

Public Disclosure Authorized

CONFORMED COPY

CREDIT NUMBER 3826-HO

Development Credit Agreement

(Trade Facilitation and Productivity Improvement Project)

between

REPUBLIC OF HONDURAS

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated January 27, 2004

Public Disclosure Authorized

CREDIT NUMBER 3826-HO

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated January 27, 2004, between the REPUBLIC OF HONDURAS (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the project described in Schedule 2 to this Agreement (the Project), has requested the Association to assist in the financing of the Project;

WHEREAS (B) the Project will be carried out by FIDE (as defined below) with the Borrower's assistance and, as part of such assistance, the Borrower will make the proceeds of the credit provided for in Article II of this Agreement (the Credit) available to FIDE, as set forth in this Agreement; and

WHEREAS (C) the Association has agreed, on the basis, *inter alia*, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement and in the agreement of even date herewith between the Association and FIDE (the Project Agreement);

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Development Credit Agreements" of the Association, dated January 1, 1985 (as amended through October 6, 1999) (the General Conditions), constitute an integral part of this Agreement.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) "CITES" means *Centros de Innovación Tecnológica*, the Borrower's centers for technological innovation;

(b) "CITES-Artesanía" means the CITES for the craft sector;

- (c) “CITEs-*Mueble*” means the CITEs for the wood and furniture sectors;
- (d) “CITEX” means the CITEs for the textile sector;
- (e) “CNCM” means *Consejo Nacional de Calidad y Metrología*, the National Quality Council to be established by the Borrower pursuant to Part B.3 (a) of the Project;
- (f) “CPME” means *Comisión para la Modernización del Estado*, the Borrower’s Commission for the Modernization of the State established by SEDP and referred to in the SEDP Implementation Agreement;
- (g) “CSAE” means *Comité de Simplificación Administrativa para Empresas*, the Committee for Simplification of Administrative Barriers to Business to be established by SEDP pursuant to the SEDP Implementation Agreement;
- (h) “FIDE” means *Fundación para la Inversión y Desarrollo de las Exportaciones*, a private foundation established pursuant to Presidential resolution number 47 issued on March 21, 1984 with the former name of *Fundación para la Investigación y Desarrollo Empresarial*, and renamed in Presidential resolution number 64-88 issued on June 23, 1986 and published in the Borrower’s Official Gazette on August 15, 1986;
- (i) “FMR” means each report prepared in accordance with Section 3.02 of the Project Agreement;
- (j) “General Operational Manual” means the manual referred to in Section 2.01 (b) of the Project Agreement;
- (k) “INFOP” means *Instituto de Formación Profesional*, the Borrower’s largest public training institute;
- (l) “IPCDC” means the Borrower’s *Instituto para la Promoción de la Competencia y la Defensa del Consumidor*, the Competition and Consumer Protection Agency created to comply with the condition set forth in paragraph 3 (b) of Schedule 1 to this Agreement;
- (m) “Matching Grants Operational Manual” means the manual referred to in Section 2.01 (c) of the Project Agreement;

- (n) “MSMEs” means micro, small and medium enterprises;
- (o) “PCU” means the project coordination unit referred to in Section 2.08 of the Project Agreement;
- (p) “Project Agreement” means the agreement, regarding the Project, between the Association and FIDE of even date herewith, as the same may be amended from time to time, and such term includes all schedules and agreements supplemental to the Project Agreement;
- (q) “Project Preparation Advance” means the project preparation advance granted by the Association to the Borrower pursuant to the letter agreement signed on behalf of the Association on May 9, 2003 and on behalf of the Borrower on October 3, 2003;
- (r) “SEDP” means *Secretaría de Estado en el Despacho de la Presidencia de la República*, the Borrower’s Office of the President;
- (s) “SEDP Implementation Agreement” means the Agreement referred to in Section 2.05 (a) (ii) of the Project Agreement;
- (t) “SEFIN” means *Secretaría de Estado en el Despacho de Finanzas*, the Borrower’s Ministry of Finance;
- (u) “SEGJ” means *Secretaría de Estado en el Despacho de Gobernación y Justicia*, the Borrower’s Ministry of Interior and Justice;
- (v) “SEGJ Implementation Agreement” means the Agreement referred to in Section 2.05 (a) (iv) of the Project Agreement;
- (w) “Selected Pilot Areas” means the four locations that have been selected in accordance with the criteria set forth in the General Operational Manual for the execution of Part D of the Project;
- (x) “SIC” means *Secretaría de Estado en los Despachos de Industria y Comercio*, the Borrower’s Ministry of Industry and Commerce;
- (y) “SIC Implementation Agreement” means the Agreement referred to in Section 2.05 (a) (i) of the Project Agreement;

(z) “Special Account” means the account referred to in Section 2.02(b) of this Agreement;

(aa) “STSS” means *Secretaría de Estado en los Despachos de Trabajo y Seguridad Social*, the Borrower’s Ministry of Labor;

(ab) “STSS Implementation Agreement” means the Agreement referred to in Section 2.05 (a) (iii) of the Project Agreement;

(ac) “Subsidiary Agreement” means the agreement to be entered into between the Borrower and FIDE pursuant to Section 3.01 (b) of this Agreement, as the same may be amended from time to time, and such term includes all schedules to the Subsidiary Agreement;

(ad) “Type A Eligible Entity” means a government office of the Borrower that has been selected following the criteria set forth in the Matching Grants Operational Manual for Type A Matching Grants (as defined in paragraph 2 of Schedule 1 to this Agreement) to undertake the reforms identified by CSAE under Part A.2 (c) of the Project;

(ae) “Type A Matching Grant Agreement” means an agreement between a Type A Eligible Entity and FIDE referred to in Section 2.06 (a) of the Project Agreement for the execution of Part A.2 (d) of the Project;

(af) “Type B.1 Eligible Entity” means an entity that has been selected following the criteria set forth in the Matching Grants Operational Manual for Type B.1 Matching Grants (as defined in paragraph 2 of Schedule 1 to this Agreement) for the execution of Part B.1 (b) of the Project;

(ag) “Type B.1 Matching Grant Agreement” means an agreement between a Type B.1 Eligible Entity and FIDE referred to in Section 2.06 (b) of the Project Agreement for the execution of Part B.1 (b) of the Project;

(ah) “Type B.3 Eligible Entity” means a laboratory or MSME that has been selected following the criteria set forth in the Matching Grants Operational Manual for Type B.3 Matching Grants (as defined in paragraph 2 of Schedule 1 to this Agreement) for the execution of Part B.3 (d) of the Project;

(ai) “Type B.3 Matching Grant Agreement” means an agreement between a Type B.3 Eligible Entity and FIDE referred to in Section 2.06 (c) of the Project Agreement for the execution of Part B.3 (d) of the Project;

(aj) “Type C Eligible Entity” means an entity that has been selected following the criteria set forth in the Matching Grants Operational Manual for Type C Matching Grants (as defined in paragraph 2 of Schedule 1 to this Agreement) for the execution of Part C.5 of the Project; and

(ak) “Type C Matching Grant Agreement” means an agreement between a Type C Eligible Entity and FIDE referred to in Section 2.06 (d) of the Project Agreement for the execution of Part C.5 of the Project.

Section 1.03. Each reference in the General Conditions to the Project implementation entity shall be deemed as a reference to FIDE.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to twenty million five hundred thousand Special Drawing Rights (SDR 20,500,000).

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods, works and services required for the Project and to be financed out of the proceeds of the Credit.

(b) The Borrower may, for the purposes of the Project, open and maintain in Dollars a separate special deposit account in its Central Bank on terms and conditions satisfactory to the Association. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 3 to this Agreement.

(c) Promptly after the Effective Date, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and pay to itself the amount required to repay the principal amount of the Project Preparation Advance withdrawn and outstanding as of such date and to pay all unpaid charges thereon. The unwithdrawn balance of the authorized amount of the Project Preparation Advance shall thereupon be canceled.

Section 2.03. The Closing Date shall be September 30, 2008 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on March 15 and September 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each March 15 and September 15 commencing March 15, 2014 and ending September 15, 2043. Each installment to and including the installment payable on September 15, 2023 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for

Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

- (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and
- (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, without any limitation or restriction upon any of its other obligations under the Development Credit

Agreement, shall cause FIDE (with the cooperation of SEDP, SIC, STSS and SEGJ) to perform in accordance with the provisions of the Project Agreement, the SEDP Implementation Agreement, the SIC Implementation Agreement, the STSS Implementation Agreement, and the SEGJ Implementation Agreement all the obligations of FIDE therein set forth, shall take and cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable FIDE to perform such obligations, and shall not take or permit to be taken any action which would prevent or interfere with such performance.

(b) The Borrower shall transfer, on a grant basis, the proceeds of the Credit to FIDE under a subsidiary agreement to be entered into between the Borrower and FIDE, under terms and conditions which shall have been approved by the Association.

(c) The Borrower shall exercise its rights and carry out its obligations under the Subsidiary Agreement in such manner as to protect the interests of the Borrower and the Association and to accomplish the purposes of the Credit, and, except as the Association shall otherwise agree, the Borrower shall not assign, amend, abrogate, repeal, terminate, waive or fail to enforce the Subsidiary Agreement or any provision thereof.

(d) In case of discrepancy between the provisions of the Development Credit Agreement and the Subsidiary Agreement or between the Project Agreement and the Subsidiary Agreement, the provisions of the Development Credit Agreement and the Project Agreement shall prevail.

Section 3.02. Except as the Association shall otherwise agree, procurement of the goods, works and services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 1 to the Project Agreement.

Section 3.03. The Borrower and the Association hereby agree that the obligations set forth in Sections 9.03, 9.04, 9.05, 9.06, 9.07 and 9.08 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) shall be carried out by FIDE pursuant to Section 2.03 of the Project Agreement.

Section 3.04. The Borrower shall participate in the reviews referred to in Section 2.11 (c) of the Project Agreement.

Section 3.05. (a) Without limitation to the provisions of Section 3.01 of this Agreement, the Borrower shall:

- (i) through SIC, enter into the SIC Implementation Agreement with FIDE;
 - (ii) through SEDP, enter into the SEDP Implementation Agreement with FIDE;
 - (iii) through STSS, enter into the STSS Implementation Agreement with FIDE; and
 - (iv) through SEGJ, enter into the SEGJ Implementation Agreement with FIDE.
- (b) (i) The Borrower (through SIC, SEDP, STSS and SEGJ, respectively) shall exercise its rights and carry out its obligations under the SIC Implementation Agreement, the SEDP Implementation Agreement, the STSS Implementation Agreement and the SEGJ Implementation Agreement in a manner as to protect the interests of the Borrower and the Association and to accomplish the purposes of the Credit; and
- (ii) except as the Association shall otherwise agree, the Borrower shall not assign, amend, abrogate, repeal, terminate, waive or fail to enforce the SIC Implementation Agreement, the SEDP Implementation Agreement, the STSS Implementation Agreement and the SEGJ Implementation Agreement or any provisions thereof.

Section 3.06. The Borrower shall ensure that no recipient of severance payments under Part A.3 (b) of the Project be rehired within the Borrower's port sector for a minimum period of five years after receipt of the payments.

Section 3.07. The Borrower shall, no later than June 30, 2004, establish and thereafter maintain the CNCM in a manner satisfactory to the Association.

Section 3.08. The Borrower shall, no later than June 30, 2004, establish and thereafter maintain an integrated transport regulatory agency that is satisfactory to the Association.

Section 3.09. The Borrower shall ensure that the actions to be undertaken by FIDE and the Borrower as a result of carrying out the Project shall not violate or contradict any provisions set forth in international trade agreements to which the Borrower is a party and that have been ratified by the Borrower's Congress.

Section 3.10. The Borrower shall, no later than June 30, 2004, define and implement a financing mechanism that is satisfactory to the Association, for FIDE's investment promotion strategy under Part B.2 (a) of the Project.

Section 3.11. After fulfillment of the condition referred to in paragraph 3 (d) of Schedule 1 to this Agreement, the Borrower shall carry out the severance payment plan referred to therein in accordance with its terms.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall maintain a financial management system, including records and accounts, and prepare financial statements, all in accordance with consistently applied accounting standards acceptable to the Association, adequate to reflect its operations, resources and expenditures related to the Project.

- (b) The Borrower shall:
 - (i) have the financial statements referred to in paragraph (a) of this Section for each fiscal year (or other period agreed to by the Association) commencing with the fiscal year in which the first withdrawal under the Project Preparation Advance was made, audited, in accordance with consistently applied auditing standards acceptable to the Association, by independent auditors acceptable to the Association;
 - (ii) furnish to the Association as soon as available, but in any case not later than four months after the end of each such year (or such other period agreed to by the Association), (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or such other period agreed to by the Association), as so audited, and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Association; and
 - (iii) furnish to the Association such other information concerning such records, accounts and the audit of such financial statements, and concerning said auditors, as the Association may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of statements of expenditure, the Borrower shall:

- (i) ensure that all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures are retained until at least one year after the Association has received the audit report for, or covering, the fiscal year in which the last withdrawal from the Credit Account was made;
- (ii) enable the Association's representatives to examine such records; and
- (iii) ensure that such statements of expenditure are included in any audit that the Association may have requested pursuant to paragraph (b) of this Section.

ARTICLE V

Remedies of the Association

Section 5.01. Pursuant to Section 6.02 (l) of the General Conditions, the following additional events are specified:

(a) FIDE shall have failed to perform any of its obligations under the Project Agreement.

(b) As a result of events which have occurred after the date of the Development Credit Agreement, an extraordinary situation shall have arisen which shall make it improbable that FIDE will be able to perform its obligations under the Project Agreement.

Section 5.02. Pursuant to Section 7.01 (h) of the General Conditions, the following additional event is specified, namely, that the event specified in paragraph (a) of Section 5.01 of this Agreement shall occur and shall continue for a period of sixty days after notice thereof shall have been given by the Association to the Borrower.

ARTICLE VI

Effective Date; Termination

Section 6.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions:

(a) that the Subsidiary Agreement has been executed on behalf of the Borrower and FIDE;

(b) that the SEDP Implementation Agreement, the SIC Implementation Agreement, the STSS Implementation Agreement and the SEGJ Implementation Agreement have been executed on behalf of the Borrower (through SEDP, SIC, STSS, and SEGJ respectively) and FIDE;

(c) that the General Operational Manual and the Matching Grants Operational Manual have been approved by FIDE and the Association;

(d) that the PCU has been established with staffing (including a general Project coordinator, the head of administration and finance, an operations manager, a Project accountant/disbursement specialist and a procurement officer), organizational systems (including a financial management system), funds, facilities and other resources in a manner satisfactory to the Association;

(e) that the auditors referred to in Section 3.01 of the Project Agreement have been appointed;

(f) that the CSAE has been established; and

(g) that a procurement plan for Project implementation, including, but not limited to, a detailed plan for the first year of Project implementation, has been prepared by FIDE and approved by the Association.

Section 6.02. The following are specified as additional matters, within the meaning of Section 12.02 (b) of the General Conditions, to be included in the opinion or opinions to be furnished to the Association:

(a) that the Project Agreement has been duly authorized or ratified by FIDE, and is legally binding upon FIDE in accordance with its terms;

(b) that the Subsidiary Agreement has been duly authorized or ratified by the Borrower and FIDE and is legally binding upon the Borrower and FIDE in accordance with its terms; and

(c) that the SEDP Implementation Agreement, the SIC Implementation Agreement, the STSS Implementation Agreement and the SEGJ Implementation Agreement have been duly authorized or ratified by the Borrower (through SEDP, SIC, STSS and SEGJ respectively) and FIDE and are legally binding upon the Borrower and FIDE in accordance with their respective terms.

Section 6.03. The date April 27, 2004 is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. The Secretary of SEFIN is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Secretaría de Estado en el Despacho de Finanzas
Tegucigalpa, M.D.C.
Honduras

Cable address:

HACIENDA
Tegucigalpa

Facsimile:

(504) 237-4142

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

Telex:

Facsimile:

INDEVAS
Washington, D.C.

248423 (MCI) or
64145 (MCI)

(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Tegucigalpa, Honduras, as of the day and year first above written.

REPUBLIC OF HONDURAS

By /s/ Arturo Alvarado

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Joseph Owen

Authorized Representative

HONORARY WITNESS ON BEHALF OF
THE REPUBLIC OF HONDURAS

/s/ Ricardo Maduro
President of the Republic of Honduras

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(1) Works	530,000	88%
(2) Goods (except those covered in Categories 6-10 below)		
(a) under Part A.1(c) of the Project	300,000	88%
(b) under Part A.3 (c) of the Project	1,460,000	88%
(c) other	1,100,000	88%
(3) Consultants' Services (except those covered in Categories 7-10 below)		
(a) under Part A.1 (c) of the Project	270,000	85%
(b) under Part A.3 (c) of the Project	40,000	85%
(c) for Audits	60,000	85%
(d) other	7,430,000	85%

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(4) Communication Services	1,550,000	100% of foreign expenditures and 88% of local expenditures
(5) Training/Workshops (except those covered in Categories 7-10 below)		
(a) under Part A.1(c) of the Project	220,000	89%
(b) other	490,000	89%
(6) Incremental operating costs (except those covered in Categories 7-10 below)	350,000	90% until disbursements under this Category have reached an aggregate amount equivalent to SDR180,000; 60% until disbursements under this Category have reached an aggregate amount equivalent to SDR280,000; and 30% thereafter
(7) Type A Grants	750,000	100%
(8) Type B.1 Grants	590,000	100%
(9) Type B.3 Grants	500,000	100%
(10) Type C Grants	730,000	100%

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(11) Severance Payments under Part A.3 (b) of the Project	1,820,000	100%
(12) Certification costs under Part B.3 (c) (ii) and Accreditation Costs under Part C.4 (b) of the Project	170,000	85%
(13) Refunding of Project Preparation Advance	1,260,000	Amount due pursuant to Section 2.02 (c) of this Agreement
(14) Unallocated	880,000	
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TOTAL	20,500,000	
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2. For the purposes of this Schedule:

(a) the term “communication services” means expenditures for radio and television advertisements incurred by the Borrower in connection with the carrying out of the communication strategy under Parts B.2 and E of the Project;

(b) the term “foreign expenditures” means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower;

(c) the term “incremental operating costs” means reasonable expenditures which would not have been incurred absent the Project, for the maintenance and leasing of vehicles and equipment, for fuel, office supplies and other consumables, rental of facilities, salaries of incremental PCU staff, utilities, travel, transportation and accommodations;

(d) the term “local expenditures” means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;

(e) the term “training/workshops” includes only: (i) reasonable travel, room, board and *per diem* expenditures incurred by trainers and trainees in connection with their training, by non-consultant training facilitators, and by non-consultant workshop participants and facilitators; (ii) course fees; (iii) training/workshop facility and equipment rentals; and (iv) expenses for the preparation, acquisition, reproduction and distribution of training/workshop materials not otherwise covered under this paragraph;

(f) the term “Type A Matching Grants” means amounts for goods, services, training and incremental operating costs under Part A.2 (d) of the Project, financed through the Type A Matching Grant Agreements referred to in Section 2.06 (a) of the Project Agreement;

(g) the term “Type B.1 Matching Grants” means amounts for goods, services, training and incremental operating costs under Part B.1 (b) of the Project, financed through the Type B.1 Matching Grant Agreements referred to in Section 2.06 (b) of the Project Agreement;

(h) the term “Type B.3 Matching Grants” means amounts for goods, services, training and incremental operating costs under Part B.3 (d) of the Project, financed through the Type B.3 Matching Grant Agreements referred to in Section 2.06 (c) of the Project Agreement; and

(i) the term “Type C Matching Grants” means amounts for goods, services, training and incremental operating costs under Part C.5 of the Project, financed through Type C Matching Grant Agreements referred to in Section 2.06 (d) of the Project Agreement.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of:

(a) payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding the equivalent of SDR one million (SDR 1,000,000), may be made on account of payments made for expenditures before that date but after May 18, 2003 (but in no case incurred earlier than the twelve months immediately before the date of this Agreement);

(b) payments for expenditures covered by disbursement categories 2 (a), 3 (a) and 5 (a) set forth in the table in paragraph 1 of this Schedule, unless a competition and consumer protection agency (the IPCDC) has been established by the Borrower in a manner that is satisfactory to the Association;

(c) payments for expenditures covered by disbursement categories 2 (b) and 3 (b) set forth in the table in paragraph 1 of this Schedule, unless: (i) the Borrower has issued and put into effect the necessary norms, satisfactory to the Association, to (A) grant to the different entities operating in the port sub-sector the power to implement the Borrower's port security program; and (B) regulate the operation of ports by private sector concessionaires; and (ii) the Association has received a legal opinion satisfactory to the Association, of counsel satisfactory to the Association, to the effect that the norms referred to in (i) above are valid and enforceable in Honduras; and

(d) payments for expenditures covered by disbursement category 11 set forth in the table in paragraph 1 of this Schedule, unless the Borrower has approved the severance payment plan for *Puerto Cortés* to be financed under Part A.3 (b) of the Project that is satisfactory to the Association, such plan to include, *inter alia*: (i) the total cost of the severance program; (ii) the planned distribution of funds; (iii) the plan's implementation schedule; (iv) the commitment of Borrower resources (as needed and in addition to the funds provided under this Agreement) to implement the program; (v) the eligibility criteria and limits of benefits for recipients of severance payments; (vi) a worker retraining program; and (vii) a strategy for publicizing the results of studies on the alternative employment found by retrenched, and to make data publicly available on changes in staff employment totals.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures for: (a) contracts for works estimated to cost less than \$1,500,000 equivalent each with the exception of the first two contracts awarded in accordance with each of the procedures referred to in Part C of Schedule 1 to the Project Agreement; (b) contracts for goods estimated to cost less than \$150,000 equivalent each with the exception of the first two contracts awarded in accordance with each of the procedures referred to in Part C of Schedule 1 to the Project Agreement; (c) contracts for the employment of consulting firms estimated to cost less than \$50,000 each; (d) contracts for the employment of individual consultants estimated to cost less than \$25,000 each; (e) training/workshops; (f) incremental operating costs; and (g) severance payments, all under such terms and conditions as the Association shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objective of the Project is to improve the Borrower's investment climate and local firms' capacity to export in order to prepare the Borrower to benefit from trade opportunities under existing and new trade promotion agreements by: (a) supporting policy and legal reforms; (b) strengthening existing institutions and creating new institutions to improve competitiveness; (c) providing advisory services and financial support to MSMEs and to firms operating in the most dynamic local industries to facilitate access to export markets and productivity improvements; (d) financing small scale initiatives to improve productivity of selected areas by upgrading local infrastructure, promoting business innovation and use of technology; and (e) increasing MSMEs' access to training and advisory services.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objectives:

Part A: Investment Climate

1. Reducing firms' anti-competitive behavior and improving consumer protection through:

(a) the provision of technical assistance to draft a competition law for the Borrower and the carrying out of workshops to help build consensus with regard to said law;

(b) the provision of technical assistance to design the administrative structure of the IPCDC in accordance with the competition law mentioned in 1 (a) above and other applicable laws; and

(c) the strengthening of the IPCDC through: (i) the acquisition of equipment; (ii) advisory services on topics related to competition policy and consumer protection; (iii) the provision of training to local and international staff on competition and consumer protection policy; (iv) the carrying out of a communications campaign on competition policy and consumer protection; and (v) the preparation of a work plan and an evaluation report for the first two and a half years of operation of the IPCDC.

2. Reducing administrative procedures in the Borrower's territory to start and operate a business and to export through:

- (a) the carrying out of evaluation studies and focus groups to assess key barriers to business registration, export and operation;
- (b) the establishment of the CSAE with functions and responsibilities satisfactory to the Association, including, *inter alia*, the responsibility to initiate reform efforts in various government agencies of the Borrower;
- (c) the provision of technical assistance to CSAE to: (i) identify areas in need of administrative reform; (ii) solicit the interest of the government offices responsible for these areas; and (iii) assist the redesign and implementation of new procedures in Type A Eligible Entities;
- (d) the provision of goods, services, training and incremental operating costs to support process re-engineering in Type A Eligible Entities (through Type A Matching Grant Agreements);
- (e) the acquisition of scanning equipment, imaging systems and consulting services to support imaging and land property registration by the Borrower; and
- (f) the carrying out of workshops and seminars related to simplification of business procedures in close coordination with the overall communication campaigns under Part E of the Project.

3. Improving quality and reducing costs of infrastructure and logistics in the Borrower's territory through:

- (a) the provision of advisory services and training to facilitate the establishment and operation of the Borrower's National Port Authority, in accordance with the Borrower's applicable law (*Ley General de Puertos*);
- (b) the making of severance payments to facilitate the concessioning of the *Puerto Cortés* port;
- (c) the provision of technical assistance and equipment to improve the security systems of the *Puerto Cortés* port;
- (d) the provision of technical assistance and training for the creation of a transport regulatory agency to manage the overall transport sector of the Borrower, including, but not limited to, technical assistance for the drafting of a law that will provide the legal framework for the creation of such entity (*Ley para la Creación del Ente Regulador del Sector Transporte*); and

(e) the carrying out of studies on the efficiency of the Borrower's distribution chain and on the needs to concession other ports in the Borrower's territory.

Part B: Promoting Private Sector Innovation

1. Creating and supporting CITEs for the wood, craft and textile sectors through:

(a) (i) the carrying out of sector analyses; (ii) the provision of facilities, equipment, training, services and promotional activities; and (iii) the design of quality labels, for the CITEs-Mueble, the CITEs Artesanía and the CITEs; and

(b) the provision of goods, services, training and incremental operating costs services by the CITEs to Type B.1 Eligible Entities (through Type B.1 Matching Grant Agreements).

2. Promoting higher value foreign direct investment in the Borrower's territory through:

(a) the development and implementation of a national investment promotion strategy, including: (i) the carrying out of sector studies to identify strategic sub-sectors where the Borrower has a competitive advantage to promote foreign-direct investment in the short and medium term, (ii) the development of a business plan based on said studies, and (iii) the execution of the national investment promotion strategy through guided promotional campaigns and guided missions to fairs and sector shows;

(b) image building of the Borrower within the international business community, including: (i) the carrying out of an investor perception survey; (ii) the design of a communications campaign directed at potential investors within the international business community; and (iii) the execution of the communications campaign in 2 (b) (ii) above over a two-year period;

(c) the design of an industrial sector diversification program in free zones and industrial parks that is consistent with any international trade agreements to which the Borrower is a party and that have been ratified by the Borrower's Congress, including: (i) the carrying out of a market demand survey in North America to estimate the potential demand for free zone space in each of the priority sectors for diversification and for each main region, (ii) the carrying out of expert studies to determine the type of free zone products and services required by foreign direct investment, and (iii) the development of a strategy to promote investor group use of such zones;

(d) the design and implementation of a linkage development program, including: (i) the carrying out of a study to identify sectors with high potential for linkages between large foreign firms and local MSMEs, and the local companies within those sectors that are likely partners for foreign investors installed in the Borrower's territory; (ii) capacity building and provision of informational resources to firms

previously identified as having potential to become suppliers of goods and services to foreign investors; and (iii) the establishment of a forum where linkage partners can associate after meeting minimum qualification standards for their sector; and

(e) the design and implementation of a foreign direct investment monitoring and evaluation program.

3. Developing and implementing a national quality system in the Borrower's territory through:

(a) the establishment of a national quality council (the CNCM) and an accreditation authority;

(b) provision of training and advisory services to improve the quality of private and public laboratories in the Borrower's territory;

(c) (i) the provision of training and advisory services to introduce quality and environmental systems in MSMEs; and (ii) the quality certification of MSMEs;

(d) the provision of goods, services, training and incremental operating costs to Type B.3 Eligible Entities (through type B.3 Matching Grant Agreements) for capacity building of laboratories in the Borrower's territory in support of the national quality system and to assist the introduction of quality and/or environmental management systems in MSMEs;

(e) promotional initiatives targeted to the owners and the chief executive officers of MSMEs and to upper and mid-level management of public agencies, to raise their awareness of the importance of quality; and

(f) the improvement of the Borrower's national quality system information service.

Part C: Improving Skills of Labor Force

1. Carrying out of a review of the structure and quality of existing public and private training institutions in the Borrower's territory, including without limitation an in-depth study of INFOP.

2. (a) Carrying out of a survey of training policies and incentives used in foreign countries; (b) carrying out of a review of the Borrower's existing laws and regulations concerning training and development of proposals to improve said laws and regulations; and (c) provision of support to build consensus on the importance of modifying the training legal framework.

3. Provision of equipment, training and technical assistance to reorganize INFOP and to upgrade the quality of its training.

4. (a) Development of standards and curriculum accreditation to certify private firms that provide training in areas related to private sector development and competitiveness, through the provision of training, equipment and consulting services; and (b) certification of said private firms.
5. Provision of goods, services, training and incremental operating costs to develop in-house training in Type C Eligible Entities (through Type C Matching Grant Agreements).
6. Carrying out of an information campaign to promote awareness of the benefits of training and to strengthen the capacity of enterprises to identify the specific work skills they need, with particular emphasis on raising the awareness of the importance of training among MSMEs.

Part D: Local Competitiveness: Improving Economic Development in Selected Pilot Areas

1. Preparation of local competitiveness and economic development plans in Selected Pilot Areas through:
 - (a) the organization of workshops and other consultation processes to develop an understanding and consensus of the potentials, obstacles and solutions required to improve the competitiveness and business development in the Selected Pilot Areas;
 - (b) the preparation of a comprehensive vision and an annual action plan for local competitiveness in each Selected Pilot Area;
 - (c) annual reviews of said competitiveness plans and development of action plans for the following year; and
 - (d) the provision of advisory services to address the Borrower's municipal environmental issues in one of the Selected Pilot Areas.
2. Improvement of quality and sustainability of local infrastructure services in the Selected Pilot Areas, through:
 - (a) the carrying out of local infrastructure assessments to evaluate the quality of existing infrastructure services and their contribution for local economic development;
 - (b) the carrying out of studies to support the creation of public-private partnerships to more effectively plan, finance and deliver locally-managed public services; and

(c) the carrying out of feasibility studies and minor works in one of the Selected Pilot Areas approved by the Association as means for leveraging additional funding for infrastructure investments implemented through public-private partnerships.

3. Capacity and institution building activities targeted to the local private and public sectors to enhance business development, including:

(a) improving local businesses' quality of products, labor skills and management processes through the provision of training and advisory services; and

(b) strengthening of the capacity of local governments to create a favorable business environment by simplifying registration processes, promoting quality certification programs, marketing of locality to attract investments, and promoting public-private partnerships for infrastructure service delivery.

4. (a) Supporting the implementation of Parts D.1, D.2 and D.3 above through funding of project coordinators and their associated operational costs in the Selected Pilot Areas; and

(b) monitoring evaluation, documentation and dissemination of the results achieved under Parts D.1, D.2 and D.3 above.

Part E: Communication Campaign on Broad Themes Related to Competitiveness

1. Identification of target segments and existing competitiveness initiatives and development of a communications campaign.

2. Development of a competitiveness training program for journalists.

3. Monitoring of the results achieved with Parts E.1 and E.2 of the Project.

Part F: Project Coordination

Provision of technical assistance, equipment, training and incremental operating costs as necessary to establish, operate and strengthen the PCU to enable it to effectively coordinate, monitor and evaluate the implementation of the Project components (including audit services for purposes of Section 3.01 of the Project Agreement).

* * *

The Project is expected to be completed by March 30, 2008.

SCHEDULE 3

Special Account

1. For the purposes of this Schedule:
 - (a) the term “eligible Categories” means Categories (1) through (12) set forth in the table in paragraph 1 of Schedule 1 to this Agreement;
 - (b) the term “eligible expenditures” means expenditures in respect of the reasonable cost of goods, works and services required for the Project and to be financed out of the proceeds of the Credit allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and
 - (c) the term “Authorized Allocation” means an amount equivalent to \$2,800,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 3 (a) of this Schedule, provided, however, that unless the Association shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to \$1,000,000 until the aggregate amount of withdrawals from the Credit Account plus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions shall be equal to or exceed the equivalent of SDR 7,000,000.
2. Payments out of the Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.
3. After the Association has received evidence satisfactory to it that the Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:
 - (a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for deposit into the Special Account of an amount or amounts which do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount or amounts as the Borrower shall have requested.
 - (b) (i) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposits into the Special Account at such intervals as the Association shall specify.

- (ii) Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for eligible expenditures. All such deposits shall be withdrawn by the Association from the Credit Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

- (a) if, at any time, the Association shall have determined that all further withdrawals should be made by the Borrower directly from the Credit Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement;

- (b) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01 (b)(ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of the records and accounts for the Special Account;

- (c) if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to the provisions of Section 6.02 of the General Conditions; or

- (d) once the total unwithdrawn amount of the Credit allocated to the eligible Categories, minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions with respect to the Project, shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit allocated to the eligible Categories shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If the Association shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association: (A) provide such additional evidence as the Association may request; or (B) deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Association made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.