

BIBLIOTECA NACIONES UNIDAS MEXICO

Distr.
RESTRICTED

LC/MEX/R.237
25 June 1990

ENGLISH
ORIGINAL: SPANISH

CATALOGADO

E C L A C

Economic Commission for Latin America and the Caribbean

HONDURAS: RECENT ECONOMIC EVOLUTION AND INTERNATIONAL
CO-OPERATION

Document prepared within the framework of activities of ECLAC Project
ITA/88/005 "Strengthening international co-operation for Central America,
the Caribbean and selected countries of South America".

90-7-162

CONTENTS

	<u>Page</u>
General aspects	1
1. The evolution of the Honduran economy in the 1980s	3
a) General overview	3
b) The external sector	4
c) The public sector and economic policy	7
2. Principal problems of the Honduran economy	9
3. International co-operation in the 1980s	11

General aspects

The area of Honduras is 112,000 km², and it is the second largest country in Central America after Nicaragua. In 1987, it had 4.7 million inhabitants. It is a country with a relatively small population, since the number of inhabitants per square kilometer is 42.

It is a mountainous country richly endowed with precious woods and with great forestry and livestock potential. A range of mountains that crosses the country from northwest to southeast divides it into the eastern region and the western region and forms two large watersheds that empty into the Caribbean and the Pacific. It has many rivers that are navigable for vessels with a shallow draught. The climate is warm and humid with an average temperature of 31o C. The rainy season is from June to October and the dry season, which sometimes affects agricultural activities because of the droughts it causes, is from November to May.

Just as the other countries of the Central American Isthmus, the main economic activity in Honduras is agriculture, which accounts for one-fourth of its GDP, followed in order of importance by the manufacturing industry with 16%, and trade with 14%. Among the main export items, traditional agricultural commodities are outstanding: bananas, coffee and wood. Of these products, bananas account for 40.8% of the total value of exports.

Population growth, which is one of the highest in the region, reached an annual average rate of 3.4% from 1980 to 1985, even surpassing countries such as Guatemala, where growth rates are all considered extremely high. From the standpoint of basic social indicators, the situation in Honduras is relatively critical. In fact, the infant mortality rate was 78.6 for every 1,000 live births in 1983. However, life expectancy at birth has increased and reached an average of 59.9 years during the period from 1980 to 1985. The country continues showing pronounced deficiencies in education which, in terms of indicators, was reflected by an illiteracy rate of 40.3% in 1982.

1. The evolution of the Honduran economy in the 1980s

a) General overview

As a result of the international depression that began at the outset of the 1980s, Honduras experienced a moderate recession and subsequently persistent financial difficulties and slow growth. Between 1980 and 1989, economic activity expanded 22%, principally in response to domestic demand. the shortage of foreign exchange and delays in servicing the external debt were permanent critical factors. Furthermore, the political disturbances in the subregion caused private investment to drop sharply at the beginning of the decade and have brought about considerable capital flight.

In this context, during the first half of the 1980s, the economic policy was aimed at preventing further economic recession at the expense of pronounced deterioration in the governmental financial situation. Significant public investments were made in infrastructure with the support of official external loans. During the second half of the decade, concern focused on controlling financial imbalances. Public spending was abruptly cut back within the framework of partial adjustment and stabilization measures. None the less, pressure from sizable military expenditures and the governmental debt were factors that caused imbalances in public finances to continue.

Domestic demand, principally from consumption, gained notable impetus stemming from the inflow of official transfers from the United States Agency for International Development. Furthermore, the export sector showed slight recovery. Nevertheless, financial problems with the exterior became notably worse towards the end of the decade.

In general a short-term economic policy was maintained, based on controls and other partial measures to attenuate the main economic imbalances. Exchange controls and import restrictions were established; tax modifications and public spending controls were adopted; arrangements were made for the selective development of traditional and non-traditional exports; and the prices of basic goods and services, as well as changes in wages, were both controlled.

Price and wage controls and a fixed exchange parity policy held back inflationary pressures and prevented sudden price changes after the impact of

international inflation in 1980-1983. Nevertheless, the economic environment in general was uncertain and unstable and fostered speculation, which was also encouraged by an exchange policy that substantially overvalued the national currency and reinforced the weakness of the sectors that produce commodities for external markets.

Furthermore, the prevailing high interest rates and the financial insolvency of the main development institutions, limited production. ^{1/}

These developments brought about important changes in the structure of the Honduran economy: a) the openness of the economy diminished (between 1980 and 1989, the share of imports in GDP dropped from 45% to 32%, while exports fell from 38% to 32%); b) exports became less diversified when traditional commodities increased from 75% to 80% of total exports between 1980 and 1989. Furthermore, the share of trade within Central America in total exports dropped from 10% to 3%; and c) capital formation fell from 25% of GDP in 1980 to 15% in 1989, with strong fluctuations in its behaviour.

Other problems persisted or even grew worse. The informal sector of the economy expanded, including particularly a significant amount of smuggling. There was also an increase in unemployment and in urban slums caused by intense migration from the countryside to the city, especially from militarily occupied border zones. Although the governmental wage bill probably increased significantly, the real average wage fell and the distribution pattern affected the poorest segments of the population most unfavourably.

b) The external sector

The external sector experienced persistent difficulties. Throughout the decade there was a deficit above one-third of the value of exports, in which debt interest payments accounted for a large proportion. (See table 1.)

^{1/} The economic crisis implied difficulties in the institutions of the public sector and particularly in development financing institutions: CONADI, FINAVI, BANDESA AND COHDEFOR.

Table 1
HONDURAS: PRINCIPAL ECONOMIC INDICATORS

	1983	1984	1985	1986	1987	1988	1989 ^{a/}
1980 Index = 100							
A. Basic economic indicators							
Gross domestic product at market prices	99.3	102.1	105.7	108.7	114.3	119.7	122.2
Population (thousands of inhabitants)	3 867	3 976	4 088	4 203	4 322	4 444	4 569
Per capita gross domestic product	91.4	91.4	92.0	92.0	94.1	95.8	95.2
Central government deficit/GDP ^{b/}	...	...	7.5	7.8	7.3	7.0	7.2
Money (M1)/GDP	13.2	12.9	12.1	9.3	8.7	8.4	7.6
Parity exchange rate (1980 = 100.0)	87.3	85.4	82.2	76.5	76.6 ^{d/}	76.2 ^{e/}	72.1 ^{e/}
Unemployment rate ^{b/}	...	...	...	12.2 ^{c/}	8.2 ^{d/}	8.1 ^{e/}	8.6 ^{e/}
Growth rates							
B. Short-term economic indicators							
Gross domestic product	-0.2	2.8	3.5	2.8	5.2	4.7	2.1
Per capita gross domestic product	-3.0	-	0.7	-	2.3	1.8	-0.6
Consumer prices							
December to December	7.8	3.7	4.2	3.2	2.9	6.7	11.4
Real minimum wages and salaries	-7.7	-4.5	-3.3	-4.2	-2.4	-4.3	-8.9
Current value of goods and services exports	4.4	5.8	6.6	11.7	-3.9	4.8	7.7
Current value of goods and services imports	10.9	16.8	-0.3	-0.1	2.5	2.8	5.0
Terms of trade in prices of goods and services	1.0	2.1	-13.2	20.2	-10.4	5.2	-1.3
Millions of dollars							
C. External sector							
Trade balance of goods and services	-111	-219	-160	-52	-119	-102	-81
Net payment of earnings and interest	152	178	190	254	238	265	263
Current account balance	-254	-386	-337	-293	-341	-349	-326
Capital account balance	207	397	303	353	406	368	319
Change in net international reserves	-39	27	-19	43	26	23	-7
Total public debt disbursed ^{f/}	2 162	2 392	2 794	3 018	3 105	3 338	3 351

Source: ECLAC, based on official figures.

^{a/} Preliminary figures.

^{b/} Percentages.

^{c/} Includes 16 cities.

^{d/} Includes 3 cities.

^{e/} Includes the urban sector of 5 regions.

^{f/} Medium- and long-term global external debt.

Weak demand and unstable prices of Honduran export commodities kept the evolution of earnings from external sales at a slow pace. Negative price developments in trade also reduced the purchasing power of exports by an average of 10% during the 1980s.

Although some fostering measures were established, commodity exports only rose from almost \$US 950 million to \$US 1,020 million between 1980 and 1989. ^{2/} Total volumes only rose 3% in spite of significant increases in bananas (14%) and coffee (48). These two products increased their share in the total value from 53% to 57%. Non-traditional exports fell by one-third, while sales to Central America dropped from 10% to 3%.

The shortage of foreign exchange led to the establishment of exchange controls and import restrictions. Thus, after falling by nearly 30% in 1980-1983, the volume of imported goods grew slowly. Although they had recovered 1980 values by the end of the decade, the volumes were still 10% lower. However, note should be taken of the development of an important contraband market that significantly increased the supply of goods from abroad. ^{3/} In general, purchases of consumer and intermediate goods recovered the levels reached at the end of the 1970s. Capital goods, in contrast and in keeping with the sharp drop in physical investment, remained depressed at a level 20% below that of 1980.

The external debt rose rapidly, especially during the first five years, and tripled the initial figure to reach \$US 3,300 million in 1989, which is three times the value of exports. Servicing, in turn, rose from 20% to 60% of the value of exports, which signified continuous difficulties in meeting payment obligations. High amounts accumulated in payment arrears, although there were continuous negotiations with the creditors. ^{4/} Beginning in 1986, flows from multilateral institutions became negative and, in 1987, payment to official creditors stopped, which caused disbursements to be suspended.

^{2/} Some measures and instruments established to support exports were: the Law on seasonal imports, the Law to promote exports, the Law to establish industrial zones for the processing of exports, the CEFES (which tripled in 1987), and export foreign exchange option certificates (CETRAS).

^{3/} Illegal imports are estimated at approximately 20% of the value of officially registered imports.

^{4/} Between 1985 and 1988, \$US 200 million was accumulated in arrears.

Exacerbation of the critical situation in the Honduran external sector was partially attenuated by a significant flow of official transfers, which, beginning in 1985, covered between one-third and one-half of the current account deficit in external payments. Thus, as previously indicated, the continuous shortage of foreign exchange led to maintaining exchange controls, import restrictions, ongoing delays in external debt servicing payments and negotiations to reschedule balances.

c) The public sector and economic policy

Difficulties in public accounts were also persistent. the fiscal deficit rose to 15% of GDP during the first years of the decade, then dropped to 7% during the second half. (See table 1 again.) ^{5/}

Between 1980 and 1986, faced with the drop in private investment, the public sector adopted a compensatory policy through significant investments in large projects with external financing, aimed principally at expanding energy capacity -which absorbed approximately 40% of investment spending- port infrastructure and the exploitation of forestry resources. The current expenditure rose notably, mainly as a result of public debt and internal transfers.

Increased public spending was successful in partially reversing the effects of the collapse in private investment. However, it also produced intense financial imbalances that led to the adoption of measures to balance public accounts. Beginning in 1986, public spending was cut back radically, particularly in investment. Furthermore, some tax modifications were adopted, which increased the revenue of the public sector from 13% to 15% of GDP by the end of the decade.

Although these measures reduced the fiscal deficit to 8% between 1986 and 1989, the financial situation of the public sector remained critical.

Some contributing factors were military expenditures, wage adjustments in certain civil servant sectors, interest payments on the internal and external debts and financial problems of decentralized state entities.

^{5/} During the entire decade, the fiscal deficit was one of the permanent concerns of economic policy. During the first years of the crisis financial arrangements were agreed on with multilateral institutions, but they were suspended because of incapability to control key variables in the economy. A structural adjustment agreement was reached towards the end of the decade.

In the context of the crisis in the development financing institutions and the exchange overvaluation, which formed an economic environment that favoured imports and discouraged the production of marketable goods, the economic policy to support production was based on a number of selective measures.

Some of these selective measures were preferential interest rates, the allocation of foreign exchange for imports and tax incentives for export production. In spite of financial and input provision difficulties, overall supply reacted to the gradual growth in domestic demand, principally to consumer spending during the second half of the decade. Recovery in private investment could also be seen, particularly in housing construction, although rates continued to be very low.

Agriculture, manufacturing and basic services grew significantly. The agricultural sector increased its activities by 18% during the decade, with the most rapid expansion in livestock production (38%). The production of exportable goods was 6% lower than in 1980, but production for domestic consumption expanded. Although basic grain production rose 12%, per capita supply decreased. Egg production rose 30%; milk, 18%; and the livestock herd, 30%.

Manufactured goods grew 22%, bolstered by the production of construction materials and food products. In basic services, the expansion of energy generation capacity was outstanding and eliminated the energy imports from the Central American area. Total demand for electricity expanded considerably (78%) in response to commercial consumption (128%), household consumption (60%) and public lighting (60%).

The limited capability to create jobs in the formal sector of the economy contrasted with a population growth of 30%, which increased the unemployment rate by more than 26% of the economically active population. Although open unemployment remained at 12% to 15%, there was a strong increase in rural unemployment, made worse by the population displacement in border areas caused by military conflicts. During the decade there was also a significant migratory flow from the countryside to the city, which resulted in more slums, growth in informal activities and strong pressure on urban services.

In spite of the shortage in foreign exchange and the setting up of a parallel market outside the banking system, inflation rates remained

moderate, particularly between 1985 and 1989. A contributing factor was the fixed parity exchange rate policy and the controls on essential consumer commodities and basic goods and services. Nevertheless, between 1980 and 1989, prices rose 70% and had a widespread impact on economic activity and people's income.

In contrast, accumulated overvaluation of the national currency reduced the relative price of imported goods and services and thereby contributed to maintaining relatively high consumption rates, especially in the light of the problems in the external sector of the economy. However, overvaluation also encouraged speculation on the foreign exchange market and private capital flight, while it discouraged the production of exportable goods in general.

Official nominal minimum wages remained unchanged from 1980 to 1989. Although some selective adjustments were made among public employees and other labour organizations with greater negotiating power, most of the population, particularly in the countryside, experienced strong reductions in purchasing power. Although the price controls on basic articles and widely used inputs helped to keep increases in food and transportation prices below the average, at the end of the decade, they were still 55% higher than in 1980.

2. Principal problems of the Honduran economy

At the end of the 1980s, difficulties in the economic situation in Honduras were becoming worse. In 1989, growth was positive, but the per capita supply of goods and services diminished.

In 1990, a new administration (1990-1994) took office in the country in a context of persistent economic imbalances, instability in internal and external finances, considerable problems in the production area and great accumulated deficiencies in basic public services.

Difficulties in making payments abroad is one of the most important barriers to economic development. Foreign exchange shortages and exchanges instability persist. The outlook for the main Honduran exports is not promising and sales of non-traditional exports have not yet reached a level of any significance. The amount of official transfers has dropped, contributing to delays in paying external debt servicing. The suspension of disbursements by official financial institutions implied stepping up negotiations to agree on a structural adjustment programme. Meanwhile,

short-term indebtedness was already used in 1989 and international reserves were reduced.

Furthermore, the financial situation is still critical in the public sector, where payment of the public debt is a significant burden. The fiscal deficit represented one-third of government expenditures and more than 7% of GDP. The financial insolvency of the development promoting institutions has placed them on the brink of disappearing. Public institutions have significant deficiencies in their operations and technical capacity to administer programmes with the effectiveness that the financial crisis demands.

Production, in turn, shows difficulties stemming from a decade of reduced private investment and the constraints that fiscal imbalances place on public investment. Consequently, the economy's capacity to create jobs is insufficient to absorb the labour force, whose level of skills is generally low. The drop in the economy's growth rate has caused a rapid increase in unemployment and underemployment. The latter principally affects the rural population. In the urban sphere, migration has swollen the ranks of the informal tertiary sector, and it should be added that poverty affects two-thirds of the Honduran population.

The reduction in public investment during the last five years of the 1980s resulted in the weakening of physical and social infrastructure development programmes. After a decade of slow growth, accumulated deficiencies in social services are sizeable. In the field of education, it is noteworthy that 42% of the economically active population is illiterate. The coverage of the basic education system is limited. In the area of health, high rates of general mortality persist (10.8 per 1,000) and infant mortality rates are also high (78.6 per 1,000). Coverage regarding the availability of sanitary services (drinking water and sewerage) is even lower. Closely linked to poverty and health, is the problem of widespread nutritional deficiencies: approximately 75% of the population under five years of age shows some degree of undernutrition.

The state of housing is also critical. At the beginning of the 1980s, approximately two-thirds of the population lived in unsuitable housing conditions. The housing deficit amounted to 450,000 units at that time.

The problem has become more serious because of migratory flows that have stepped up urbanization. The largest cities in the country had growth rates

above 7%. In 1984, there were already 45,000 refugees and displaced persons from the war, which superimposed difficulties on the social problems that already existed.

Finally, note should be taken of the problem of environmental deterioration. Population pressure on the land has accelerated the deforestation rate in the country, since a large portion of the rural population uses firewood as fuel.

3. International co-operation in the 1980s

International co-operation received by Honduras increased considerably during the 1980s. Thanks to financial support and donations, the country was able to mitigate the economic crisis during the initial years of the 1980s.

Even though a precise assessment of the composition of co-operation and the programmes and projects involved is not available, its evolution may be described in broad terms. In the 1970s an annual average of \$US 24 million in non-refunding international technical co-operation was received; during the initial years of the 1980s that figure rose to \$US 38 million a year.

During the first five years of the 1980s, the country administered the implementation of approximately 165 programmes with a duration between one and five years. Technical co-operation was distributed principally to primary sectors (57%, the social sector (25%) and infrastructure (3.2%).^{6/}

Financial co-operation grew strongly during the first half of the 1980s in conjunction with the above-mentioned public investment programme in which bilateral financing sources increased considerably.

Public investment was aimed principally at the basic infrastructure, energy, communications and agriculture sectors and, to a lesser degree, at the social sectors.

During the 1980s important steps were taken to improve the administration of international co-operation. These steps include especially the designation of the Ministry of Planning as the interinstitutional co-

^{6/} Outstanding areas of activity were agrarian reform, diversification and improvement of agricultural production, forestry production, improvement of service institutions, reactivation of livestock raising, preparation of integrated regional development studies, and incentives for small and medium-scale industry. In the social area co-operation was aimed at environmental improvement, basic sanitation programmes, construction and improvement of dwellings and social promotion education.

ordinating body for the programmes and projects implemented by the public sector. Although considerable progress was made in these tasks, several factors stood in the way of optimum administration of international co-operation.

These factors include: the lack of a suitable administrative and legal framework to control international co-operation and the absence of mechanisms to make technical co-operation offers compatible with the sectoral needs and priorities of the country. Although CONSUPLANE has submitted a bill to Congress to regulate technical and financial co-operation, it has not yet been put into operation.

The lack of a organizational framework in the 1980s led to the duplication or overlapping of projects and to reduced optimization both in the transfer of knowledge and in national counterparts. The lack of clarity in the definition of public policies and institutional powers also gave rise to a lack of co-ordination in public administration. Executing units that frequently developed very few links with the governmental institutions responsible for the programmes proliferated.

The absence of efficient administration mechanisms also made it difficult to ensure complementarity in the international technical and financial co-operation from the same country of origin.

Operationally, the lack of human resources to identify, generate, follow up, assess and control development projects was, in practice, a significant obstacle. Towards the mid 1980s, the programme implementation coefficient was significantly low (60%).

Administrative and institutional factors, including bureaucratic processes for selecting and hiring technical staff and purchasing goods and services, also affected the evolution of programmes and projects. Furthermore, financial problems in the public sector resulted in limitations in allocating counterparts in national currency. This affected the disbursement and reimbursement capacity of external loans, which ultimately led to the suspension of loans. Finally, from a regional standpoint, the economic, organizational and human resource limitations of the local governments also reinforced the trend for decisions regarding programmes and projects to be handled in a centralized manner.