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ECONOMIC AND LEGAL STATUS OF FOREIGN INVESTMENTS
IN SELECTED COUNTRIES OF LATIN AMERICA

(Prepared by the Secretariat)

FOREIGN INVESTMENTS IN HONDURAS

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I. THE NATURE OF FOREIGN INVESTMENTS IN HONDURAS

Four Honduran sterling loans were floated in London from 1867 to 1870. The first, a 5 per cent loan of £90,000, was issued to refund Honduras' portion of the external debt of the Central American Federation which was dissolved in 1827, and to meet several small obligations in London. A second issue, floated in 1867, was a 10 per cent loan of £1 million for construction of an inter-oceanic railway. This was followed in 1869 by a 6 2/3 per cent loan of approximately £2 1/2 million and in 1870, a 10 per cent loan of £2 1/2 million. Although the last-mentioned loan was supposed to bring to completion the railway construction, only a short section was ever built. The loans had various guarantees, but due to the failure of the railway to produce revenue, the loans went into default in 1872.

In subsequent years many attempts were made to settle this debt and to raise additional funds for the inter-oceanic railway. However, no agreement for refunding and adjusting the outstanding loans was approved by the British bondholders until 1923. The Congress of Honduras accepted the settlement suggested on 8 March 1926. It provided for redemption of the outstanding bonds, then amounting to approximately £5.3 million, by semi-annual payments of £20,000 over a 30-year period. Total payments on the outstanding debt therefore would amount to £1.2 million, or approximately 22 1/2 per cent of the outstanding indebtedness; no provision was made for the settlement of interest arrears. No interest was to be paid from 1926 to 1956. The settlement plan was accepted by holders of bonds with a value of £4.8 million which will be redeemed before the expiration of the thirty-year period. On 30 June 1950, the total still to be repaid under the agreement amounted to about £110,000. The status of the £590,000 worth of bonds the holders of which did not assent to the arrangement, remains undetermined.^{1/} In order to obtain the necessary revenue to repay the external debt, the Government has levied a 3 per cent charge on all consular invoices for imports.

Three medium-term loans were obtained from United States commercial banks in New Orleans in 1928, 1931 and 1933. The first loan for \$1.5 million was

^{1/} The Council of the Corporation of Foreign Bondholders, Annual Reports, (London), 1926 and subsequent years.

to refund Government debts to a number of banks and foreign companies. The second, for \$250,000 was obtained to provide foreign exchange reserves in connexion with the establishment of the new currency in 1931. The third for \$300,000 was made in 1933. All three were repaid by 1936.

The Export-Import Bank granted a credit of \$2.7 million to Honduras in March 1942 for the purpose of purchasing materials and equipment for the construction of the Inter-American Highway running through Honduras. The credit carried an interest charge of 4 per cent and was repayable in semi-annual instalments in seven years beginning 31 January 1950. The Honduran Government has only used \$1 million of this credit, which was taken up by United States commercial banks with a guaranty by the Export-Import Bank, and by June 1950 the total amount borrowed had been repaid.^{1/}

No official Honduran figures for direct investments are available.^{2/} It appears, however, that after the experience with Honduran Government securities, little interest was evinced by British financial interests in other types of investments in Honduras. Since the first decade of the twentieth century the United States has been the only significant source of foreign investment in the country. According to the United States census of American investments abroad, direct investments in 1943 were as follows:

Table 4. Value of United States Business Investments in Enterprises in Honduras, 31 May 1943

(In millions of dollars)

Manufacturing	1.7
Mining and smelting	2.1
Public utilities and transportation	8.1
Agriculture	23.4
Miscellaneous	1.9
Total	37.2

Source: United States Treasury Department, Census of American-Owned Assets in Foreign Countries (Washington, D.C., 1947) page 70. Data include branches and those foreign corporations in which United States residents hold 25 per cent or more of the outstanding voting stock.

^{1/} Export-Import Bank, Semi-Annual Reports to Congress, (Washington, D.C.).

^{2/} In its reply to the questionnaire of the Economic Commission for Latin America on foreign investments, the Government stated that a census of foreign investments is one of the first tasks to be undertaken by the Central Bank established in July 1950.

In the four-year period 1946-1949, new United States private direct investments valued at \$42 million were made in Honduras.^{1/} Since no new investments are likely to have been made during the years 1943-1945, total United States direct investments in Honduras at the end of 1949 may be estimated at approximately \$79 million, more than twice the 1943 figure. In 1943 seventeen United States corporations reported interests in controlled enterprises in Honduras. Only three of these play a significant role in the Honduran economy. The largest of them is the United Fruit Company, which operates in Honduras through the Tela Railroad Company. Another company engaged in the production of fruit is the Standard Fruit and Steamship Company.

Table 2. United States Investments in Agricultural Enterprises in Honduras
(In millions of dollars)

1914	6.7
1919	15.3
1924	36.2
1929	74.8
1935	24.2
1943	23.4
1947	45.4

Source: Cleona Lewis, America's Stake in International Investments, (Washington, D.C., 1938), page 590. United States Treasury Department, Census of American-Owned Assets in Foreign Countries (Washington, D.C., 1947), page 70. United States Department of Commerce, Survey of Current Business, November 1949, (Washington, D.C.), page 22.

United States investments in agricultural enterprises, mostly banana plantations, increased steadily between 1914 and 1929, reflecting a considerable inflow of capital. Subsequently, the value of the investments was substantially written down, largely as the result of the ravages of banana plant diseases.

In reply to the ECLA questionnaire on foreign investments, the Honduran Government stated that the agricultural properties of the United Fruit Company of Boston had a "present value" of more than \$100 million. This figure may

^{1/} United States Department of Commerce, Survey of Current Business, January 1951, page 23.

be compared with the estimate of \$45.4 million in table 2 for all United States agricultural investments at the end of 1947 which refers to the book value of the enterprises concerned.

The major United States mining company operating in Honduras is the New York and Honduras Rosario Mining Company. Of less significance and at times inactive, are the Agua Fria Mining Company and the New Idria Mining Company. Most of the manufacturing public utility and transportation investments reported in the United States census are owned by these three concerns which, in order to operate satisfactorily in Honduras, had to create their own railway communications, water and school systems as well as a number of light manufacturing industries.

The United States Government has an investment of about \$1.9 million in agricultural installations in Honduras.^{1/} This was made during World War II, when as a result of the increased need for natural fibres, a farm for growing abaca was established in Honduras by the Reconstruction Finance Corporation. This United States Government agency owns the farm and bears the financial responsibilities but has turned over the management to the United Fruit Company.

^{1/} United States Department of Commerce, Clearing Office for Foreign Transactions, Foreign Transactions of the U.S. Government, September 1950, (Washington, D.C.), page A-81.

II. ECONOMIC SIGNIFICANCE OF FOREIGN INVESTMENTS

As observed, the major agricultural, mining and public utility enterprises in Honduras have been developed with foreign capital. A substantial portion of Honduran exports is produced by foreign-owned enterprises and since the new tax law of 1950 the Government relies heavily upon revenue from these enterprises. Notwithstanding this contribution of the foreign companies to the economy of Honduras, the country as a whole remains relatively poor and undeveloped. The fertile valleys are separated from each other and from the population centres by mountain barriers, and the resulting transportation problem has remained largely unsolved except in areas where the fruit companies have created facilities for banana shipments to the sea coast.

The large plantations are confined mainly to regions close to the coast. At the end of 1947 the United Fruit Company had under cultivation approximately 43,000 acres and the Standard Fruit Company somewhat less than 10,000 acres. Most of the land, which deteriorates rapidly, is used for the cultivation of bananas. Originally the investment of the fruit companies was not very large, but with the spread of the Panama and sigatoka diseases, large spraying and irrigation installations became necessary. The sigatoka disease has been largely brought under control following the installation of permanent equipment costing more than \$150 per acre of banana planting.^{1/}

In recent years, the fruit companies have tried to diversify their planting and have successfully grown coconuts and other tropical products. However, banana production remains the most important activity. Abaca is now also grown but has not yet become a crop of major significance.

Honduras is rich in minerals, but their inaccessibility in mountain areas has permitted only a few mines to be commercially exploited. Precious metals have accounted for most metal exports for many years. The foreign-owned New York and Honduras Rosario Mining Company has operated under a concession granted in 1920 and has produced mostly silver and some gold. Recently some lead deposits have also been exploited. In 1948 this company acquired additional land for exploration.

^{1/} Charles Morrow Wilson, Empire in Green and Gold, (New York, 1947), page 275.

All major public utility enterprises are foreign-owned. Two of the important railways have been built and are still owned by the two United States fruit companies and used for shipping bananas from the plantations to the sea coast. A third railway, the National Railway of Honduras, was financed by bonds floated in the United Kingdom, and is now managed by the United Fruit Company for the Honduran Government. Although intended as an inter-oceanic railway, only a small section was completed.

The Inter-American Highway, which crosses Honduras and passes south of the capital, was built partly with funds made available by the Export-Import Bank. This highway and the Inter-Oceanic Highway are the only two all-weather highways in the country.

Electric power is generated largely in connexion with the operations of three large foreign concerns referred to above. In 1945, seven of the eight major electric power plants which accounted for over 90 per cent of Honduras' power generation were owned in the United States.^{1/}

The water works of Tegucigalpa and Comayagua were built by the New York and Honduras Rosario Mining Company, as provided in an original concession contract effective 1 January 1920. The cost of this construction, which became the property of the Government, represented about 4 per cent of its net income during the twenty years of the concession.^{2/}

Several of the few manufacturing enterprises in the country are owned or were developed by foreign interests. Lumber which is needed for the foreign-owned railroads is processed in lumber yards belonging to these companies. The Standard Fruit Company also owns a substantial interest in the production of beer, and a modern cigar factory is owned by the British-American Tobacco Company.

According to the balance-of-payments statement reproduced below (table 3), bananas account for the great bulk of the inflow of funds on current account. The bananas exported are derived chiefly from foreign-owned plantations; the remainder are bought by the two United States fruit companies from independent growers. On the debit side, imports by the foreign-owned concerns and their

^{1/} United States Tariff Commission, Mining and Manufacturing Industries in Honduras, (Washington, D.C., 1949), page 12.

^{2/} Moody's Industrials, (New York, 1948), page 1869.

dividend remittances require a substantial amount of exchange. Also, in the capital account new investments by the foreign concerns play an important role.

Table 3. Honduras - Estimated Balance of Payments,
1946-47 and 1947-48

Inward (+) or outward (-) payments
in millions of lempiras^{a/}

	<u>1947-48</u>	<u>1946-47</u>
<u>Goods and services</u>		
Merchandise imports (c.i.f.)	-71.2	-58.9
Merchandise exports (f.o.b.)		
Bananas ^{b/}	+60.8	+53.5
Other products	+24.5	+19.0
Trade balance	+14.1	+13.6
Expenditure of United States		
Government	+ 0.5	+ 0.7
Miscellaneous services	- 5.2	- 6.0
Investment yield	-22.9	-24.4
Balance of goods and services	-13.5	-16.1
<u>Capital items</u>		
Investment by fruit companies (net)	+10.0	+ 9.0
Debt repaid to British bondholders	- 0.3	- 0.3
United States Government		
transactions (net)	+ 0.1	+ 1.6
Decline in exchange reserves	+ 3.1	+ 1.9
Total capital items	+12.9	+12.2
Balance due to errors and omissions	- 0.6	- 3.9

Source: Banco Central de Honduras, Boletin Mensual, July 1950,
(Tegucigalpa). The figures refer to fiscal years beginning
1 July.

a/ One lempira equals U.S.\$0.50.

b/ For balance-of-payments purposes the value of bananas was determined on the basis of f.o.b. prices in port-of-entry in the United States less transportation costs; Honduran trade statistics record exports at a lower figure.

/Since

Since the foreign companies sell in the exchange market only sufficient funds to cover their local requirements, the following figures for the exchange made available by them during the post-war years are of interest.

Table 4. Exchange Purchases by Honduran Government
(In millions of lempiras)

(Years ending 30 June)	United Fruit Tela R.R.	Standard Fruit	Rosario Mining	Agua Fria Mining	Other exports	Invisibles	Total
1945-46	6.7	1.7	.8	.1	.5	6.4	16.1
1946-47	11.1	2.1	1.0	.1	.3	7.4	19.6
1947-48	8.6	2.3	.9	.1	.4	10.8	25.6
1948-49	11.4	2.4	.9	.1	1.9	6.1	22.8
1949-50 ^{a/}	9.0	.9	.8	.1	2.7	4.3	17.7

Source: Banco Central de Honduras, Boletin Mensual, July 1950, (Tegucigalpa).

^{a/} Ten months ending April 1950.

In most recent years over half of the official purchases of foreign exchange have been made from the foreign-owned companies. Since 1948, however, exports by Honduran-owned enterprises have substantially increased. It should also be noted that since 1950, when foreign concerns became liable to a new income tax, they have had to increase substantially their sales of foreign exchange. It is estimated from 1951 inclusive their payments of this tax will amount to about 7 million lempiras (\$3.5 million) annually.

During most of the period since the end of the economic depression of the 1930's, Honduras has suffered no real foreign exchange stringency. In particular, in the post-war period no shortage occurred which would have necessitated the imposition of import and exchange controls. During the 1930's the local expenditure of agricultural enterprises in connexion with the large installations necessary for combatting various plant diseases helped to prevent balance-of-payments difficulties.

While no detailed statistics with respect to the United Fruit Company's earnings in Honduras are available for past years, it is believed that the yield has been substantial. It has been unofficially estimated that the

Company's share in the new income tax of 15 per cent introduced in 1950 will amount to 5 million lempiras (\$2.5 million), implying income subject to taxes of about 35 million lempiras (about \$17 million).

The following statistics relate to the operations of the New York and Honduras Rosario Mining Company:^{1/}

Table 5. New York and Honduras Rosario Mining Company:
Production, Income and Dividends

	Value of gold and silver produced	Net income	Earnings per share	Dividends per share
	(millions of dollars)	(thousands of dollars)	(in dollars)	(in dollars)
1941	2.0	503	3.70	2.375
1942	2.2	564	3.03	2.55
1943	2.1	573	3.09	2.65
1944	2.1	535	2.88	2.75
1945	2.4	697	3.75	2.00
1946	2.8	1,014	5.46	4.65
1947	2.2	551	2.97	2.80
1948	2.4	606	3.26	2.30
1949	3.8	613	3.30	2.50

Source: Moody's Industrials, (New York, 1948 and 1950).

Until recently the direct financial contribution of the foreign-owned concerns to the Government was relatively small since they were not subject to direct taxation and were exempt from the payment of most import duties. However, under the new income tax law their contribution to public revenues will be increased. It may be mentioned that the foreign concerns have provided a number of services usually considered as governmental functions. Under their concession contracts they are required to provide school and hospital services, maintain a police force in the area of their operations and provide other essential services.

^{1/} In its reply to the ECLA questionnaire the Honduran Government stated that this enterprise was established in 1880 with a capital of \$500,000 and that its properties are now valued at "several millions" of dollars.

III. GOVERNMENT POLICY AND FOREIGN INVESTMENT

The entry of foreign capital into the country is not subject to restrictions, and foreign capital enjoys practically complete equality with domestic capital; foreign residents in Honduras may freely engage in any trade or industry in Honduras but are subject to the same rights and obligations as nationals. According to Article 286 of the Commercial Code, foreign concerns are regarded as domestic enterprises; this implies the denial to foreign concerns of diplomatic protection.

According to the Law of Agriculture promulgated by a decree of 3 April 1936, "the State is the original owner of surface and subsoil rights and may transfer them to private owners, thus making them private property".^{1/} The same law provides that the State may impose restrictions on private property to facilitate the establishment of public utilities or for other purposes.

There are no constitutional provisions which regulate the granting of concessions, notwithstanding the fact that such concessions have played an important part in the country's economy during the last fifty years. Concessions are usually obtained by a petition to the Ministry concerned; in case favourable action is taken, a concession contract is prepared and submitted for approval and ratification to the President of the country and subsequently to the Legislature.

Any resident of Honduras may engage in agriculture. However, foreigners may not obtain full title to land within forty kilometres of sea coasts or borders. Decree No. 5 of the Constituent Assembly of 1936, relating to subsidies and concessions for agriculture, provides that privileges may be granted for periods up to ten years and concessions for the promotion of new industries and colonization for a term of up to ninety years; such concessions are not renewable.^{2/}

^{1/} Inter-American Development Commission, A Statement of the Laws of Honduras, (Washington, D.C., 1947), page 56.

^{2/} Ibid., page 57.

The Mining Code, promulgated by a decree of 15 February 1937, reiterates the provisions of the Agricultural Law of 1936, providing that the State is the owner of all mineral deposits, even though the surface of the areas where they are located is owned by corporations or private individuals. The State will grant private interests the right to make explorations, to work the mines and to dispose of the minerals provided these interests abide by the regulations of the Mining Code. For some minerals, such as petroleum, coal, iron and a few others, exploitation may be undertaken only if a contract for not more than twenty years is made with the President of Honduras.^{1/} Seventy-five per cent of all workers employed by mining enterprises must be Hondurans.

The Banking Law promulgated by a decree of 11 March 1937 provides that foreign banks may be established in the country, but permission must be obtained from the President through the Minister of Finance.

Exchange control was established in 1934. Since the exchange receipts of the country are sufficient for all requirements, no quantitative restrictions on trade have been put into effect; however, the exchange licensing system continues to exist formally.^{2/} Licences for payments abroad are freely granted.

Prior to the passage of the income tax law of November 1949, the Honduran Government obtained its revenue primarily from customs duties and government monopolies. As noted above, the new income tax law is expected to yield substantial revenue, since under amended concession contracts the foreign-owned agricultural and mining enterprises have agreed to pay this tax. The law provides that net business incomes are subject to rates ranging from 4 per cent on incomes from 2,500 to 50,000 lempiras to 15 per cent on income in excess of one million lempiras (\$500,000).

The Honduran tariff is generally of a revenue character, but protection is granted to a few domestic industries. A large portion of imports required by foreign enterprises are free of duty under provisions in concession contracts.

^{1/} Ibid., page 42.

^{2/} International Monetary Fund, First Annual Report on Exchange Restrictions, (Washington, D.C., 1950) page 111.

In the fiscal year 1947-1948, almost 40 per cent of all imports were free of duty. The income from government monopolies stems primarily from a tax on alcoholic beverages.

Since foreign concessions play a vital role in the Honduran economy, the principal features of recent concession contracts may be noted. The New York and Honduras Rosario Mining Company obtained its original concession in 1920 for a twenty-year period ending 31 December 1940. A new contract was concluded in 1940 to run to 31 December 1960. In it the company is guaranteed that:^{1/}

- (1) no increase in taxes and duties will be imposed;
- (2) mining supplies may be imported without payment of duties;
- (3) mining products may be freely exported;
- (4) an internal communications system may be operated;
- (5) the company's employees will not be subjected to military duty in peacetime.

In turn the company obligated itself:

- (1) to maintain a police force, hospital and schools in connexion with its operations;
- (2) to pay an income tax of 7 per cent^{2/} of net income;
- (3) to advance \$250,000 in respect of future tax obligations.

The United Fruit Company, operating in Honduras through the Tela Railroad Company, negotiated in 1949 an important amendment to its basic concession contract of 1912 with the Honduran Government. The major provisions of the amended contract are:^{3/}

- (1) The Company agrees to continue or increase planting of African palm, cacao and abaca.
- (2) All machinery and supplies may be brought in free of duty.
- (3) The Company agrees to pay the new 15 per cent income tax upon its net profits. (In order to arrive at a fair valuation for exported bananas and the profits of the United Fruit Company pertaining to the

^{1/} Moody's Industrials, (New York, 1948), pages 1869-1870.

^{2/} The Company has recently agreed to pay income tax of 15 per cent as provided in the new income tax law. This was done with the approval of the United States Bureau of Internal Revenue; the tax paid in Honduras can be fully deducted from taxes due in the United States.

^{3/} La Gaceta, 11 November 1949, (Tegucigalpa).

activities in Honduras, the calculations acceptable to the United States Bureau of Internal Revenue will be accepted by the Honduran Government.)

- (4) The Government agrees not to impose new or increase existing taxes.
- (5) No exchange restrictions will be imposed except by mutual accord in case of emergency.
- (6) The Company has the right to do business in Honduras, export its products freely, and may not be subjected to expropriation except for public works of required necessity and then only provided the Honduran Government has previously paid just compensation in United States currency.
- (7) No restrictions may be imposed with respect to the number of foreigners employed in management functions. However, with respect to labourers, the Company has agreed to employ at least 70 per cent Hondurans.
