I. INTRODUCTION

1. During the past decade, Honduras has been continuously involved in IMF-supported programs—a Stand-by Arrangement in 1990–92; an Enhanced Structural Adjustment Facility (ESAF) in 1992–97; a Poverty Reduction and Growth Facility (PRGF) in 1999–2001, and a recent one starting in 2004. Throughout most of the past decade, program performance was weak in terms of both quantitative and structural performance criteria. Fiscal performance was particularly poor because of account of continuous public sector wage pressures and a weak performance in tax collection.

2. The recent IMF ex post assessment, which looks at the relationship between Honduras and the IMF during the past decade, identifies weak ownership and the lack of political space as the key constraints on moving ahead with structural reforms. In their reaction to the assessment, the authorities felt that a stronger emphasis by the IMF in support of strong governance and institutions could have improved that performance.

3. With this information as a background, it is useful to identify the main activities of IMF TA in Honduras since 1990. These are shown in Table 1. Two periods can be clearly distinguished: the pre-FY1999 period, where the volume of TA was relatively low and fluctuated highly from year to year, and the period from FY1999–2004, when the volume of TA increased sharply and remained high.

4. During the first period, most of the TA was provided by short-term missions comprising several mission members. The major areas of focus were public expenditure management and foreign exchange and money market developments. From FY1999 on, TA increased sharply and focused on three specific topics: tax policy and administration, banking sector supervision, and statistics. The bulk of TA was provided in the first two areas through resident or full-time peripatetic experts. Thus the reason for the large and stable increase in the volume of TA was the switch toward full-time experts who either remained in the field or kept visiting the country for several years.

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30 Based on interviews conducted by IEO with government officials and multilateral and bilateral TA providers in Tegucigalpa, Honduras between June 28 and July 2, 2004 and interviews with Bank and Fund staff in Washington, DC as well as internal Fund memoranda and communications and World Bank and IMF staff reports.

Table 1. Technical Assistance in Honduras
(In person days)\(^1\)

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Sources: OTM and TIMS.

1 For short-term experts (less than six months), and missions weekend days are included. For long-term experts weekend days are not included.
5. One question is why, despite a continuous series of IMF programs since the early 1990s incorporating significant fiscal and banking sector policy measures, the volume of TA during that early period was relatively low and sporadic, particularly in a country characterized by a low level of institutional capacity. In fact, the ex post assessment report explicitly refers to this lack of sufficient TA in the early 1990s. Early provision of TA on open market operations may have improved monetary management at a faster pace and resulted in a better inflation performance in the early 1990s. Early provision of TA by MFD in the area of banking sector supervision “might have helped to address sooner the lack of qualified staff in the newly formed banking commission, which was a factor cited as contributing to the initial slow progress in strengthening banking supervision.”

6. The issue is whether an earlier and more proactive stand by the IMF in offering TA in key reform areas that were simultaneously supported by programs may have been an appropriate strategy—particularly in dealing with a country with a low institutional capacity.

A. The FY1999–2003 Period

7. In order to address the policy slippages that emerged under the 1992–97 Enhanced Structural Adjustment Facility (ESAF) and build up a track record, the authorities agreed during 1997 on an IMF Staff Monitored Program. Although macroeconomic performance improved during the period, most of the structural reforms agreed under the program were not completed. These included specific steps to strengthen on-site supervision of banks and introduce consolidated supervision over financial groups.

8. During the 1998 Article IV discussions with the new government that assumed office early that year, the authorities stated their intention to move quickly toward a new ESAF to complete the long-overdue reforms on the structural front. Critical components of the new ESAF were to increase public savings to meet urgent social and infrastructural expenditures and accelerate reforms in the public sector and the financial sector. Improvements in tax administration were singled out as an important area in order to improve public savings.

9. Regarding the banking sector, the 1998 Article IV consultation explicitly recognized the need to quickly speed up actions in this area: “Enforcement of existing prudential regulations remains weak, and little progress has been made toward implementing consolidated supervision of financial groups, regulating connecting lending, conducting more frequent on site inspection, and putting in place contingency plans to deal with possible banking system problems” (Paragraph 31).

10. Program discussions, however, were interrupted by Hurricane Mitch at the end of 1998. A new ESAF/PRGF was then approved in March 1999 with a renewed commitment for structural reforms, especially in the areas of banking, pensions, civil service, and restructuring of the electricity and telecommunications sector.

11. The need for TA in banking supervision did not stem only from program needs but was also the result of an important institutional change that took place in 1996. This was the transfer of the banking supervisory function from the Central Bank to a newly created
independent agency, the National Commission of Banks and Insurance Companies (CNBS). In 1997, this move triggered an important piece of IMF TA in this area, aimed at providing a blueprint of actions to strengthen the overall institutional capacity of the Commission and identify further TA needs to facilitate their implementation.

12. At a later stage, a similar blueprint of policy reforms was developed in the area of tax policy and administration on the basis of an FAD mission that visited Honduras in 2000. The mission also provided a road map for further IMF TA in this area in order to assist in the implementation of such reforms.

13. Finally, some specific IMF TA activities in the area of statistics were developed during the period—particularly in the area of money and banking statistics, which was deemed to be important for an improved management of monetary policy and banking supervision activities.

14. These three main TA activities are analyzed, including views obtained from counterparts during a field visit to Honduras in June 2004.

B. Technical Assistance in the Area of Banking Supervision

15. In September 1997, a TA mission from MFD (then MAE) prepared a report entitled “Analysis of the Regulatory Framework of the Financial System and the Conditions of the Banking System” (in Spanish) so as to advise the newly created CNBS on steps to improve its supervisory function. The report provided specific recommendations and a plan of actions with priorities and time tables.

16. In April 1998, the President of the Central Bank of Honduras requested TA from the IMF with the specific purpose of assisting the Commission in implementing the work program outlined in the 1997 report. A peripatetic expert on an almost full-time basis started to visit Honduras in June 1999 with the purpose of advising the Commission and developing a training program. The specific terms of reference included:

- Procedures for a consolidated CAMEL type examinations (a framework for supervision that looked into capital, assets, management, equity, and liquidity), with a corresponding manual for examiners.

- Procedures for properly analyzing and monitoring insider-related lending.

- Administration of the examination process to include planning, internal controls, and work processes.

- A rating system for different components of bank operations and composite ratings for the financial institutions, and

- Training of personnel in all the above areas.
17. As work proceeded, some additional needs were identified, in particular the need for: (a) loan analysis procedures based on borrowers’ ability to repay, rather than the collateral pledge; (b) examination procedures to detect improprieties and irregular practices by bank personnel; (c) early warning systems; (d) consolidated examination procedures of the entire financial group; and (e) a properly structured off-site monitoring process.

18. The TA strategy and sequence described above was well conceived. TA started with an overall diagnostic report providing an analytical and implementation blueprint, followed by on-the-ground advice regarding the specifics of implementation, including training needs. This strategy was particularly appropriate when advising a newly created institution.

Adjustment to work program: Hurricane Mitch and crisis in the financial sector

19. The first stage of the work (July-September 1998), focusing on examination techniques, training and field testing work, was interrupted in October by Hurricane Mitch. The hurricane devastated the country and the Commission requested the expert to assist in assessing the damage created to the financial sector and especially to the insurance sector—the latter being severely hit.

20. As a result, the process of strengthening the examination process was placed on the back burner and the resident expert was put in charge of overseeing (with the cooperation of consultants from the World Bank) the examination of the loan portfolios of all 23 banks to assess the magnitude of the losses.

21. The massive review of loan portfolios during the first half of 1999—with the assistance of previously trained examiners—detected widespread and previously undisclosed problems. Most of these portfolio problems had developed for some time, irrespective of the hurricane. Particularly serious was the situation created by the trust departments (Fideicomisos) in an important bank, containing huge losses and insider-related abuses—a situation that also called for the expert’s advice.

22. In spite of this crisis-related demand on the expert’s time, progress was made in putting together the CAMEL-based examination system, although there was less time to proceed with the required training necessary to implement the new procedures. One question is whether an additional expert should have been brought in to assist during the crisis so as to allow the original expert to continue his longer-term work on supervision procedures and training.

Returning to the original terms of reference, 2000–01

23. In March 1999, a three-year ESAF arrangement was approved for Honduras. The Policy Framework Paper (PFP) matrix emphasized the need to accelerate institutional reform and, in the case of the financial sector, it singled out the need to (a) strengthen the technical capabilities of CNBS supervisors and examiners; and (b) implement prudential norms incorporating lending to related parties, risk-weighted capital, external debt, and open foreign exchange positions.
24. At the end of 1999, and as part of the renewal of the contract of the expert, TA activities returned to the original institution-building and training objectives. A brief report from the expert to the authorities stressed the need of compliance with the Basel Principles on Banking Supervision as the organizing principle of the TA activities. The report identified some critical areas on which the Commission had to focus, namely improving and using the database (risk center) derived from monitoring and examining banks and adopting a clear and uniform process to confront those banks not fulfilling prudential regulations. Further training and enhancement of the morale of the personnel of the Commission remained as important objectives.

25. The progress reports to headquarters during 2000 and 2001 showed in general a moderately good progress by the Commission in adopting some of the TA recommendations. The resident expert was successfully able to:

- create and implement the supervisory database;
- create and implement a program to fully utilize loan data from the Risk Center (Central de Riezgos);
- establish an off-site monitoring process, which included controls over data and reports;
- establish procedures to examine and analyze financial groups on a consolidated basis;
- continue on the job training to the examination and off-site monitoring; and
- provide advice to the personnel involved in liquidations and creations of loans.

26. There was a judgment that “given the present judicial structure, the commission had acted very responsibly in pursuing its regulatory responsibilities and corrective actions on the problems it has identified.” Areas where less progress was made included establishing an early warning system and improving the administrative controls on banks, particularly in comparing bank reports with data available from other sources.

27. In spite of the improved ability of the examiners to document the true state of the banks and the increased evidence of the weak situation of some of them, the major remaining problem was the weak authority of the Commission to impose criminal and civil penalties on those defrauding the financial institutions. The resident expert concluded that many of the corrective supervisory actions taken by the Commission had not yielded results because the judicial system had blocked these efforts. In fact, there were cases where the banks themselves used the judicial system to sue the Commission.
Progress as seen by the program reviews of the 1999–2001 PRGF arrangement

28. It is interesting to examine the consecutive mission reviews of the PRGF arrangement regarding progress in the supervision of the financial sector as well as overall financial sector performance.

- **Second review, March 2000.** The program of on-site examination of banks was resumed after the Bancorp crisis. Fifteen banks, including the weakest institutions, were examined with the support of the MAE expert in Tegucigalpa. The CNBS had also begun to supervise finance companies, stock exchange brokerage houses, and public pension funds. Several banks had capital adequacy ratios below requirements, but they showed some improving trends, partly a result of better capitalization and provisioning required by the CNBS.

- **Third review, August 2000.** The program of on-site inspections was completed as agreed in the IMF Letter of Intent. In spite of the efforts by the CNBS to prevent additional financial crisis by requiring high levels of reserves and capital, no major improvement had been observed—several institutions were still in critical conditions. By June 2000, the share of assets and banks with serious problems had increased compared with December 1999. Given the lack of progress in strengthening the financial system, the third review was not completed.

- **Fourth review, March 2001; negotiations for the third year of the PRGF, July 2001.** During the second year of the PRGF, most CNBS efforts were aimed at intensifying on-site supervision and increasing solvency of financial institutions. On-site inspections were extended to savings and loans associations and finance companies. Little progress was detected in the strength of the banking sector. Indeed, the fall in coffee prices and the increase in oil prices made that weakness even more critical. By the end of May, 22 banks had capital adequacy levels below those required by law, compared with three banks in December 2000.

It is important to note that during 2001 the resident expert had to again abandon his efforts to support overall supervision and the examination process and, at the request of the Commission, refocused his work on establishing procedures to deal with problem and insolvent banks, which had to be liquidated. This work became an urgent priority. In summary, throughout the period 1999–2001, the technical assistance effort fluctuated between institution-building activities aimed at enhancing the supervision capabilities of the Commission and advice on crisis management in connection with a series of closures and liquidations of insolvent banks.

- **Fifth review, May 2002.** In light of the persistent deterioration of two small insolvent banks, the authorities adopted measures to resolve bank failures. There were, however, three other institutions that showed signs of vulnerability. Consequently, the mission expressed concerns about the low level of provisioning of the system as a whole.
29. In early 2002, a new government came to power and the Commission changed management. With the agreement of the new management, the expert’s terms of reference were updated for the remainder of his appointment (until the end of the year). The terms of reference restored activities aimed at continuing on-the-job training for examiners and enhancing the off-site monitoring process, helping implement the manual of the CAMEL framework and continuing to assist the commission in developing an early warning system.

30. The new management of the Commission took forceful steps to accelerate improvements in supervision and compliance, and showed renewed interest in following up on the TA provided by the resident expert. For example, the manual for examiners, which followed the CAMEL framework, was updated and the board of the Commission adopted it formally, ensuring that deviations or noncompliance with it would lead to disciplinary action. The resident expert also prepared an analysis of the degree of compliance with the manual and the commission’s management and then issued a timetable to ensure that some corrective actions would be taken.

31. The end-of-assignment report by the resident expert, written in December 2002, made a striking comparison between the forcefulness of the new management of the Commission and the previous management in implementing and taking advantage of the TA provided. In fact it explicitly referred to the little interest the previous management of the Commission had in the follow up and implementation of that work. What is surprising is why this information was not explicitly reported to MFD earlier on.

32. Of late, the new management of the commission has taken some critical new initiatives. The commission has prepared three draft bills, on financial sector laws, banking sector laws, and deposit insurance, which are broadly consistent with the recommendations of more recent MFD TA activities. These draft bills cover issues regarding the banking-resolution framework and consolidated supervision. The bills are now with Congress. The commission has also issued regulations on capital adequacy, loan classification, and provisioning.

End-of-assignment report of resident expert

33. The end-of-assignment report of the resident expert covering the whole period from June 1998 to December 2002 is a particularly useful document from which to derive lessons. It summarizes well the challenges, it is candid in assessing problems, and it provides a clear road map for follow-up actions.

- The first issue is that the original terms of reference, which focused on medium-term capacity building and training in the supervision area, had to be abandoned and efforts had to switch to assist in crisis management as several banking crisis developed. The unprecedented review of an entire country’s loan portfolio revealed many previously undisclosed problems, including the illegal use of trust resources to fund personal wrongdoings.
These changes in the terms of reference put the resident expert in the midst of serious conflicting and judicial types of bank-resolution issues. The question arises whether this was a wise choice by headquarters and whether these activities should have been carried out by somebody else, in order to create some separation between medium-term institution building and short-term policy advice under crisis management.

The report is very candid in acknowledging the large differences in how different Commission managements were able to use effectively the TA provided, and the strong impact of the latest management in taking advantage of this TA. As a matter of fact, it acknowledged that many of the key TA activities were not implemented by the past Commission owing to lack of interest and cooperation by a subset of the management of the commission. The question arises, however, why these developments were not explicitly reported to MFD by the expert at that time. It would have been highly desirable if this could have been known earlier, particularly when MFD had to make decisions regarding the yearly renewal of the TA assistance provided during that period.

A major lesson is that it is critical for resident experts, resident representatives, and MFD staff to keep closely in touch and for these problems to be shared candidly and on time. MFD needs to be aware of such developments and to raise them at the highest level of government, if necessary.

The end-of-assignment report provided the new commission a very specific and candid assessment of what are the priorities for the future. In this respect, it is a good example of good practice.

C. Technical Assistance in the Area of Tax Administration

Background

34. In response to a request from the authorities for technical assistance in the area of tax policy and administration, a preparatory mission visited Honduras in December 2000 to define with the Minister of Finance, the major areas of this activity. It was agreed the upcoming diagnostic mission would start by assisting the authorities to develop a blue-print of reforms with clear priorities for implementation. The reforms would have four objectives: (a) promote economic growth by removing provisions that hindered economic efficiency; (b) reduce corruption by simplifying the tax system and eliminating privileges to some tax payers; (c) increase equity by eliminating exceptions and broadening the income tax base; and (d) improve the competitiveness of Honduras commodities and services through the adjustment of the VAT.

35. The diagnostic mission would include a work plan for the short run (2001) and longer term (2002 and beyond). Some of the reforms were to be implemented by the current administration during 2001 and some would be left to the new administration that would take office in early 2002.
36. The diagnostic mission visited Honduras in January 2001 and issued a comprehensive report (in Spanish) called “Proposals for the Reform of the Tax System and Tax Administration.” The report had two set of recommendations, one on tax policy reforms (Volume I) and the other on measures to improve tax administration (Volume II). The proposals were quite specific and clearly prioritized and provided a very good blueprint for specific actions.

37. On the tax policy side, most recommendations focused on the need to reduce the widespread use of tax exemptions, both to the VAT and to the income tax applicable to some type of earnings. It also recommended a reduction in the dispersion of import tariffs.

38. As far as tax administration, the report suggested a work program as follows:

- To establish, as first priority, an effective control of large taxpayers.
- To revamp current procedures for collecting taxes and renegotiate collection arrangements with banks.
- To redefine the tax return processing system. The present system had several weaknesses and produced low-quality voluntary compliance.
- To redefine audit procedures, focusing on selective cross-checking of information.
- To implement the ASYCUDA ++ system in all customs offices. This would require interconnecting all offices with telephone lines.
- To introduce a system to detect undervaluation of imports.
- To process customs duty payments using the same (new) system to process domestic tax payments.

39. The authorities felt particularly optimistic about the possibilities of starting the reforms on tax and customs administration and formally requested further TA from FAD in the form of a resident expert who could advise the revenue agency (DEI) on implementation.

Terms of reference

40. A resident expert was stationed in June 2001 in Honduras for a one-year assignment with the responsibility of also providing assistance to neighboring El Salvador in similar areas. Approximately two-thirds of the expert’s time was devoted to Honduras.

32 “Propuestas para la reforma del Sistema Tributario.”
41. The terms of reference for the expert were to focus on the eight priority areas described above by (a) providing technical assistance to the DEI; (b) identify realistic reforms that would specially take into account institutional capacity and resource constraints; (c) coordinate with the authorities and the Inter-American Development Bank’s own technical assistance project in similar areas; (d) promote links and understanding among the different agencies that were part of the overall effort; (e) advise if needed on necessary legislation; (f) advise on training and reallocations of local staff if needed; (g) advise in improving information systems; and (h) help identify additional consultants to work on specific areas if so requested by the authorities.

42. The terms of reference specified that, after a month of being in the field, and in consultation with local experts and IDB counterparts, a detailed work plan of activities was to be submitted by the expert to the IMF. This procedure was to allow the expert to better incorporate in the work plan local conditions that could not be fully foreseen from Washington.

**Tracking and feedback during project delivery**

43. The project had a good process for tracking progress during the period. About 11 interim reports (prepared every 2–3 months) provided information to HQ, and headquarters staff in turn provided detailed guidance. After the first year of operations, a supervisory mission visited Honduras in July 2002.

44. The new authorities, who came to power in early 2002 after some period of hesitation, eagerly endorsed the TA program. The SYCUDA ++ system was implemented in customs and procedures for processing tax returns and collecting taxes through banks were designed. However, three main problems remained:

(a) The system did not refund VAT to exporters but instead granted exporters certificates that exempted them ex ante from VAT on all their purchases. This mechanism tended to erode the VAT. (The supervisory mission requested the resident expert to prepare a document on this matter so as to include this topic in the work plan for the second year.)

(b) Significant difficulties in collecting tax arrears because the responsibilities for such collection were with the judiciary, not the DEI. This called for changes to the procedural tax law to expedite collection of arrears. This was judged to be a priority.

(c) The need for a more aggressive program in customs to curb smuggling and enhance collections. The mission recommended extending the work of the resident expert for an extra year based on a detailed work plan for this additional period.

45. A second supervisory mission visited Honduras in April 2003 to assess progress in implementing TA in this area. The management of the DEI had been working closely with the resident expert and had been supporting the implementation of reforms in the different areas. The supervision mission made a thorough assessment of progress in implementation in the several components of the TA activities.
46. Important progress was made in controlling large taxpayers’ compliance, modernizing the system of tax collection through banks and implementing payments and tax returns by electronic systems. Most of the steps in these areas have been implemented. What is crucial is to incorporate measures in the tax code so as to strengthen the enforcement capabilities of the DEI in these areas.

47. Less progress was made in the area of auditing of taxpayers, reforms to refund actual VAT payments to exporters, and, most important, measures to improve customs administration and reduce the undervaluation of imports. Modernization efforts in customs have not followed the recommendations of the TA provided by FAD.

48. The DEI authorities indicated their interest in addressing the remaining outstanding issues and they prepared a revised work plan in these areas to be supported by the resident expert. The mission recommended a further extension of the resident expert’s contract for another six months in order to carry out this work.

**Assessment of progress at the end of the TA activities**

49. In March 1994, a post-project assessment by FAD based on the resident expert’s final report, summarized the results to date in the different components of the TA that was provided:

i) **Putting together systems to control compliance among large and medium taxpayers**

50. A majority of measures envisaged in the work plan in this area have been, or are being, implemented. Starting in January 2003, large taxpayers have been required to file returns electronically through banks, and since November 2003 this has become mandatory for medium taxpayers. A new electronic tax system has been designed with three modules (registry, current account, and debt collection) and the current-account module was implemented in January 2004. It is estimated that by December 2003, about two-third of all large and medium taxpayers’ returns were being filed electronically.

ii) **Updating the taxpayer registry**

51. A new identification-number system was approved and the module of the new E-tax system will allow the registry to be continuously updated.

iii) **Controlling stop-filers and delinquent taxpayers and the auditing process**

52. During 2003, a provisional system was developed to control stop-filers drawing large taxpayers and the DEI has started to submit delinquent taxpayers to the judicial system. The DEI also began an audit program based on the VAT invoice cross-checking program.
iv) **Controlling the printing and issuing of VAT invoices**

53. In April 2003, a fiscal law approved creating a register of printers to control the issuance of fraudulent invoices and regulations are now in place. The resident expert prepared draft recommendations on how to implement the regulation.

v) **Improving the present process of refunding VAT exporters**

54. No progress has been made in this area.

vi) **Custom administration**

55. Modernization efforts in customs have not followed FAD recommendations and most measures in the work plan have not been carried out. The issue of how to handle the under-reporting of imports has not been addressed.

vii) **Amendments to the tax code**

56. There is an urgent need to incorporate measures that will enhance the ability of the DEI to enforce tax payments and impose penalties. The resident expert left several proposals in that direction.

**Too early to tell: enforcing the new enhanced institutional capacity of the DEI**

57. Except for the little progress in strengthening the system to collect customs revenues, most of the TA activities aimed at enhancing the institutional capabilities of the DEI have been implemented—and both the resident expert and the DEI authorities have collaborated well in that direction.

58. Whether the TA provided will achieve its ultimate objective—as stated in the four original objectives—will now depend heavily on that enhanced capability of the DEI being effectively implemented and enforced. Systems are now in place, the more politically difficult decisions that need to be taken following implementation now became crucial.

59. The speed and intensity in which the new system will be used for cross-checking of returns (for example, VAT vs. income-tax) and for an aggressive auditing of tax payers will become crucial. It will allow an enhanced identification of stop-filers and delinquent taxpayers, particularly large and medium ones. Strengthening the tax code so as to allow the DEI to enforce tax payments and penalties is also critical in allowing the DEI to use its new capabilities. It will also become important to control effectively the fraudulent issuance of VAT invoices, for example, and to implement the new regulations.
D. Technical Assistance in the Area of Statistics

60. The area of statistics was the third major area where the IMF provided TA during the period FY1999–2003, amounting to a little over 100 man days during the period. This TA was provided through a short-term TA mission to Honduras in the area of national accounts and monetary and financial statistics. The latter was the most important activity, especially in the mission that visited Honduras at the end of July 2002.

61. The purpose of the mission was to assess the progress achieved as a result of an earlier mission that visited Honduras in May 1998 and to advise the Central Bank on steps to develop a monthly money and banking statistics compilation system conforming to international standards. The objectives of the mission were to:

- Review the compilation of external assets and liabilities to clearly identify those items that should be included as international reserves.

- Review the compilation of domestic sector accounts to properly classify the components of the nonfinancial public sector (central government, local governments, decentralized agencies, and nonfinancial public enterprises), the financial sector (central bank, other depository corporations, and other financial intermediaries), and the private sector.

- Investigate the progress made in the system for reporting monetary and banking data to the Fund and, in particular, to make recommendations to reduce the delays in reporting data for the consolidated accounts of the banking system.

- Evaluate the data compiled for other financial intermediaries.

- Advise the authorities on how to overcome specific data shortcomings, such as the clear identification of government bonds given to the Central Bank for recapitalization and future debt relied under the Heavily Indebted Poor Countries (HIPC) Initiative.

- Assist the authorities in resolving any problems regarding the completion of the foreign reserves template and to investigate the timing and steps taken by the authorities to join the General Data Dissemination System (GDDS).

62. The findings and recommendation of the mission were written in a comprehensive report entitled “Report of the Mission on Statistics on Money and Banking,” August 2000 (in Spanish). The report made very clear recommendations for specific actions, specifying how implementation can be measured, a possible timetable for actions, and providing some commentary on the intermediate steps and external factors that were necessary to fulfill the timetable. All of these were summarized in a user-friendly “recommendations matrix.” This matrix could be considered as a best-practice way to summarize the findings and recommendations of a typical TA report.
In this particular case, the “recommendation matrix” was discussed as a draft with the authorities. Thus the intermediate steps and timetables were the product of a close consultation process with the authorities.

One issue that arises is whether such matrices should also discuss more explicitly the resource implications of implementing the recommendations. As discussed later, the resource implication of TA recommendations was a point raised repeatedly by counterparts in the evaluation team’s visit to the field. These concerns from the authorities should be elaborated in such matrices. In the case of improving statistical systems, the resource implications may become particularly important.

A short TA mission visited Honduras a year later (September 2001) in order to (a) assess the progress made in implementing the 2000 mission recommendations; (b) advise on establishing a fully integrated system of statistical information in the area of money and banking that would be able to fulfill the needs of domestic policy makers as well as external audiences. The mission report was able to track clearly how much progress was made regarding the 2000 recommendation and the reasons for delays. Again, the tracking format is ideal, allowing a clear identification of problem areas.

All in all, the Central Bank of Honduras has made progress in following STA recommendations in the area of money and banking. The only weak area has been slow progress in having a fully sectorized balance sheet for the depository corporations, which hampers information on public sector financing by level of government.

It is important to point out that STA has of late improved its country focus on TA by starting to prepare an annual Country Statistical Development Strategy. The strategy for Honduras, updated for May 2004, presents a clear diagnosis of the remaining problems in the statistical area, the views of area departments and local users on what improvements are needed, and coordination with donors. It is a welcome document that would help to identify priorities, track progress, and help link TA with other providers.

E. Views from Counterparts in the Field

During the last week of June 2004, part of the evaluation team visited Honduras to obtain feedback from the authorities and counterparts that worked with the TA experts. Discussions were also held with the IMF Resident Representative and representatives of donor agencies such as the IDB, USAID, and the World Bank.

- There is unanimity that in Honduras there is a scarcity of well trained professionals that limits the ability of public sector institutions to absorb TA. Public officials repeatedly mentioned how the low level of salaries and the constant rotation of personnel because of the electoral cycle (a large part of the technical cadre is replaced under each new administration) prevents building up a stable critical mass of professionals in the public sector agencies. This is a major constraint to absorbing TA. One suggestion was to synchronize better the delivery of TA with the political
cycle of the country. Focusing that delivery at the start of a new administration would at least assure a minimum stability of the personnel in the agency receiving TA.

- There was a unanimous view that both of the long-term experts working on banking supervision and tax administration made an outstanding contribution in their areas of expertise. There were considered almost model consultants: the counterparts valued their hands-on approach, their leadership qualities, and their abilities to coach and explain. They were considered ideal colleagues and at present are sorely missed. Many examples were given of the experts going beyond their term of reference in order to be helpful in the face of unforeseen problems.

- The need to improve further the coordination of TA among donors was raised several times—although it is clear that lately such coordination has improved significantly. The “G-7 network” with monthly meetings is an interesting initiative being pursued currently in Honduras. Several counterparts stressed the need to avoid receiving contradictory advice from the IFIs. On the other hand, some Hondurans heads of agency mentioned that coordination among donors is a problem only when the agency does not know what it wants. If the head of a local institution has a clear view of what the TA needs are, this will automatically provide guidance to donors about priorities and division of labor.

- Many counterparts acknowledged that the Fund is now given much more attention to supporting the implementation of the recommendations of TA reports. However, they stressed that much of the follow-up requires additional resources that are not available (in the case of statistics, for example, these needs are being financed by a new loan provided by the IDB). A suggestion was made to bundle IMF TA more often with a package of donor aid so as to be able to finance the implementation of TA recommendations. This would require a much closer synchronization with the work of other donors. It would also possibly require a stronger concentration of TA in some critical areas.

- Regarding short-term TA missions, some counterparts felt these missions often do not take sufficiently into account the inputs from the authorities when reaching their recommendations. The typical mission only presents its results at the end of their stay, leaving little room for comments. Suggestions were made about the need for mid-mission meetings, where the mission could “brainstorm” with local experts in order to enrich their conclusions and assure counterparts that they are taking into account some of the local conditions.

- Counterparts valued very much the efforts by the IMF to use experts with hands-on experience in similar countries.

- Counterparts recommended that experts should refrain from directly drafting pieces of legislation. In spite of good intentions, the language of that drafting may not be consistent with the local institutional context and may even be unconstitutional and
hence inapplicable. Experts should advise on strategy and content but not do the actual drafting themselves.

- A major issue raised in the areas of both banking supervision and tax administration are the constraints imposed by the legal framework and the judiciary, which limit the enforcement of policies by the relevant agencies and hence the possibilities of actually implementing TA. The legal system sets limits on enforcing actions on banks as a result of improved supervision, or enforcing payments of tax obligations and tax arrears after they have been detected by an improved tax administration agency.

- Many of the counterparts expressed strong preferences for having long-term consultants as the first stage of helping build the threshold of a minimum institutional capacity. They have more time to adapt their recommendations to the country’s reality and then to follow up on implementation. However, long-term experts should not stay on the job for more than two years; after that the possibility of conflict increases and the transfer of knowledge is reduced. Once a minimum institutional capacity threshold has been reached, the ideal modality is to have more short-term TA missions with a very specific objective.

F. Lessons

69. The following are some of the lessons that can be drawn from the TA provided to Honduras during the period studied.

Need for a more strategic and integrated process to identify TA priorities

70. Most of the TA activities during the period seem to have resulted from separate requests from specific heads of agencies, such as the Central Bank, Banking Commission, and Finance Ministry, or from specific operational needs such as that for a TA on public expenditure management in the context of the HIPC initiative. They do not seem to emerge from a more strategic and forward-looking process where the authorities and IMF staff have made cross sectoral comparisons of TA priorities linked to a medium-term reform program.

71. As a matter of fact, the only activities during the period that may have played that role were the Technical Assistance Consultations (TC) incorporated in the 2001 Article IV consultations. TCs were a response to an initiative aimed at better integrating surveillance with the prioritization of TA, to be first conducted in pilot groups of countries. The initiative was later discontinued because it was found by all parties to be a costly and not very effective instrument to identify future TA priorities.

72. An examination of the 2001 TC provides some light on why this exercise was not particularly useful. The reason is that it reads as a mechanical and pro forma exercise. It describes past TA activities and lists current request from the authorities, sector by sector, namely FAD, MFD, and STA. This information could have been derived directly from the functional departments’ documents. It does not reflect a process of “brainstorming” with the authorities where longer-term needs where discussed and priorities established. The TC does
not convey a sense that area departments have some type of TA strategy emanating from a medium-term policy framework that would allow comparing TA priorities across functional department lines. There is no surprise that the exercise was not found useful. The reason, however, is not that the overall idea was a priori not useful—the reason is that it was implemented half-heartedly with little enthusiasm by staff and lack of preparation so as to encourage the authorities to take a leading role in the exercise.

73. Of late, FAD and STA have been preparing country strategy notes that take a more strategic view of TA needs, such as the Honduras fiscal strategy (March 2003) and the country statistics strategy (January 2004). These are good initiatives to help identify priorities within departmental lines. However, these good practices are not a substitute for a process where TA needs and priorities can be identified across departmental lines and with a longer term horizon related to the overall development strategy of the country. This requires a much stronger preparation and involvement from the area department as well as from the authorities. For example, there is no sense on what should be the overall IMF TA strategy for Honduras for the next three years. And this is of concern given that Honduras is a PRGF country.

**TA has had a good impact in improving the institutional capacity and know-how of agencies.** The final impact will depend on these agencies acting and enforcing that capacity. These actions are sometimes politically difficult, requiring the support of higher authorities. TA consultants and headquarters staff need to report candidly if this becomes a major constraint.

74. In the areas of both banking supervision and tax administration important progress has been made in improving the know-how of the respective agencies, via exposure to best international practices, training, the development of manuals, and improved information technology. Thus there has been progress on what may be called the intermediate objectives of TA. The final impact will depend on agencies having the ability to act and enforce that capacity. During the period 1998–2002 studied there is some ex post evidence that in the area of banking supervision—where TA started in 1998—more could have been achieved in the actual enforcement of supervision if some of the authorities would have encouraged more actively those actions.

75. TA in the area of tax administration started much later, in June 2001. A new management took over the tax administration in mid-course. As reported earlier the final impact of the TA will depend critically in empowering the agency to act and enforce tax payments, including from politically well-connected taxpayers.

76. Experts and IMF Staff have not reported as explicitly and candidly as necessary those situations where political will has become the critical limitation hindering agencies from enforcing the new capacity. They act as if “rocking the boat is not welcomed” on the part of IMF management at headquarters. It is important for that management to explicitly encourage changes in such habits.
Lack of an effective judicial system as a constraint

77. The lack of an effective judicial system that would allow the banking supervisory functions and tax administration agency to enforce actions and penalties (if necessary) was raised by both counterparts and IMF experts. If this is well known at the outset of assistance, it calls for some complementary TA or reforms (if they can be implemented without the need of TA) on the judicial side that can be implemented simultaneously with the TA provided to the relevant agencies. Situations have to be avoided in which the judicial system allows government agencies to be sued as soon as they start to enforce their obligations. On these occasions, the IMF Legal Department should be consulted or involved. Why the Legal Department was not involved in TA in Honduras is a puzzle.

Lack of resources to implement some of the TA recommendations

78. This was a problem often raised in our visit to Honduras. If the effective implementation of specific TA will require resource commitments by the authorities, this will need to be discussed at the outset. It should be part of a written agreement with the authorities and will need to be part of the overall process of TA prioritization.

Excessive rotation of personnel in agencies a result of the electoral cycle

79. This problem was raised repeatedly by local experts and Honduran counterparts. It is an area which it is difficult to influence from the outside. The most that can be done is to obtain some commitments from the authorities, which will be binding on any new administration, that at least during the period of TA activities (particularly if they involve several years) some minimum stability of the technical personnel of agencies will be maintained. A more radical alternative in countries where such rotation is severe is to time TA so it can only start at the beginning of a particular administration.

Selection of experts able to coach and interact is critical

80. Everybody in the field praised the long-term experts who advise on banking supervision and tax administration. Not only did the Honduran counterparts praise their technical knowledge and experience, but they particularly welcomed their personality attributes that influenced their credibility and impact. They made an extra effort to interact, explain, and coach their counterparts, an effort highly appreciated by mid-level technical personnel in the agencies. They were also willing to advise in the case of emerging situations that were not explicitly provided for in their terms of reference, such as advising in handling crisis banks, helping negotiate agreements with commercial banks in implementing the electronic system in tax administration, and other instances. This consideration has important implications for the selection of experts by functional departments.

Improvement of coordination and communication among donors

81. In the case of Honduras such coordination and communication has improved significantly, including an active role of the resident representative, these developments
being acknowledged by all donors with whom we spoke. But this was less true during the period studied, particularly in the case of coordination between the IMF and the World Bank, where tensions arose in the field when both institutions advised on the state of bank portfolios as a result of Hurricane Mitch. Better and earlier coordination between the IMF and the IDB in the area of tax administration would also have helped to increase the complementarity of the work of the two institutions.

**A natural cycle of long-term and short-term TA**

82. When the Fund faces low levels of institutional capacity, the sequence of having first a major diagnostic study followed by a relative longer-term involvement of an expert to assist on the practical aspects of implementation seems to have worked well. This sequence can then be followed by short-term mission that can help in specific areas as implementation takes place in future follow-ups.

**More interaction of short-term missions with local authorities**

83. Local officials voiced the need for more interaction with short-term missions while they are in the field and before they finalize their recommendations. A “mid-course” brainstorming with the mission would avoid the authorities being confronted and surprised by the recommendations just before the mission returns to headquarters.
## LIST OF INDIVIDUALS INTERVIEWED

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<tr>
<th>Name</th>
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<tr>
<td>Lic. Jose Antonia Borjas</td>
<td>Director of Fiscal Studies</td>
<td>Central Bank of Honduras</td>
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<tr>
<td>Lic. Suyapa Cristina Funes</td>
<td>Director of the Economic Studies Department</td>
<td>Central Bank of Honduras</td>
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<tr>
<td>Maria Elena Mondragón</td>
<td>President</td>
<td>Central Bank of Honduras</td>
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<tr>
<td>Ana Cristina Mejia</td>
<td>President</td>
<td>CNBS</td>
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<td>Evasio Asencio</td>
<td>Advisor</td>
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<td>Jorge Castellanos</td>
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<td>Jose Castejon</td>
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<td>Lic. Mario Murillo</td>
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<td>Lic. German Padilla</td>
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<td>Ramon Martinez</td>
<td>Advisor</td>
<td>CNBS</td>
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<tr>
<td>Lic. Marlen Urtecho</td>
<td>Director</td>
<td>Customs Department</td>
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<tr>
<td>Cristobal Silva</td>
<td>Country Manager</td>
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<td>Ana Lucia Coronel</td>
<td>Resident Representative</td>
<td>IMF</td>
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<td>Lic. Feliciano Herrera</td>
<td>Director of UNAT</td>
<td>Ministry of Finance</td>
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<tr>
<td>Dolores Castro</td>
<td>Advisor</td>
<td>Tax Collecting Agency</td>
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<td>Dr. Ernesto Collinndes</td>
<td>Legal Department</td>
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<td>Lic. Arturo Gomez</td>
<td>Advisor</td>
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