environment.

**Indigenous populations**
6. The Government undertakes to ensure that indigenous populations fully participate in and benefit from all project activities, and that their interests are respected during project implementation. To this end, it will ensure that:

   (a) The project is carried out in accordance with the provisions of national legislation relating to the indigenous populations benefiting from the project;

   (b) Indigenous communities are adequately and equitably represented in project activities;

   (c) Indigenous communities benefiting from the project participate in policy dialogue and local governance;

   (d) The declarations, agreements and/or covenants ratified by the Government are adhered to; and

   (e) The project does not involve encroaching upon territories traditionally occupied by indigenous communities.

**Counterpart funds**
7. The Government funds will cover all such contributions as may be required by national legislation and all taxes and duties on the importation of goods, public works and services acquired with the loan proceeds.

**Fraud and corruption**
8. The Government will promptly bring to the attention of IFAD any allegations or concerns of fraud and/or corruption in relation to the project of which it may become aware.
Suspension

9.  (a) IFAD will suspend the right of the Government to request the withdrawal of funds from the loan account if the required audit has not been satisfactorily concluded within six months of the due date.

(b) IFAD may suspend, in whole or in part, the right of the Government to request the withdrawal of funds from the loan account, upon the occurrence of any of the events set forth below:

   (i) The general coordinator has been removed from the project without the prior agreement of IFAD;

   (ii) IFAD has determined, in consultation with the Government, that the material benefits of the project are not adequately reaching the target group;

   (iii) The right of the Government to withdraw the loan proceeds has been suspended, cancelled or terminated, in whole or in part, or the loan has become due and payable prior to the agreed due date, or an event has occurred that, through notification or with the passage of time, could give rise to one of the aforementioned circumstances;

   (iv) The project operating manual, or any provision thereof, has been waived, suspended, terminated, amended or otherwise modified without the prior consent of IFAD, and IFAD has determined that such waiver, suspension, termination, amendment or modification has had, or is likely to have, a material adverse effect on the project;

   (v) Procurement and contracting are not being carried out in accordance with the loan agreement;

   (vi) The Government has defaulted in the performance of any covenant set forth in the loan agreement and IFAD has determined, in consultation with the Government, that such default has had, or is likely to have, a material adverse effect on the project; and

   (vii) IFAD has knowledge, or has informed the Government, of any plausible allegations of corrupt or fraudulent practice relating to the Government and/or the project, and the Government has not taken appropriate steps to remedy such allegations to the satisfaction of IFAD.

Conditions for withdrawal

10. No withdrawals from the loan account will be made until: (i) IFAD and the cooperating institution have approved the draft operating manual and administrative, accounting and financial procedures; (ii) the draft of the first annual work plan, including a first procurement and contracting plan, has been approved by IFAD and the cooperating institution; and (iii) the Government has effected the budget allocation, deposited the first instalment of counterpart funding and made it available to the Ministry of Agriculture.

Effectiveness

11. The loan agreement will become effective upon fulfillment of the following conditions precedent:

   (a) The general coordinator of the PCU has been appointed in accordance with the provisions of the loan agreement;

   (b) The Government has duly opened the special account;

   (c) The loan agreement has been duly signed, and the signature and performance thereof by the Government has been duly authorized and ratified by all necessary institutional, administrative and governmental action; and
(d) A favourable legal opinion, issued by the Office of the Attorney General of the Republic or another legal counsel approved by IFAD has, in form and substance acceptable to IFAD, been delivered by the Government to IFAD.
Key reference documents

Country reference documents
Honduras – Políticas de Estado Agroalimentario y el Medio Rural. Secretaría de Agricultura y Ganadería (SAG)
Honduras – El Programa de Competitividad Rural del Gobierno de Honduras
Honduras – Red Solidaria del Gobierno de Honduras

IFAD reference documents
IFAD. Republic of Honduras: Result-based Country Strategic Opportunities Programme, RB-COSOP. (April 2007)
IFAD. Inception Report. "Enhancing Competitiveness of the Rural Economy” (December 2006)
IFAD. Formulation Report. "Enhancing Competitiveness of the Rural Economy Project” (June 2007)
IFAD. PRONADEL Mid-term Review. Department of Socio-economic Development and Environment. Zamorano

Other miscellaneous reference documents
Mapeo de las cadenas agroalimentarias de maíz y frijol en Centro América [mapping maize and beans agrifood chains in Central America]. Managua, June 2007. IICA – COSUDE.
## Logical framework

<table>
<thead>
<tr>
<th>Objective hierarchy</th>
<th>Key performance indicators and targets (RIMS indicators are in ITALICS)</th>
<th>Monitoring mechanisms and information sources</th>
<th>Assumptions and risks</th>
</tr>
</thead>
</table>
| **Development objective** | Poverty of rural poor in Yoro Department significantly reduced | • Economic growth of rural sector by 4%  
• Extreme poverty in the department reduced by 2%  
• Child malnutrition reduced accordingly to national target (national target: from 29% a 22%) | • Baseline and impact surveys including RIMS Impact Survey in 1st year, mid-term, completion  
• M+ E system of ERP by UNAT |  
| **Project Purpose** | Rural poor households in Yoro Department have improved their organizational capacities, their territorial management practices and their market position | • 9000 direct beneficiary HH including 2000 indigenous HH count with 10% increase in rural per capita income  
• 10% increase in marketing of agricultural products by benef. HH (3000 HH with coffee, 2500 HH with maize and beans and 1500 HH with diary)  
• 20% increase of business ventures established between beneficiary HH and commercial entrepreneurs  
• 75% of beneficiary HH (affiliated to 120 organisations) with functioning business activities or enterprises, after completion of project support  
• 20% of organisations managed by women are entrepreneurial initiatives  
• 75% of rural organisations functioning as enterprises after completion | • Baseline, midterm and completion surveys including RIMS Impact  
• HH survey on sales and commercial contracts  
• Focus group discussions | Legal framework is favourable for public and private investments in rural areas with high concentration of poor |
| **Component 1:** | **Output 1:** Management and entrepreneurial capacities of rural organisations strengthened | **Organizational development and territorial management**  
• 240 organisations (35% of org. with women in leadership position) with improved capabilities in management techniques and entrepreneurship  
• 7000 persons (35% women) trained in management, economic and social topics  
• 240 organisational development plans formulated  
• 30% of rural organisations trained in managing their ‘caja rurales’ | • Training and TA records  
• Documentation of organis. Development plans  
• Records of caja rurales | Social investment to improve access to basic services for extreme poor HH covered by third parties |
| **Output 2:** Capacities for sustainable territorial management strengthened |  
• 30 territorial maps for management of 100,000 ha elaborated  
• 12 tribes (2000 HH) assisted in land conflict resolutions  
• 12 tribes (2000 HH) with improved capacities for management of communal land  
• 240 organisations trained in soil and water management  
• 700 indigenous women with legal documents | • Documentation of maps  
• Documentation of conflict cases  
• Training records  
• Copies of legal documents | Government agents and indigenous federations support indigenous project activities |
| **Output 3:** Rural poor organizations have improved their access to technical, commercial and financial services |  
• 6 commercial ventures with agro-industrial enterprises established  
• 240 organisations access technical assistance  
• 2100 HH access sustainable financial services  
• 10 cooperate service provider and 30 IFIS with improved business and entrepreneurial capacities especially oriented to assist rural poor | • Documentation of business alliances  
• Assessment of TA and financial services  
• Training record | Investment climate and market conditions favourable for business alliances with rural poor |
| **Component 2** | **Market insertion and positioning** |  
| **Output 4:** Rural poor organisations strengthened and empowered in terms of the marketing position of their products | • 120 organisations with entrepreneurial plans (35% managed by women) for café, milk and grain production  
• 250 contracts of 120 organisations with service providers for entrepreneurial development and marketing signed | • Documentation of business plans,  
• Contracts with service providers | Appropriate conditions for providing financial services for rural poor exists |