

**FOR  
AGENDA**

SM/82/151

CONTAINS CONFIDENTIAL  
INFORMATION

July 28, 1982

To: Members of the Executive Board  
From: The Acting Secretary  
Subject: Honduras - Staff Report for the 1982 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with Honduras.

This subject will be brought to the agenda for discussion on a date to be announced.

Att: (1)

Other Distribution:  
Department Heads

INTERNATIONAL MONETARY FUND

HONDURAS

Staff Report for the 1982 Article IV Consultation

Prepared by the Staff Representatives for the 1982  
Consultation with Honduras

Approved by E. Walter Robichek and Manuel Guitian

July 23, 1982

I. Introduction

The 1982 Article IV consultation discussions with Honduras <sup>1/</sup> were conducted in Tegucigalpa during the period of April 26-May 21, 1982. Representatives of Honduras in these discussions included the President of the Central Bank, the Minister of Finance, the Minister of Economy, the Minister of Public Works, the Executive Secretary of the National Planning Council, and senior officials of various ministries, the Central Bank, and several state enterprises. A group of representatives who participated in these discussions were R. A. [redacted] (Head), L. Cardemil, M. Hernandez (all WHD), P. Rado (FAD), K. Swiderski (EP-ETR), and M. Sucharov (Secretary-WHD). Mr. H. Jafri, resident representative of the Fund in Honduras, assisted the mission.

The last Article IV consultation with Honduras was held in April-May 1980 and the relevant documents (SM/80/165 and SM/80/175) were considered by the Executive Board on August 4, 1980 (EBM/80/118). The staff report on Honduras' program for the third year under the extended arrangement approved in June 1979 (EBS/81/130) was considered by the Executive Board on June 29, 1981 (EBM/81/100) and a request for a purchase under the compensatory financing facility (EBS/81/249) was approved on January 8, 1982 (EBM/82/3).

II. Recent Developments and Performance  
Under the Extended Arrangement

In June 1982 the three-year extended arrangement with Honduras expired. This arrangement had as its main aim the strengthening of the public finances at a time when the Honduran Government was embarking on a major development effort to diversify the economy, to improve its basic infrastructure, and to maintain the growth momentum achieved during the coffee boom years 1976-77. In late 1978 a five-year development plan (1979-83) was adopted to mobilize domestic and foreign

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<sup>1/</sup> Honduras has accepted the obligations of Article VIII, Sections 2, 3, and 4.

resources to finance high levels of public investment particularly in the areas of hydropower generation, forestry development, agrarian reform, and other economic and social infrastructure. This development plan was evaluated by the World Bank and the Inter-American Development Bank which, together with various bilateral development agencies, have supported it financially. Although Honduras did not have an immediate balance of payments need when it entered into the arrangement, it was believed that the implementation of the development plan might result in balance of payments pressures.

Honduras' performance under the extended arrangement was mixed. During the first 12-month period of the arrangement (July 1979-June 1980), Honduras observed the main quantitative performance criteria of the program, but during the second semester of 1980 significant departures began to emerge (Table 1).<sup>1/</sup> Subsequently, purchasing rights under the arrangement were temporarily interrupted during the first half of 1981 because of delays in the implementation of fiscal actions needed to comply with the program. A program for the final 12-month period of the arrangement, which included revised targets through 1982, was approved by the Executive Board on June 29, 1981. However, by late August 1981, Honduras was not observing the two credit ceilings of the program and after that date was unable to bring its performance back into line with program projections.

The main reason for Honduras' inability to observe the limits and targets of the EFF program during the last two years has been the weak performance of the public sector, especially the Central Government. In addition, several financial intermediaries began to encounter serious difficulties during the latter half of 1980, and such difficulties became particularly acute during 1981. Pressures from both the public and banking sectors led the Central Bank to expand its net domestic assets well in excess of the program limits with the result that both the ceiling on the Central Bank's net domestic assets and that on the banking system's net credit to the public sector were exceeded most of the time during the last two years.

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<sup>1/</sup> Under the arrangement, quantitative performance criteria were set initially for the period July 1979-December 1980.

Table 1. Honduras: Performance Under EFF Ceilings

	1979	1980		1981		1982
	Dec.	June	Dec.	July	Dec.	June
(In millions of lempiras)						
1. <u>Net domestic assets of the</u> <u>Central Bank</u>						
Ceiling <u>1/</u>	-8	-29	-1	120	165	135
Actual	-59	-50	88	118	344	433
Excess over ceiling (-)	51	21	-89	2	-179	-298
2. <u>Banking system net credit to</u> <u>the public sector</u>						
Ceiling <u>2/</u>	270	260	310	470	480	460
Actual	270	303	421	467	572	648
Excess over ceiling (-)	--	-43	-111	3	-92	-188
(In millions of U.S. dollars)						
3. <u>Public sector's net external</u> <u>borrowing at commercial terms</u>						
Ceiling <u>3/</u>	25	50	70	...	25	50
Actual	6	-10	28	...	-5	42
Excess over ceiling (-)	19	60	42	...	30	8

Source Central Bank of Honduras.

1/ Applicable at all times.

2/ Applicable monthly.

3/ Applicable semiannually, and measured with respect to initial date of program period.

To a significant extent, the economic and political crisis in Central America had an adverse impact on Honduras' economic performance, a factor that could not have been anticipated at the time the original EFF program was framed in early 1979. Honduras has been relatively free of political violence, but the spillover effects of the civil strife in El Salvador, Guatemala, and Nicaragua since late 1979 have eroded confidence in Honduras with adverse consequences for investment, trade, and domestic financial savings. Real GDP grew strongly in 1979, in line with program projections, but there was a marked deceleration in 1980 to a rate well below the one anticipated, and in 1981 the Honduran economy was virtually stagnant. The primary manifestation in the balance of payments of Honduras of the unstable political situation in the region has been weaker than expected net capital inflows in each of the last three years. This was especially apparent in the case of the private nonfinancial sector, but also for the financial system,

notably in 1980 and 1981. During these years Honduran banks were required to repay foreign lines of credit, as normal financing from commercial banks abroad was reduced. Consequently, Honduras' balance of payments performance in 1980 and 1981 was much weaker than expected, even though its current account deficit was either in line with, or somewhat smaller than, that programed (Table 2).

Compounding the impact of exogenous factors, the conduct of fiscal and monetary policy was a major contributing factor to the weak performance of Honduras under the extended arrangement. During both 1980 and 1981, the overall deficit of the public sector was well in excess of the program targets, mainly because of a deterioration in the current account position of the Central Government. In each of these years, revenue yields were significantly lower, and current expenditure significantly higher, than programed. As a consequence, the current account surplus of the public sector declined from around 6 per cent of GDP in 1979 to 3 per cent in 1980 and to 1-1/2 per cent in 1981, a performance significantly weaker than that envisaged in the EFF programs.

On the revenue side, lower levels of foreign trade and weaker domestic economic activity than expected accounted for some of the shortfall in 1980 and 1981, but an important explanatory factor appears to have been a deterioration in tax administration and enforcement. In addition, the incremental tax effort in each year fell short of that originally intended in terms of the scope of the revenue measures involved. The 1980 program called for the introduction of selective consumption duties and changes in the sales and income taxes which were intended to yield additional tax revenues equivalent to about 2 per cent of GDP. The authorities adopted a different tax package with an equivalent revenue yield in 1980 which included the introduction of a pay-as-you-go system in the corporate income tax, a progressive tax on sugar exports, and a 1 per cent ad valorem tax on other previously exempted exports, but about three fourths of its anticipated yield resulted from the temporary double taxation involved in the overlapping of the new and old systems of corporate income tax collection. Despite these measures, total public sector revenues remained virtually unchanged in relation to GDP, as the strong growth in income tax yield was partly offset by the poor performance of a number of other taxes, mainly because of a deterioration in tax administration, particularly of import and sales taxes.

A similar situation presented itself in 1981. When the EFF program for 1981 was being framed, the authorities proposed to introduce the same tax measures originally contemplated for the 1980 program. However, these proposals were withdrawn and, at the end of April 1981, the authorities introduced instead an ad valorem import surcharge of 10 per cent for final consumer goods and one of 5 per cent for raw materials and capital goods. This measure was expected to have an incremental effect on revenue growth in 1981 equivalent to about 1-1/2 per cent of GDP. Nevertheless, total central government revenues actually fell slightly in absolute terms last year, in part because of weaker than projected economic conditions, but also because of further slippages in customs and sales tax administration.

Table 2. Honduras: Macroeconomic Flows

(As a per cent of GDP)

	1979		1980		1981	
	Prog.	Actual	Prog.	Actual	Prog.	Actual
<u>Balance of payments current account</u>	-12.5	-8.9	-12.6	-12.6	-12.0	-10.8
Goods, nonfactor services, and transfers	-7.9	-3.3	-7.9	-6.6	-6.0	-5.0
Of which: trade account	(-8.4)	(-4.4)	(-8.5)	(-7.7)	(-7.2)	(-6.5)
Factor payments	-4.6	-5.6	-4.7	-6.0	-6.0	-5.8
<u>Capital account</u>	12.5	10.1	12.6	10.0	10.8	7.0
Nonfinancial private sector	4.9	2.5	4.9	3.4	3.3	1.3
Nonfinancial public sector	5.6	4.7	5.8	5.7	5.9	5.8
Financial intermediaries	1.9	2.9	1.9	0.9	1.6	-0.1
<u>Change in net international reserves (increase -)</u>	—	-1.2	—	2.6	1.2	3.8
<u>Public sector current account surplus</u>	5.3	5.8	6.2	2.9	4.4	1.8
General government current account	3.5	4.1	4.5	1.6	3.2	0.4
Revenue	(19.0)	(18.1)	(20.0)	(18.2)	(18.4)	(17.5)
Expenditure	(-15.4)	(-14.0)	(-15.4)	(-16.6)	(-15.2)	(-17.2)
State enterprises' operating surplus	1.8	1.7	1.6	1.3	1.2	1.4
<u>Capital expenditure and net lending</u>	-12.5	-11.0	-12.8	-12.0	-11.7	-10.2
Fixed investment	-10.2	-10.0	-10.5	-10.2	-9.4	-7.9
Other capital expenditure	-2.3	-1.0	-2.3	-1.9	-2.3	-2.2
<u>Overall deficit</u>	-7.3	-5.2	-6.6	-9.0	-7.3	-8.5
External financing	5.6	4.7	5.8	5.7	5.9	5.8
Domestic financing	1.7	0.5	0.8	3.3	1.4	2.7
<u>Investment and savings</u>						
Fixed capital formation	23.9	27.2	24.7	27.0	24.5	24.3
Public sector	(10.2)	(10.0)	(10.5)	(10.2)	(9.4)	(7.9)
Private sector	(13.7)	(17.2)	(14.2)	(16.8)	(15.1)	(16.4)
Inventory change	2.4	2.1	1.0	1.6	2.4	-0.3
<u>Investment=savings</u>	26.3	29.3	25.7	28.6	26.9	24.0
External savings	8.8	4.3	8.9	7.5	6.9	5.8
Domestic savings	17.5	25.0	16.8	21.1	20.0	18.2
Public sector	(5.3)	(5.8)	(6.2)	(2.9)	(4.4)	(1.8)
Private sector	(12.2)	(19.2)	(10.6)	(18.2)	(15.6)	(16.4)

Sources: Staff report on recent economic developments; and EBS/81/110.

The targets for public sector savings and the overall deficit were also exceeded in 1980-81 because of a rapid growth in expenditure. Public sector current expenditure rose by nearly 40 per cent in 1980, considerably in excess of the 14 per cent growth rate budgeted by the Government. The sharp expansion in current expenditures in 1980 reflected salary adjustments and extensive additions to the budget in the areas of education, health, and agrarian reform. The growth in public sector capital outlays also accelerated in that year, rising by nearly one third, mainly because of higher outlays by the National Electricity Enterprise (ENEE), the Honduran Telecommunications Enterprise (HONDUTEL), and the National Agrarian Institute (INA). During 1981 the growth of current expenditure decelerated, but it was still above the programmed rate, whereas public sector capital outlays fell significantly in absolute terms to about the same level as in 1979. This decline, contrary to program projections, reflected administrative bottlenecks, the lack of domestic counterpart funds, and the suspension of work at an important port project (Puerto Castilla) because of a dispute between the Government and a foreign contractor.

As a consequence of the deterioration in the public finances in 1980 and 1981, the banking system had to finance the public sector at a rate well in excess of the program ceilings. During 1980 net banking system credit to the public sector was in excess of the ceiling by L 111 million, and in 1981 the excess was L 92 million. In view of the sluggish growth in private financial savings, the excess demand for bank credit on the part of the public sector resulted in some squeeze on credit to the private sector. The latter amounted to only one half of the projected growth in 1980 and about four fifths of the growth rate estimated in 1981. Although the actual growth of private financial savings in 1981 was higher than in 1980, and higher than programmed, this growth was offset to a large extent by a reduction in the lines of credit of domestic banks from commercial banks abroad. In an attempt to supplement their loanable funds in 1980-81, the domestic banks drew down their reserve deposits with the Central Bank and from time to time incurred reserve deficiencies.

The problems of the financial sector were aggravated by the weak performance of three entities which experienced particularly severe difficulties. One of these, a private commercial bank (BANFINAN), was forced into liquidation in late 1980, after a period of financial mismanagement. At the beginning of 1981, an extraordinary credit from the Central Bank of L 20 million was intended to help pay off its deposit liabilities to the public, but during the year the amount of Central Bank credit used for this purpose rose to L 50 million. In addition, the state-owned Agricultural Development Bank (BANADESA) ran up a large overdraft position with the Central Bank, amounting to L 34 million at the end of 1981, as a result of a sharp increase in the number of loans which it could not recover. Finally, the Central Bank was required to extend special credits last year to the state-owned Industrial Development Corporation (CONADI) which was unable to service fully its external debt because of a deterioration in its financial position.

As a result of the combined pressures from the public and financial sectors, the Central Bank exceeded the applicable ceiling on its net domestic assets by L 89 million at the end of 1980 and by L 179 million at the end of 1981.

### III. Economic Prospects and Policies

Since early 1982 the Honduran authorities, under a newly elected Administration, have taken a number of measures to improve the public finances and the balance of payments.<sup>1/</sup> Because of the lagged effect of these measures and the underlying weakness of the economy, the authorities did not expect financial performance to improve significantly in 1982, but they foresaw a marked reduction in the overall fiscal and balance of payments deficits for 1983. Accordingly, the consultation discussions focused primarily on the elements of a stabilization program geared to these objectives. In these discussions, the Honduran authorities expressed their intention to negotiate a stand-by arrangement later in the year in support of a financial program extending through the end of 1983.

In the short run, the Honduran authorities considered that the level of domestic economic activity would continue to be depressed because of weak export demand, sluggish private investment, and the dampening effect of monetary and fiscal restraint. The possibility of economic recovery in 1983 was viewed as dependent mainly on a pickup in public investment and a return to higher growth in the industrial countries.

#### 1. External sector policies

The Honduran authorities thought that the balance of payments would remain weak in 1982 primarily because of the poor outlook for exports. In 1981 the value of exports declined by 6-1/2 per cent, the first decrease in six years, and in 1982 a further small decline is forecast (Table 3). Except for an increase in the case of bananas, Honduras' major export commodity, most other export products are projected to show no growth or some decline this year. The prospects for sugar and tobacco are particularly bleak, as in the former case the combination of low international prices and the imposition of export quotas by the United States, and in the latter case the effects of local disease, are expected to depress earnings in these sectors. Imports are estimated to rise marginally this year, after a sharp decline in 1981, as public investment will be higher in 1982. Nevertheless, depressed economic conditions and restraints on credit growth are expected to contain the demand for private imports.

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<sup>1/</sup> In November 1981, presidential elections were held for the first time in ten years, thus completing the transition from military to civilian rule which began with the election of a Constitutional Assembly in April 1980. The new Government was inaugurated in January 1982.



Table 3. Honduras: Summary Balance of Payments

(In millions of U.S. dollars)

	1979		1980		1981		1982	
	Prog.1/	Act.	Prog.1/	Act.	Prog.1/	Act.	Prog.	Proj.
Current account	-254	-192	-294	-321	-345	-296	-331	
Trade balance	-172	-95	-198	-196	-207	-178	-205	
Exports, f.o.b.	(659)	(756)	(735)	(849)	(880)	(795)	(790)	
Imports, c.i.f.	(-831)	(-852)	(-933)	(-1,045)	(-1,087)	(-973)	(-995)	
Factor payments (net)	-94	-120	-109	-153	-173	-158	-175	
Other services and transfers (net)	12	24	13	29	35	40	49	
Capital account	249	213	289	250	305	165	255	
Nonfinancial private sector 2/	100	55	115	87	95	19	26	
Nonfinancial public sector	115	100	135	144	170	159	167	
Financial intermediaries	34	58	39	19	40	-13	19	
Debt relief	--	--	--	--	--	--	43	
Allocation of SDRs	5	5	5	5	5	5	--	
Overall balance	--	26	--	-66	-35	-126	-76	
External debt arrears	--	--	--	--	--	21	-21	
Rescheduling	--	--	--	--	--	--	21	
Change in net international reserves	--	--	--	--	--	--	--	
of the Central Bank (increase -)	--	-26	--	66	35	105	76	

Sources: Central Bank of Honduras; and Fund staff estimates.

1/ As presented in EBS/81/130.

2/ Includes net errors and omissions.

Although the current account deficit is projected to remain at about the same level in relation to GDP as in 1981, net capital inflows are likely to be substantially higher in 1982 than in 1981, because of a combination of larger official aid linked with the public investment program and the Caribbean Basin Initiative of the United States and of a rescheduling of certain foreign commercial debt which is being sought. The authorities believed that the continuation of these inflows next year, together with a recovery in exports, held out the prospect of approximate balance of payments equilibrium in 1983.

The authorities placed a high priority on the restructuring during 1982 of the foreign commercial debt of a number of public entities and private enterprises with public sector guarantee. The most important of these entities is CONADI, but also included is the Honduran Banana Corporation (COHBANA), the Honduran Coffee Institute (IHCAFE), the National Port Authority (ENP), the municipalities of Tegucigalpa and San Pedro Sula, and the Honduran Cement Company (HONDUCEM). The total foreign commercial debt for which rescheduling is being sought amounts to about US\$200 million and it is estimated that repayments of principal amounting to about US\$60 million in 1982 will be involved.

In view of the problem of foreign commercial borrowing which emerged over the last few years, the authorities have decided to tighten their procedures for external debt control. Under the new Constitution enacted in December 1981, all foreign borrowing by the public sector requires the explicit approval of the legislative branch. In addition, a commission comprising representatives of the Central Bank, the Ministry of Finance, and the National Planning Agency (CONSUPLANE) has been established to review each request for foreign borrowing by public sector entities. Requests for official guarantees of private foreign borrowing will be scrutinized more carefully by the Central Government or the Central Bank, and CONADI's foreign borrowing operations, in particular, have been suspended. It is also expected that a new Public Credit Law will be presented to Congress before the end of 1982, whose main purposes will be to strengthen the coordinating and supervisory functions of the Public Credit Office of the Ministry of Finance and to codify the new procedures established since the end of 1981 for controlling the external borrowing operations of public sector entities.

Notwithstanding the problem of foreign commercial borrowing described above, the overall external debt position of Honduras continues to be generally favorable. At the end of 1981, total external public debt outstanding amounted to US\$1.3 billion, equivalent to 48 per cent of GDP. Most of this debt is with official bilateral and multilateral agencies and financial institutions and is concessionary in nature. Total debt service payments amounted to 16 per cent of exports of goods and services in 1981 and are projected at around 20 per cent, on average, for the period 1982-84.

Honduras' exchange and trade system has traditionally been free of any restrictions on international transactions. In late 1980, exchange requests in excess of US\$5,000 were made subject to prior approval and surrender requirements were applied to certain exports

with a view toward restraining capital outflows. Subsequently, in September 1981, registration requirements were extended to all exports and surrender requirements were extended to all exchange receipts. At the same time, a priority system was established for the allocation of foreign exchange which has given rise to arrears on import payments estimated at US\$13.5 million as of the end of April 1982.<sup>1/</sup> In May 1982 the authorities replaced this priority scheme with a similar one which will operate at the stage of import permits. The authorities considered this restraint as a temporary measure which they would use only during the present period of acute foreign exchange shortage, and indicated that it would be eliminated as soon as conditions permitted.

Despite the balance of payments pressures experienced in the last two years and the emergence of arrears, the authorities believed that the present exchange value of the Honduran lempira was basically adequate. The real effective exchange rate for the lempira appreciated by about 7 per cent during 1981 mainly because of the strength of the U.S. dollar. But this appreciation followed a period of about eight years in which the Honduran lempira depreciated in real effective terms by about 20 per cent. There was some concern expressed by the Honduran representatives over the competitive position of Honduran exporters within the Central American region, especially vis-a-vis Costa Rica and El Salvador, which have recently experienced significant exchange rate adjustments. As for trade outside the region, the Honduran authorities believed that their external position would remain competitive as long as they maintained a reasonable equivalence between domestic cost increases and price rises in their major trading partners, as has traditionally been the case. The authorities were also wary that in an open economy, such as that of Honduras, a change in the external value of the lempira could have significant inflationary effects which would outweigh the beneficial impact of a currency adjustment on domestic relative prices for traded goods. On these grounds the Honduran representatives argued that a successful adjustment program had to be based primarily on demand management policies.

## 2. Fiscal policy

The Government's fiscal policy is aimed basically at strengthening public savings in order to reverse the deterioration experienced during the last two years. In this way, the authorities hoped to mobilize noninflationary resources for public investment while reducing at the same time the public sector's dependence on domestic bank financing. On the revenue side, a number of actions have either already been adopted or are planned to be adopted this year. In January 1982 a tax package was approved in the context of the 1982 budget exercise which included an increase in the sales tax rate from 3 per cent to 5 per cent, the introduction of income tax surcharges of 10 per cent and 15 per cent for the upper brackets of the income tax schedule, and the elimination of many income tax exemptions.

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<sup>1/</sup> These changes in the exchange system were reported to the Executive Board in EBS/81/207.

In June 1982 the authorities presented a second tax package to Congress, which included the establishment of new selective consumption duties (ranging from 10 per cent to 50 per cent) and legislation calling for a substantial increase in penalties for tax evasion and delays in tax payments. At the same time, a regulation improving the administration of the sales tax was introduced by Executive order.<sup>1/</sup>

The authorities also indicated their intention to institute a comprehensive reform of the customs tariff before the end of 1982 with a view to improving revenue yields during 1983. This reform would involve the substitution of ad valorem for specific rates, the elimination of existing surcharges, an increase in the average duty rate, and a change in the nomenclature of the tariff from that based on the uniform Central American code (NAUCA) to that based on the Brussels code (NCCA).

Efforts are also being made to strengthen the financial position of the state enterprises. In the case of the National Port Authority (ENP), a program of adjustments in service charges was initiated in June 1982 which will increase revenues of ENP this year by about 30 per cent. In addition, the National Electricity Authority (ENEE) is planning to raise its rates by 20 per cent in September 1982. These adjustments, together with other measures to control costs, are expected to strengthen the public enterprise sector and to enable it to finance a larger share of its investment expenditure.

The combined effect of all the revenue measures taken in 1982 is to increase public sector revenues by about 15 per cent this year and to raise the ratio of these revenues to GDP from 19 per cent in 1981 to 20 per cent in 1982 (Table 4). The tax measures presented to Congress in June 1982, together with the customs reform, are projected to yield incremental revenue equivalent to more than 2 per cent of GDP in 1983.

The efforts to improve public sector revenue performance have been complemented by a program to contain the growth in public expenditures. In March 1982, the Executive ordered a cut of 10 per cent in budgeted current expenditures throughout the public sector. During 1982 no wage increases will be granted for government workers, excess personnel is being reduced, and vacancies have remained unfilled. As a result, current expenditures of the public sector are projected to rise by about 9-1/2 per cent in 1982, or somewhat less than the rate recorded in 1981. In addition, the Government has strengthened the oversight functions of the Superintendency of Decentralized Agencies whose main role is to monitor the financial operations of the state enterprises and other decentralized public agencies. Moreover, all of the budgets of the main public sector entities have been reviewed by a joint commission comprising the Ministry of Finance, the National Planning Office (CONSUPLANE) and the Superintendency of Decentralized Agencies to ensure that they will be in compliance with the Presidential directive calling for a 10 per cent cut in current outlays.

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<sup>1/</sup> The proposed changes in tax administration were based on the recommendations of an expert from the Fund's fiscal panel.

Table 4. Honduras: Summary Operations of the Public Sector

	1979		1980		1981		1982
	Prog.1/	Act.	Prog.1/	Act.	Prog.1/	Act.	Proj.
(In millions of lempiras)							
<u>Total revenue</u>	<u>845</u>	<u>858</u>	<u>1,004</u>	<u>994</u>	<u>1,134</u>	<u>1,038</u>	<u>1,194</u>
<u>Total expenditure and net lending</u>	<u>1,142</u>	<u>1,080</u>	<u>1,311</u>	<u>1,452</u>	<u>1,554</u>	<u>1,502</u>	<u>1,720</u>
Current expenditure	630	603	718	842	881	945	1,035
Capital expenditure	472	446	550	548	623	440	488
Net lending	.0	31	43	62	50	117	197
<u>Current surplus</u>	<u>215</u>	<u>249</u>	<u>286</u>	<u>143</u>	<u>253</u>	<u>99</u>	<u>154</u>
<u>Overall deficit</u>	<u>-297</u>	<u>-222</u>	<u>-307</u>	<u>-458</u>	<u>-420</u>	<u>-464</u>	<u>-526</u>
External financing	229	202	268	288	340	317	335
Domestic financing	68	20	39	170	80	147	191
(As a per cent of GDP)							
<u>Total revenue</u>	<u>20.7</u>	<u>19.9</u>	<u>21.6</u>	<u>19.6</u>	<u>19.7</u>	<u>18.9</u>	<u>19.8</u>
<u>Total expenditure and net lending</u>	<u>28.0</u>	<u>25.1</u>	<u>28.2</u>	<u>28.6</u>	<u>26.9</u>	<u>27.4</u>	<u>28.5</u>
Current expenditure	15.4	14.0	15.4	16.6	15.2	17.2	17.2
Capital expenditure	11.6	10.0	11.8	10.8	10.8	8.0	8.1
Net lending	0.9	1.1	1.0	1.2	0.9	2.2	3.3
<u>Current surplus</u>	<u>5.3</u>	<u>5.8</u>	<u>6.2</u>	<u>2.8</u>	<u>4.4</u>	<u>1.8</u>	<u>2.5</u>
<u>Overall deficit</u>	<u>-7.3</u>	<u>-5.2</u>	<u>-6.6</u>	<u>-9.0</u>	<u>-7.3</u>	<u>-8.5</u>	<u>-8.7</u>
External financing	5.6	4.7	5.8	5.7	5.9	5.8	5.5
Domestic financing	1.7	0.5	0.8	3.3	1.4	2.7	3.2

Sources: Central Bank of Honduras, Ministry of Finance; and Fund staff estimates.

1/ As presented in EBS/81/130.

Total expenditure of the public sector is projected to rise by around 14-1/2 per cent in 1982. Although the growth rate of current expenditure in 1982 will decline with respect to last year, the growth in capital expenditure is expected to accelerate, in view of the Government's efforts to improve the execution of the public investment program. In this connection, it was reported that the construction of the important El Cajon hydroelectric project was basically on schedule, and the port expansion at Puerto Castilla was expected to be completed later this year to permit the export of new wood production from the Olancho region.

In addition, the authorities explained that net lending of the public sector will increase sharply in 1982 because of the burden on the Central Government of interest payments on certain guaranteed debts of the financial and private sectors to foreign commercial banks which cannot be paid by the National Investment Corporation (CONADI) and the Honduran Cement Co. (HONDUCEM). These payments are estimated at about L 75 million in 1982. In view of these extraordinary expenditures, the improvement in public savings in 1982, based on the revenue and expenditure measures described above, will not produce a reduction of the overall deficit of the public sector this year. Indeed, the financing requirements of the public sector are likely to increase both in absolute terms and in relation to GDP this year. However, the authorities were confident that in 1983, when the full year's impact of the tax measures adopted in 1982 would be felt, the overall public sector deficit would be significantly reduced.

Most of the public sector financing in 1982 is expected to be covered by disbursements of long-term development loans, however, a significant portion of the deficit (around 3 per cent of GDP) will need to be financed from domestic sources. In order to minimize the impact of this domestic borrowing on the credit expansion of the Central Bank, the authorities intend to increase the sale of government bonds in the nonbank market.

### 3. Monetary policy

In the area of monetary policy, the main objectives of the authorities are to encourage the growth of financial savings, to provide an adequate expansion of credit to the private sector, and to ensure the soundness of domestic financial institutions, both public and private.

The authorities indicated their intention to continue the policy of interest rate flexibility during 1982 to ensure a positive return in real terms to domestic savers and to maintain competitiveness vis-à-vis financial markets abroad. During the last two years, the authorities have gradually liberalized the interest rate structure such that the only remaining interest rate ceiling is for domestic bank loans (i.e., 19 per cent). There is no ceiling on bank deposit rates, nor on loans financed with funds borrowed from abroad. At present, local bank rates for time deposits range up to a maximum of 16 per cent. In

May 1982, the authorities simplified the structure of lending rates by unifying the ceiling on all new bank loans at 19 per cent. Similarly, the rediscount rate of the Central Bank was raised to 15 per cent for all operations, except the financing of basic grains production which remains at 10 per cent. Both the rediscount rate of the Central Bank and the maximum bank lending rate will henceforth be reviewed quarterly to determine whether upward or downward adjustments would be appropriate in the light of domestic and foreign market conditions. As of mid-1982, the yield on government bonds was raised to 12 per cent (tax exempt) in order to facilitate the placement of these bonds with the private sector.

The authorities reported that steps were being taken to increase the penalties for legal reserve deficiencies and to strengthen the role of the Superintendent of Banks. As of May 1982, the authorities raised the rate on Central Bank advances to cover reserve deficiencies from 2 percentage points above the maximum commercial bank lending rate to 5 percentage points. In such cases, the Superintendent of Banks will develop a program with each bank to ensure that such advances are temporary and that compliance with the legal reserve requirements is achieved within a prescribed period of time. In cases where banks do not use Central Bank resources to cover their reserve deficiencies, legal fines will be applied, and access to other Central Bank financing will be suspended. By law, the fines for legal reserve deficiencies are only 1 per cent per month; however, the authorities indicated that these fines would be raised in the context of a reform of the banking law to be introduced before the end of 1982.

The authorities have also taken steps to strengthen the performance of the public financial institutions (CONADI and BANADESA). CONADI's lending operations have been suspended pending the completion of a detailed study of its finances and the financial position of its borrowers. As mentioned earlier, the Government is in the process of rescheduling the foreign commercial debt held directly by CONADI or guaranteed by it. Moreover, a decision is to be announced soon on the future role of CONADI which may involve the transfer of its lending functions to the Industrial Development Fund (FONDEI) operated by the Central Government.

In the case of BANADESA, efforts are being made to improve its loan recovery performance which was poor during the last two years. The Government has proposed an increase in the capitalization of BANADESA to strengthen its financial position which is to be effected over a period of several years through the annual budget exercise. In addition, BANADESA's debt with the Central Bank arising from overdrafts, loans, and advances has been consolidated into a medium-term obligation which is to be repaid with part of the proceeds of each year's contribution to BANADESA's capital.

Bank liabilities to the private sector are projected to grow at a rate of about 7 per cent during 1982. These resources will be supplemented by the use of medium- and long-term foreign loans intermediated

through the Central Bank, representing mainly credits under the Mexican-Venezuelan regional oil facility and credits from bilateral agencies under the U.S. Government's Caribbean Basin Initiative. During 1982 the net use of these resources is projected at US\$33 million (Table 5). The authorities expected that a significant portion of these resources would be channeled via rediscounts to the rest of the banking system to allow bank credit to the private sector to grow at roughly the same rate as in 1981, or around 8 per cent.

Table 5. Honduras Summary Operations of the Central Bank

(Annual flows in millions of lempiras)

	1979		1980		1981		1982
	Prog.1/	Act.	Prog.1/	Act.	Prog.1/	Act.	Proj.
<u>Net foreign assets</u>	--	<u>51</u>	--	<u>-140</u>	<u>-69</u>	<u>-231</u>	<u>-151</u>
<u>Net domestic assets</u>	<u>35</u>	<u>7</u>	<u>39</u>	<u>147</u>	<u>77</u>	<u>257</u>	<u>163</u>
Net credit to public sector 2/	67	68	39	151	60	151	150
Net credit to banks 2/	-28	7	-4	63	59	50	65
Medium- and long-term foreign liabilities	-4	-65	4	-44	-51	3	-79
Other (net)	--	-3	--	-23	9	53	27
<u>Currency issue</u>	<u>35</u>	<u>58</u>	<u>39</u>	<u>7</u>	<u>8</u>	<u>26</u>	<u>12</u>

Sources: Central Bank of Honduras; and Fund staff estimates.

1/ As presented in EBS/81/130.

2/ Government securities held as part of legal reserve requirements were included in Central Bank's net credit to the public sector, and in net claims by banks on the Central Bank, under the EFF arrangement.

#### 4. Wage and price policies

The policy of the authorities is not to intervene in the wage determination process. In recent years, because of the weakening of economic conditions in Honduras, labor pressures for wage increases in the private sector have subsided and it appears, on the basis of fragmentary evidence, that wage rates, in general, have lagged behind inflation. The same holds true for the public sector. Minimum wages were raised in both 1980 and 1981, but the authorities do not intend to raise them in 1982. In the public sector, no increase in wage rates was included in the central government budget for 1982, and increases in the rest of the public sector will only be granted this year if they can be accommodated within the financial constraints of the entities concerned.



The one area of wage policy where the authorities expressed some concern was a law approved last year by the Constitutional Assembly calling for the extension of a bonus payment for either a thirteenth month or seventh day to all workers in the economy. It was acknowledged that the implementation of this law could have serious consequences on costs and/or employment in many enterprises, even though the practice of bonus payments was already widespread. Accordingly, the authorities intended to reach an agreement with the business sector that these bonuses would be paid only insofar as the financial conditions of individual enterprises permitted.

The authorities reported that they intended to reduce the scope of price controls gradually over time, so as to allow most prices in the economy to be set by market forces. Price controls have been enforced since 1974 for a variety of essential food supplies, household items, and intermediate goods. As of March 1982, the number of commodities subject to price controls was reduced substantially. In addition to limiting the application of price controls, the authorities hope to make the system of price control adjustments more automatic, especially in the case of imported commodities. This is already the practice in the case of fuel derivatives which in the past have been adjusted upward periodically in line with crude petroleum prices in the world market. As of mid-1982, the domestic price of premium gasoline was the equivalent of US\$2.08 per gallon.

#### IV. Staff Appraisal

Honduras' three-year extended arrangement expired in June 1982. Performance was satisfactory during the first 12-month period of this arrangement, but significant departures emerged since the latter half of 1980, and Honduras was unable to observe the quantitative performance criteria set for the final 12-month period of the arrangement. The adverse effects on confidence and economic activity in Honduras of the political and economic crisis in Central America were worse than anticipated, and this fact may help to explain to some extent the poor results under the EFF program. However, significant slippages in fiscal management and financial control were also partly responsible for the deviations from the program targets. Both an erosion in the tax effort and sharp increases in current spending led to a substantial deterioration in public savings, which was reflected in an increased reliance of the public sector on Central Bank financing well in excess of program limits. At the same time, a deterioration in the administration of two public financial intermediaries and sporadic legal reserve deficiencies of the private commercial banks have increased the pressure on Central Bank resources. The result of these developments was a loss of net international reserves of the Central Bank of US\$66 million in 1980 and of US\$105 million in 1981.

Under a new administration, the Honduran authorities are now in the process of developing a stabilization program which is designed to move the economy toward balance of payments equilibrium. Because of

the lagged effect of many of the adjustment measures and the underlying weakness of the economy a significant improvement in the fiscal and external position of Honduras cannot be expected until 1983. In support of this stabilization effort, the Honduran Government has expressed its intention to negotiate a stand-by arrangement with the Fund later this year.

In the fiscal area, the authorities are adopting measures in 1982 which are projected to raise public sector revenues this year by the equivalent of 1 per cent of GDP. Also, a comprehensive reform of the customs tariff is under study which is expected to boost central government revenues significantly in 1983. On the expenditure side, the Government has instituted an austerity program with regard to current expenditure; but total public expenditure will rise faster than nominal GDP this year because of an improved execution of the public investment program and because of the assumption by the Central Government of interest payments on foreign commercial debt which cannot be met by certain institutions. As a complement to its fiscal action, the Government is also seeking to reschedule the repayments of principal on this foreign commercial debt.

Consequently, the domestic financing needs of the public sector this year are expected to be larger than they were in 1981. In order to minimize the impact of the public sector's larger domestic borrowing requirement in 1982, the authorities should be prepared to take additional revenue and/or expenditure measures and to increase the sale of government bonds in the domestic nonbank market. To encourage the demand for these bonds, the authorities have indicated their intention to maintain a flexible posture on domestic interest rates. In view of the relatively weak growth in private financial savings, the staff would encourage the Honduran authorities to lift the one remaining interest rate ceiling. Corrective action is also needed to strengthen the position of the public financial intermediaries and to eliminate the problem of legal reserve deficiencies, and the staff notes the efforts that are being made in this direction.

In framing their adjustment program, the Honduran authorities have reaffirmed their commitment to maintain a unified exchange rate and an exchange system free of restrictions on current international transactions, a commitment which underscores the critical importance of restrictive demand management policies and a tight control over domestic costs. Since late 1980, regulations on sales and surrender of exchange have been tightened, but these do not involve restrictions on payments and transfers for current international transactions subject to the Fund's approval under Article VIII. However, since late 1981 payments delays have occurred which have given rise to arrears on current international transactions and which do involve the Fund's approving jurisdiction. The staff urges the authorities to eliminate these arrears as soon as conditions permit. In the expectation that the Honduran authorities may request a stand-by arrangement in the near future, which would have as one of its goals the elimination of these arrears, the staff recommends that no action be taken by the Executive Board at this time.

Fund Relations with Honduras  
(As of June 30, 1982)

Status: Article VIII.

Quota: SDR 51 million.

Fund holdings of lempiras:	Millions of SDRs	Per Cent of Quota
Total	106.7	209.2
of which:		
Credit tranches	(12.8)	(25.0)
EFF	(19.7)	(38.5)
CFF	(23.3)	(45.7)

SDR Department:	Millions of SDRs	Per Cent of Allocation
Net cumulative allocation	19.1	100.0
Holdings	2.0	10.6

Trust Fund (second period):	Estimated maximum entitlement:	SDR 14.1 million
	Disbursed:	SDR 14.1 million

Gold distribution: 21,396 fine ounces.

Direct distribution  
of profits from  
gold sales: US\$4.0 million.

Exchange rate: US\$0.50 per lempira.

Last Article IV  
consultation: May 1980, discussed by the Executive  
Board on August 4, 1980 (EBM/80/118).

Resident represen-  
tative and techni-  
cal assistance: In December 1981, a Fund staff member  
was assigned as resident representative  
in Honduras for a period of one year.  
In early April 1982, an expert from the  
Fund's fiscal panel completed a two-month  
assignment as advisor on tax policy and  
administration. In September a CBD expert  
in bank supervision is expected to take up  
an assignment at the Central Bank for a  
period of one year.

HONDURAS--Basic Data

Area and population

Area	112,088 sq. kilometers
Population (mid-1981)	3.8 million
Annual rate of population increase (1976-81)	3.6 per cent

<u>GNP (1981)</u>	SDR 2,221 million
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<u>GNP per capita (1981 est.)</u>	SDR 584
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	1979	1980 (per cent)	Prel. 1981
<u>Origin of GDP</u>			
Agriculture	32	31	32
Manufacturing	16	17	17
Construction	5	5	5
Transport and communications	8	9	9
Commercial services	13	13	13
Other	26	25	24

Ratios to GDP

Balance of payments current account deficit	8.9	12.6	10.8
Exports of goods and services	39.9	38.1	33.1
Imports of goods and services	49.8	51.6	44.9
Central government overall deficit	4.2	7.7	7.5
Central government revenues	(14.7)	(15.0)	(13.5)
Central government expenditures	(18.9)	(22.6)	(20.9)
External public debt (end of year)	39.7	43.5	47.8
External debt service payments	4.7	4.9	5.3
Gross domestic savings	25.1	21.2	18.0
Gross domestic investment	29.3	28.6	24.0
Money and quasi-money (end of year) <sup>1/</sup>	32.1	29.2	29.8

Annual rates of change in selected economic indicators

<u>GDP</u>			
Real GDP per capita	3.0	-1.1	-3.2
Real GDP	6.6	2.6	0.3
GDP at current prices	19.0	17.9	8.1
Domestic expenditure (at current prices)	18.4	21.5	6.7
Gross fixed investment	20.0	16.8	-2.8
Consumption	16.5	24.0	12.5

Prices

GDP deflator	11.6	14.9	7.8
Consumer prices (annual averages)	12.1	18.1	9.4

Central government finances

Central government revenues	16.4	19.9	-2.4
Central government expenditures	6.6	41.2	0.4

APPENDIX II

<u>Annual rates of change (continued)</u>	<u>1979</u>	<u>1980</u>	<u>Prel.</u>	
<u>Money and credit</u>		(per cent)		
Money and quasi-money <u>1/</u>	12.4	7.2	10.4	
Money	(14.9)	(10.8)	(4.5)	
Quasi-money <u>1/</u>	(10.8)	(4.8)	(14.4)	
<u>Domestic assets of the financial system <u>2/</u></u>	19.3	18.5	22.6	
Credit to public sector (net)	(3.2)	(7.9)	(6.5)	
Credit to private sector	(12.3)	(7.1)	(8.2)	
<u>Trade</u>				
Merchandise exports (f.o.b.)	20.5	12.2	-6.4	
Merchandise imports (c.i.f.)	19.7	22.7	-6.9	
<u>Central government finances</u>	(millions of lempiras)			
Revenues	633	759	741	
Expenditures	813	1,148	1,153	
Current account surplus	87	--	-81	
Overall deficit (-)	-180	-389	-412	
External financing (net)	125	251	225	
Internal financing (net)	55	138	187	
<u>Balance of payments</u>	(millions of U.S. dollars)			
Merchandise exports (f.o.b.)	756	849	795	
Merchandise imports (c.i.f.)	-852	-1,045	-973	
Investment income (net)	-120	-154	-158	
Other services and transfers (net)	24	29	40	
Balance on current and transfer accounts	-192	-321	-296	
Official capital (net)	100	144	159	
Financial system capital (net) <u>3/</u>	63	24	-8	
Private capital (net) <u>4/</u>	55	87	19	
Net official international reserves (increase -)	-26	66	105	
External debt arrears	--	--	21	
<u>International reserve position</u>	Dec. 31 1980	March 31 1981	Dec. 31 1981	March 31 1982
	(millions of U.S. dollars)			
Central Bank (gross)	162.1	154.9	118.6	100.7
Central Bank (net)	115.8	119.0	10.5	-30.3
Rest of banking system (net)	-54.2	-32.8	-19.6	-20.8

1/ Excludes bonds issued by the nonfinancial public sector and currency and deposits of nonbank private financial intermediaries.

2/ In relation to the stock of liabilities to the private sector at the beginning of the period

3/ Includes transactions with nonmonetary international agencies and allocation of SDRs.

4/ Includes net errors and omissions.