HONDURAS

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Millions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998 1/
Income, Production and Employment:			
Nominal GDP (US$) 2/	3,738.0	4,666.9	4,806.5
Real GDP Growth (pct)	3.7	4.5	3.0
GDP by Sector:			
Agriculture	665.0	920.8	948/8
Manufacturing	630.0	733.5	770.2
Services	205.8	399.7	411.7
Government	195.0	222.7	225.0
Per Capita GDP (US$) 3/	652.0	790.0	809.9
Labor Force (000s)	1,873.5	1,955.0	2,033.2
Unemployment Rate (pct) 4/	6.3	6.3	6.3
Money and Prices (annual percentage growth):			
Money Supply (M2)	37.4	42.9	N/A
Consumer Price Inflation	25.4	12.8	16.3
Exchange Rate (LP/US$ annual average)			
Official	11.84	13.0	13.4
Parallel	11.83	13.0	13.4
Balance of Payments and Trade:			
Total Exports FOB 5/	1,422.5	1,535.6	1,613.5
Exports to U.S. 6/	N/A	N/A	N/A
Total Imports CIF 5/	1,758.9	2,060.2	2,428.4
Imports from U.S. 6/	N/A	N/A	N/A
Trade Balance 5/	N/A	N/A	N/A
Trade Balance with U.S. 6/	N/A	N/A	N/A
Current Account Deficit/GDP (pct) 7/	5.0	2.1	21.8
External Public Debt	3,815.8	3,847.3	N/A
Debt Service Payments/GDP (pct)	11.0	N/A	N/A
Fiscal Deficit/GDP (pct)	3.4	2.6	1.5
Gold and Foreign Exchange Reserves	283	440	N/A

Aid from U.S. 8/	43.0	36.1	36.0
Aid from Other Countries 8/	96	116	N/A

1/ 1998 figures are estimates based on data available in October.
2/ GDP at factor cost.
3/ Using GDP at factor cost results in a lower measure of per capita GDP income.
4/ Represents urban unemployment. Underemployment approaches 30 percent.
5/ Merchandise trade; does not include re-exports under the Caribbean Basin Initiative.
6/ Source: U.S. Department of Commerce and U.S. Census Bureau; exports FAS, imports customs basis.
7/ (-) Indicates a surplus current account.
8/ See section five.

1. General Policy Framework

Despite abundant natural resources and substantial U.S. (and other bilateral and multilateral) economic assistance, Honduras remains one of the poorest countries in the hemisphere, with low per capita income and low health and education indicators. Since 1990, successive governments have embarked on economic reform programs, dismantling price controls, lowering import tariff duties, removing many nontariff barriers to trade, adopting a free market exchange rate regime, removing interest rate controls, and passing legislation favorable to foreign investment. The biggest success story is the growth of the Maquila industry from virtually no production in 1990 to the generation of over $300 million in foreign exchange and employment of 100,000 workers in 1998. The government's fiscal deficit (as a percentage of GDP) has been reduced from 10 percent in 1990 to 1.5 percent in 1998. GDP growth was projected to be five percent and inflation a manageable 14 percent in 1998.

However, during the last week of October 1998, an unprecedented disaster struck every region of Honduras when Hurricane Mitch dumped a huge amount of rain on the country. The result was massive flooding and landslides that killed over 5,000 people (thousands more are still missing), left hundreds of thousands homeless, caused over $3 billion in destruction, seriously damaged the road network, virtually wiped out the banana crop and deprived tens of thousands of their livelihoods. Massive international humanitarian assistance -- led by the U.S. -- saved many lives, provided for basic needs, and temporarily reopened the road network. Substantial international aid will be needed over the medium term to help rebuild Honduras' infrastructure and productive economic capacity. The government's macroeconomic goals for 1999 have been revised downward, with growth sharply reduced and the budget deficit and unemployment sharply increased.

Since the disaster, Honduras has redoubled its efforts to provide a favorable climate for foreign investment. In the last two months of 1998, congress passed legislation reforming the Mining Code, allowing concessional operation of airports and seaports, providing incentives for renewable energy projects (many by U.S. investors), and allowing foreign tourism development in coastal areas. Congress earlier passed a law authorizing the sale of fifty percent of the state-owned telephone company to a foreign partner and the auctioning of Band B cellular service. The government also pledged to accelerate the privatization of the electric company's distribution system.

The central bank remains committed to anti-inflationary monetary policies, though liquidity problems that were exacerbated by the disaster have led to a slight relaxation.
The reserve requirement (reduced four points to 25 percent in the aftermath of the hurricane) continues to be the favored policy tool to control money supply growth and inflation, although open market operations have been taking on an increasing role.

Honduras became a founding member of the World Trade Organization (WTO) on January 1, 1995. Honduras also concluded negotiations with the U.S. on a Bilateral Investment Treaty (BIT), which was signed on July 1, 1995. The BIT was ratified by the Honduran Congress and is expected to be presented to the U.S. Senate for ratification early in 1999. Honduras actively participates in the Free Trade Area of the Americas (FTAA) negotiation process.

2. Exchange Rate Policy

The central bank sets the weekly base exchange rate by calculating the difference between the expected monthly rate of domestic inflation and estimated inflation among Honduras's 12 major trading partners. The central bank allows buyers to bid at prices up to five percent above or below the base rate.

The Foreign Exchange Repatriation Law passed in September 1990 requires all Honduran exporters, except those operating in free trade zones and export processing zones, to repatriate 100 percent of their export earnings through the commercial banking system. Presently, commercial banks are required to sell 100 percent of these repatriated earnings to the central bank, which in turn auctions up to 60 percent in the open market.

3. Structural Policies

Trade Policy: In an effort to increase trade and maintain competitiveness with its Central American neighbors, in recent years Honduras has cut its import duties to between zero and 20 percent for most items. In 1995, Honduras and other Central American Common Market (CACM) members agreed to work toward the full implementation of a common external tariff ranging between zero and 15 percent for most products, but allowed each country to determine the timing of changes. In 1997, tariff rates were reduced to one percent on capital goods, medicines and agricultural inputs, and on raw materials and inputs produced outside of the Central American region. Honduras also intends to reduce its extra-regional tariffs for other goods (intermediate and finished) over the next several years to between 10 and 17 percent.

Honduras has sought to expand trade by negotiating, together with its Central American neighbors, free trade agreements with other Latin American countries. In late 1998, negotiations were nearing conclusion with both Mexico and the Dominican Republic, although disagreement on exempt product lists has delayed final agreement.

Pricing Policy: Before Hurricane Mitch, the only products under consumer price controls were bread, coffee, medicines and petroleum products (gasoline, diesel and liquid propane gas). In the aftermath of the disaster, temporary price controls were placed on staple food products.

Tax Policies: In order to increase Honduras' competitiveness and attract foreign investment beyond tax exempt free trade zones and industrial parks, newly-inaugurated President Flores persuaded congress in April 1998 to reduce the corporate tax rate from 40 percent to 25 percent. In order to compensate for lost revenue, the basic sales tax was increased from 7 to 12 percent. Sales taxes were increased to 15 percent on liquor and tobacco products, and are even higher on new car purchases. Export taxes on bananas are being reduced in stages from 50 cents to four cents a box by the year 2000.

4. Debt Management Policies

Debt service on Honduras' approximately $4 billion external debt is a major constraint on growth and represents about 35 percent of the government budget. Since early 1990, the government has been working to restore the country's creditworthiness, reschedule its external debt and regain support from the multilateral development banks. Despite Paris Club debt rescheduling agreements in July 1995 and March 1996, and over $500 million in bilateral debt forgiveness (including $430 million by the U.S. in 1991), Honduras has been unable to comply with the goals of an Enhanced Structural Adjustment Facility (ESAF), first negotiated with the IMF in 1992 and re-negotiated several times.

In September 1998, congress passed a bill authorizing the privatization of the telephone company, a key requirement of the 1997 IMF Staff Monitored Program (SMP). In the aftermath of Hurricane Mitch, Honduras has received pledges from both bilateral and multilateral creditors to reduce the debt service burden by suspension of bilateral debt interest and/or principal payments for three years, and contributions to a fund to help pay multilateral debt payments. The government has pledged to maintain responsible fiscal and monetary policies and accelerate the privatization of the state-owned electric company's distribution system. Congress passed legislation in November 1998 authorizing concessional operation of public infrastructure such as airports, seaports, and highways. These IMF-recommended actions mean a new ESAF with the Fund will likely be negotiated in January 1999.

5. Aid

Over the last three fiscal years, USAID/Honduras has disbursed approximately $115.1 million, including $4.8 million in PL-480 Title II funds in FY 1998. The annual distribution of these disbursements have averaged around $38.3 million. The annual disbursements are expected to more than double in FY 99 as a result of the disaster assistance and new aid provided for the reconstruction effort. Prior to the hurricane, assistance expenditures were used for development activities in the areas of health, education, economic growth and policy, democracy, natural resources, and the environment.

In 1998, Honduras received $500,000 for International Military Education and Training (IMET). Currently there remains approximately $12.2 million in residual foreign military sales (FMS) monies to support construction and maintenance of equipment. These funds are expected to be exhausted over the next few years. In fiscal year 1998, the U.S. also provided Honduras with $195,000 to support anti-narcotics efforts and $1.7 million for the Department of Justice's International Criminal Investigative Training Assistance Program (ICITAP) to provide technical assistance and training to professionalize civilian police institutions. Honduras received approximately $116 million in transfers from other official donors in 1997, and expects to double this in 1998, primarily because of Hurricane Mitch. Honduras also receives substantial assistance from the international financial institutions in the form of soft loans.

6. Significant Barriers to U.S. Exports

Import Policy: While reforms have gone far to open up Honduras to U.S. exports and investment, some protectionist policies remain. For example, although all import licensing requirements have been eliminated, Honduras has resorted to the imposition of sanitary regulations that effectively deny market access to U.S. chicken parts.

Services Barriers: Under Honduran law, special government authorization must be obtained to invest in the tourism, hotel and banking service sectors. Foreigners are not permitted majority ownership of foreign exchange trading companies. In addition, foreigners may not hold a seat in Honduras' two stock exchanges or provide direct brokerage services in these exchanges.

Labeling and Registration of Processed Foods: Honduran law requires that all processed food products be labeled in Spanish and registered with the Ministry of Health. The laws are inconsistently enforced at present. However, these requirements may discourage some suppliers.

Investment Barriers: Several restrictions exist on foreign investment in Honduras, despite the 1992 Investment Law. For example, special government authorization is required for foreign investment in the following sectors: forestry, telecommunications, basic health services, air transport, fishing and aquaculture, exploration of sub-surface resources, insurance and financial services, private education services, and agriculture and agro-industrial activities exceeding land tenancy limits established by the Agricultural Modernization Law of 1992 and the Land Reform Law of 1974. The law also requires Honduran majority ownership in certain types of investment, including beneficiaries of the National Agrarian Reform Law, commercial fishing and direct exploitation of forest resources and local transportation.

Honduran law also prohibits foreigners from establishing businesses capitalized at under 150,000 lempiras (about $11,000). In all investments, at least 90 percent of a company's labor force must be national, and at least 80 percent of the payroll must be paid to Hondurans. Finally, while a one-stop investment window has been instituted in the Ministry of Industry and Trade to facilitate investment, the ministry has not provided complete information or assistance to the foreign investor. The newly-formed Tourism Ministry has tried to facilitate foreign investment, and in December 1998 congress passed the first vote (of two required) of a constitutional amendment to allow foreign ownership of coastal land for tourism development purposes.

Government Procurement Practices: The Government Procurement Law (decree no. 148.5) governs the contractual and purchasing relations of Honduran state agencies. Under this law, foreign firms are given national treatment for public bids, although they are required to act through a local agent. In practice, U.S. firms complain about the mismanagement and lack of transparency of government bid processes. After Hurricane Mitch, congress passed an emergency law allowing the government to dispense with the normal bidding process and execute direct purchases in reconstruction-related projects. The government has taken pains to reassure the public and the international community that reconstruction projects will be carefully audited to prevent corruption.

Customs Procedures: Customs administrative procedures are burdensome. There are extensive documentary requirements and other red tape involving the payment of numerous import duties, customs surcharges, selective consumption taxes, and warehouse levies.

7. Export Subsidies Policies

With the exception of free trade zones and industrial parks, almost all export subsidies have been eliminated. The Temporary Import Law, passed in 1984, allows exporters to bring raw materials and capital equipment into Honduran territory exempt from customs duties if the product is to be exported outside Central America. This law also provides a ten year tax holiday on profits from these exports under certain conditions.

The Export Processing Zones (ZIPS) exempt the payment of import duties and other charges on goods and capital equipment. In addition, the production and sale of goods within the ZIPS are exempt from state and municipal taxes. Firms operating in ZIPS are exempt from income taxes for 20 years, and from municipal taxes for 10 years. In May 1998, the Honduran Government passed legislation allowing the establishment of ZIPS throughout the country.

8. Protection of U.S. Intellectual Property

In 1998, Honduras was identified in the "Watch List" category of the U.S. Government's annual “Special 301” review. A report prepared by the International Intellectual Property Alliance (IIPA) estimates that losses in Honduras due to copyright infringements cost U.S. firms $8.3 million in 1997. There is widespread piracy of many forms of copyrighted works -- movies, sound recordings, and software -- and the illegitimate registration of well-known trademarks has been a problem. Honduras saw a portion of its trade preferences under the Generalized System of Preferences (GSP) and the Caribbean Basin Initiative (CBI) suspended on April 20, 1998 because of its failure to control broadcast television piracy. However, these benefits were restored on June 30, 1998 following government action to suspend and fine the offending stations.

In December 1998, the government reaffirmed its commitment to comply fully with the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement January 1, 2000 deadline. Progress is being made in the negotiation of a bilateral IPR agreement with the United States.

Patents: The Patent Law enacted in September 1993 provides patent protection for pharmaceuticals, although the patent term of seventeen years from the date of application must be extended by at least three years to meet international standards. Honduran law contains overly broad compulsory licensing provisions and provides no protection for products in the pipeline. A TRIPS-compliant Central American patent and trademark treaty is pending before the congress.

Trademarks: The illegitimate registration of well-known trademarks is a problem in Honduras, in spite of modifications to the Trademark Law made in 1993.

Copyrights: The piracy of books, sound and video recordings, compact discs, computer software, and television programs is widespread in Honduras. Despite some progress, copyright protection remains problematic. A TRIPS-compliant reformed copyright law should be presented to congress in early 1999.

9. Worker Rights

a. The Right of Association: Workers have the legal right to form and join labor unions; the unions are independent of government and political parties. Three large peasant organizations are affiliated directly with the labor movement. Unions participate in public rallies against government policies, and make extensive use of the news media to advance their views. Since only about fourteen percent of the work force is unionized, however, the economic and political influence of organized labor has diminished in recent years. The Constitution provides for the right to strike, along with a wide range of other basic labor rights, which the authorities honor in practice. The Civil Service Code, however, denies the right to strike to government workers, other than employees of state-owned enterprises. There were illegal work stoppages during the year, conducted by public sector employees in health and related industries.

b. The Right to Organize and Bargain Collectively: The law protects workers' rights to organize and to bargain collectively; collective bargaining agreements are the norm for companies in which workers are organized. However, although the Labor Code prohibits retribution by employers for trade union activity, it is a common occurrence. Employers actually dismiss relatively few workers for union activity once a union is recognized; such cases, however, serve to discourage workers elsewhere from attempting to organize. Workers in both unionized and non-unionized companies are under the protection of the Labor Code, which gives them the right to seek redress from the Ministry of Labor. Over the past year the Ministry of Labor took action in several cases, pressuring employers to observe the code. Labor or civil courts can require employers to rehire employees fired for union activity, but such rulings are uncommon. Labor leaders criticize the ministry for not enforcing the Labor Code, for taking too long to make decisions, and for being timid and indifferent to workers' needs. The ministry has increased inspections and the training of its inspectors; it needs to do more, however, to adhere completely to international labor standards.

c. Prohibition of Forced or Compulsory Labor: The Constitution and the law prohibit forced or compulsory labor. Although over the past year there were no official reports of such practices in the area of child labor, there were credible allegations of compulsory overtime at plants in export processing zones, in particular for women, who constitute an estimated eighty percent of the work force in the Maquiladora sector.

d. Minimum Age for Employment of Children: According to government and human rights groups, an estimated 350,000 children work illegally. The Constitution and the Labor Code prohibit the employment of minors under the age of sixteen, except that a child who is fifteen years of age is permitted to work with the permission of his parents and the Ministry of Labor. The Children's Code prohibits a child of fourteen years of age or less from working, even with parental permission, and establishes prison sentences of three to five years for individuals who allow children to work illegally. An employer who legally hires a fifteen-year-old must certify that the child has finished or is finishing his compulsory schooling. The Ministry of Labor grants a number of work permits to fifteen-year-olds each year. It is common, however, for younger children to obtain these documents, or to purchase forged permits. The Ministry of Labor cannot effectively enforce child labor laws, except in the Maquiladora sector, and violations of the Labor Code occur frequently in rural areas and in small companies. Many children work on small family farms, as street vendors, or in small workshops to supplement the family income. In September 1998, the government created the National Commission for the Gradual and Progressive Eradication of Child Labor.

e. Acceptable Conditions of Work: In 1998, the government decreed a median 17 percent increase in the minimum wage. Daily pay rates vary by geographic zone and the sector of the economy affected; urban workers earn slightly more than workers in the countryside. The lowest minimum wage occurs in the agricultural sector, where it ranges from $2.07 to $2.20 (28.65 to 30.40 lempiras) per day, depending on whether the employer has more than fifteen employees; the highest minimum wage is $3.39 (46.80 lempiras) per day in the export sector. All workers are entitled to the equivalent of an additional one month's salary in June and December of each year. The law prescribes a maximum eight-hour day and a 44-hour workweek. There is a requirement of at least one 24-hour rest period every eight days. The Labor Code provides for a paid vacation of ten workdays after one year, and of twenty workdays after four years. However, employers frequently ignore these regulations due to the high level of unemployment and underemployment and the lack of effective enforcement by the Ministry of Labor.

f. Rights In Sectors With U.S. Investment: The worker rights enumerated above are respected more fully in sectors with sizable U.S. investment than in sectors of the economy lacking substantive U.S. participation. For example, in a number of U.S.-owned Maquila plants, workers have shown little enthusiasm for unionizing, since they consider their treatment, salary, and working conditions to be as good as, or better than, those in unionized plants. In establishing new investments in Honduras, U.S. businesses in recent years consciously have constructed their plants to meet more stringent U.S. Government laws and regulations.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis -- 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		21
Total Manufacturing		159
Food & Kindred Products	152	
Chemicals & Allied Products	3	
Primary & Fabricated Metals	(1)	
Industrial Machinery and Equipment	0	
Electric & Electronic Equipment	0	
Transportation Equipment	0	
Other Manufacturing	3	
Wholesale Trade		2
Banking		(2)
Finance/Insurance/Real Estate		21
Services		0
Other Industries		(2)
TOTAL ALL INDUSTRIES		183

(1) Less than $500,000 (+/-).
(2) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.