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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

HONDURAS

PROJECT PAPER

ECONOMIC STABILIZATION FACILITY

AID/LAC/P-367

Project Number: 522-0323
Grant Number: 522-K-602C

UNCLASSIFIED

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CLASSIFICATION:

Att 1 to App 3B, Ch 3, HB 4

AID 1120-1 (8-88)	DEPARTMENT OF STATE AGENCY FOR INTERNATIONAL DEVELOPMENT	1. PAAD NO. 522-0323	522-K-602C
		2. COUNTRY Honduras	
		3. CATEGORY Cash Transfer	
		4. DATE May 15, 1987	
5. TO: AA/LAC: Dwight Ink		6. OYB CHANGE NO. n/a	
7. FROM LAC/DR: Terrence J. Brown		8. OYB INCREASE	
9. APPROVAL REQUESTED FOR COMMITMENT OF: \$ 65,000 000		10. APPROPRIATION - ALLOTMENT LESA-87-35522-KG31 737-65-522-00-50-71	
11. TYPE FUNDING <input type="checkbox"/> LOAN <input type="checkbox"/> GRANT	12. LOCAL CURRENCY ARRANGEMENT <input type="checkbox"/> INFORMAL <input type="checkbox"/> FORMAL <input type="checkbox"/> NONE	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
15. COMMODITIES FINANCED			

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.:
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: \$65,000,000	Other:

18. SUMMARY DESCRIPTION

The purposes of this program are to provide: (1) immediate balance of payments support to Honduras to assure the allocation of urgently needed foreign exchange and credit to the Honduran private sector; and (2) continued support to a viable stabilization program that will lead to sustained economic growth in the medium term and reduce dependence on U.S. economic assistance over the longer term.

Program funds will be disbursed into a separate ESF account or accounts in the U.S. from which payments for eligible transactions will be made. Eligible transactions include the importation of raw materials, intermediate goods, spare parts, agricultural inputs, and capital goods from the U.S., and crude petroleum, and petroleum products and derivatives from Mexico and Venezuela (all for the private sector). The funds will be disbursed in two tranches of \$30 million and \$35 million. Upon disbursement of the dollars, an equivalent amount of Lempiras will be deposited in a Special Account in the Central Bank of Honduras to be used for mutually agreed upon development purposes consistent with the Foreign Assistance Act, especially

Sections 103 through 106.

19. CLEARANCES	DATE
LAC/DP: W. Wheeler	6/8/87
GC/LAC: G. Davidson	6/20/87
LAC/CAP: P.C. Costello	6/15/87
ARA/ECP: W. Barmon	6/15/87
LAC/DR: I. Levy	
PPC/EA: K. Kauffman	6/15/87
SER/EM: Christenson	6/15/87

20. ACTION

<input type="checkbox"/> APPROVED	<input type="checkbox"/> DISAPPROVED
<i>Malcolm Bontle</i>	6/18/87
AUTHORIZED SIGNATURE	DATE
TITLE	

CLASSIFICATION:

PROGRAM ASSISTANCE APPROVAL DOCUMENT

ECONOMIC STABILIZATION FACILITY
(522-0283)

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PROGRAM ASSISTANCE APPROVAL DOCUMENT
ECONOMIC STABILIZATION FACILITY

I. SUMMARY AND RECOMMENDATION

A. Recommendation

USAID/Honduras recommends authorization of an economic support fund grant of \$100,000,000. The first \$65,000,000 would be provided from the FY 1987 appropriation level approved by the Congress. The balance of \$35,000,000 would be provided from, in order of precedence: (1) a FY 1987 supplemental appropriation if approved by the Congress and/or (2) the FY 1988 appropriation level approved by the Congress.

B. Grantee

The grantee will be the Government of Honduras (GOH) acting through the Ministry of Finance and Public Credit (MFPC).

C. Program Summary

1. Antecedents

In 1986, the GOH initiated, with technical and financial support by USAID, a comprehensive program of economic stabilization, recuperation and structural reform. This program consisted of two components. The monetary program was directed towards harmonizing immediate objectives for stabilization and growth. The structural reform program was directed towards improving economic prospects in the medium term. On balance, the two components of this program were successfully implemented.

In combination with favorable international price developments, full compliance with the monetary program component of the FY 1986 ESF Program was instrumental in enabling Honduras to achieve real GDP growth of 3 percent, reduce the urban open unemployment rate by over one full percentage point, contain inflation to 4.4 percent and, simultaneously, reduce both the fiscal deficit and the current account deficit in the balance of payments by approximately 2 percentage points of GDP. A reasonably good start was also made on the implementation of the structural reform component of the FY 1986 ESF Program. This component consisted of 29 measures designed to raise GDP, employment and investment over the midterm by improving the efficiency with which the economy allocates the resources available to it. To this end, the structural reforms were grouped under four major headings:

- (1) rationalizing public sector operations,
- (2) enhancing export competitiveness,
- (3) promoting private sector investment, and
- (4) restoring internal and external confidence in the economy.

The importance of the structural reform component of the FY 1986 ESF Program, while not of immediate impact on the macroeconomic aggregates that are the ultimate policy targets, should not be underestimated. This merits illustration. The establishment of a career judicial system (Measure 28), by providing greater assurances on the protection of human and property rights, should reduce the perceived risk of private sector investment in Honduras. The renegotiation of the publicly guaranteed, private external debt (Measure 29) should measurably enhance Honduras' creditworthiness in the eyes of the international financial community. The passage of legislation designed to provide investment tax credit and tax loss carry-overs (Measures 20 and 21) should stimulate private sector investment. The privatization of state-owned enterprises (Measure 6) and related activities should place these enterprises/activities under significantly more efficient management while simultaneously reducing the drain on the limited fiscal resources available to the government. These five examples are only illustrative, as distinct from exhaustive, of the breadth and significance of the 29 structural reforms that were initiated with the FY 1986 ESF Program.

2. Outline of Proposed FY 1987 ESF Program

In essence, the proposed FY 1987 ESF Program represents a continuation into 1987 of the support for the COH Economic Program that was initiated by the new Azcona Administration in 1986 with USAID technical and financial assistance.

Reflecting this, the FY 1987 ESF agreement supports the 1987 COH Economic Program that consists of two components and associated objectives: (1) a monetary program that, in 1987, is designed to preserve most of the the sharp gains in stabilization and growth outcomes that were recorded in 1986, and (2) a structural reform program designed to produce significant midterm improvements in prospects for growth, employment and investment through improving the efficiency with which resources are allocated in Honduras.

With respect to the monetary program, the external circumstances that clearly favored Honduras' economic prospects and outcomes for 1986 have sharply reversed in 1987. This is particularly so with respect to coffee prices, but is also reflected in rising petroleum prices and higher external debt-service obligations. We estimate that the monetary program is compatible with: (1) real GDP growth in the range of 1 to 3 percent, (2) a current account deficit in the balance of payments of between 7.8 and 8.8 percent of GDP, and (3) a deficit of the consolidated nonfinancial public sector between 6.4 and 7.2 percent of GDP. If the current account deficit in the balance of payments is held to the lower figure in its range, the outcome will be about one-half percentage point of GDP above the deficit recorded in 1986. If the overall deficit of the consolidated nonfinancial public sector is held to the lower figure in its range, the outcome will fully preserve the sharp gains recorded in 1986. Major efforts have been undertaken to develop fiscal and exchange regime policy packages that are consistent with the monetary program and supportive of

containing the fiscal and current account deficits to the lower figures in their respective ranges. Thus, in order to hold the line on the fiscal deficit as a percent of GDP, the GOH has developed and begun to implement a fiscal package that should produce budget savings of 110 to 130 million lempiras (two lempiras equal one U.S. dollar at the official rate) relative to the deficit that had been projected in March of 1987. With respect to the foreign exchange regime, new measures have or are being introduced to expand the coverage of trade, services and capital account transactions under a liberalized exchange rate regime. In this same connection, we believe that the net international reserve target in the monetary program will require further steps towards enhancing the role of exchange rate flexibility in producing a viable balance-of-payments position.

With respect to the structural reform component of the GOH economic program for 1987, the emphasis will be placed upon carrying to completion/taking further concrete steps in the implementation of the structural reforms initiated in 1986. A limited set of additional structural reforms will also be initiated, these being keyed to explicit recommendations made in recent IMF and World Bank economic reports. We are reasonably confident about the prospects for passage in 1987 of the legislative package associated with the structural reform program. As reported in Tegucigalpa 6102, the Industrial Export Processing Zone Law was passed by Congress on April 2, 1987. On April 30, 1987, the Congress passed both the Export Promotion Law and the Banana Export Incentives Law. The prospects look good for the tariff reform, perhaps the single most contentious component of the package.

As with the FY 1986 ESF Program, disbursement of FY 1987 ESF assistance will be tranché in accordance with quarterly performance targets related to implementation goals. For the monetary program, these consist in quarterly targets/ceilings on overall net domestic credit, on net domestic credit to the public sector and on net international reserves (NIRs) of the Central Bank. For the structural reform program, the corresponding quarterly implementation targets have been established in the form of a detailed implementation calendar that has been developed for each structural reform measure. Reporting to AID/W on implementation of the structural reforms will be periodically consolidated under the four major sub-goals of the reforms: (1) rationalizing public sector operations, (2) promoting private sector investment, (3) enhancing export competitiveness, and (4) restoring internal and external confidence in the economy. We believe that this periodic, consolidated reporting on the structural reform measures will effectively address the concerns raised by AID/W in State 46302. Specific details on the monetary and structural reform components of the GOH economic program are laid out in Section IV. Disbursements are programmed to take place on July 31 for \$30 million, on October 31 for \$30 million, and on December 31 for \$40 million, for a total disbursement of \$100 million.

3. Issues Associated with the FY 1987 ESF Program
(See Annex VII)

II. RECENT HONDURAN ECONOMIC PERFORMANCE

A. Summary

Both with respect to economic growth and stabilization outcomes in 1986, Honduras continued to make progress towards the goal of substantially improving macroeconomic performance. As summarized in Table II.1, real GDP growth was positive, inflation continued to be at quite moderate levels and substantial gains were registered by two key stabilization indicators -- the deficit in the current account of the balance of payments and the overall deficit of the consolidated nonfinancial public sector. In addition, net international reserves of the Central Bank rose significantly, and the urban open unemployment rate declined by more than one full percentage point.

In spite of these improvements, however, certain elements in the underlying economic situation in 1986 remained very weak. Real private sector investment, while registering moderate growth, remained significantly below the levels recorded in the mid-1970's. Reflecting increasingly heavy external amortization payments on past external borrowing, the debt-service ratio rose to about 30 percent of export earnings in 1986 compared to 27 percent in 1985. This rise in the debt-service ratio occurred in spite of a 1986 merchandise export earnings growth rate of 12 percent.

B. Growth

Bolstered by the effects on foreign exchange availability of higher coffee prices, lower petroleum prices and \$107.5 million in U.S. balance-of-payments assistance, the Honduran economy registered 3 percent real economic growth in 1986, about the same as the rates of real growth achieved during 1984 and 1985. From a sector of origin perspective, growth was positive in all but two sectors, mining and construction. Real GDP originating in the mining sector dropped by 4.5 percent while that originating in construction fell 8.3 percent. In the former, labor problems reflecting wage demands in the face of weak international prices for lead, zinc, and silver resulted in a strike that severely reduced output. In the construction sector, the completion of the El Cajon hydroelectric project resulted in a decline in public sector construction in 1986 that was only partially offset by a rise in private sector construction.

From the perspective of the final demand aggregates, as distinct from sector of origin, both the net export and consumption sectors made positive contributions to GDP growth. This was not, however, the case with respect to the investment sector, a sector of crucial importance for improving macroeconomic performance over the midterm. Overall real investment declined by 12 percent in 1986. This reflected a 26 percent fall in real public sector investment resulting from a number of factors -- the completion in 1985 of the El Cajon Hydroelectric Project, a tight fiscal situation and limited public sector investment support by multilateral financial institutions. Following an average real growth rate of only 1 percent over 1984 and 1985, real private sector investment expanded 6.6 percent in 1986. Nonetheless, the level of real private sector investment remained significantly below levels attained in the mid 1970's.

TABLE II.1
HONDURAS: SUMMARY OF SOCIAL, ECONOMIC AND
FINANCIAL INDICATORS
 1983-1986

<u>Real Indicators</u> (Annual Growth Rates)	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>Prel</u> <u>1986</u>
Real GDP (Revised Series 1978 = 100)	1.1%	3.2%	2.9%	3.0%
Real Gross Fixed Capital Formation	15.1%	17.6%	-8.1%	-12.2%
Private Sector	13.9%	1.2%	0.9%	6.6%
Public Sector	16.0%	31.2%	-13.8%	-26.2%
<u>Quality of Life Indicators</u>				
Per Capita GDP in Constant 1986 Dollars	836	836	834	834
Real Per Capita GDP Growth Rate	-2.3%	-0.1%	-0.3%	--
Population Growth Rate	3.5%	3.3%	3.2%	3.0%
Infant Mortality Rate (Deaths per 1000 Live Births)	NA	78	NA	70
Life Expectancy at Birth (Years)	NA	58	61	62
Literacy Rate	-----57.5%-----			
Percent of New First Graders Expected to Complete Sixth Grade	NA	41.0%	45.0%	NA
<u>Inflation</u> (Annual Growth Rates)				
Consumer Price Index	8.3%	4.7%	3.4%	4.4%
Wholesale Price Index	7.3%	0.8%	0.7%	1.4%
GDP Deflator	4.4%	4.6%	4.7%	4.2%
<u>Financial Indicators</u> (as percentage of GDP)				
Consolidated Nonfinancial Public Sector (CNFPS) Expenditures	31.3%	31.6%	30.9%	28.4%
Fiscal Deficit	12.3%	11.3%	8.9%	6.4%
Fiscal Deficit of the Central Government	10.2%	11.4%	9.3%	7.3%
Deficit in the Balance-of-Payments Current Account	8.7%	12.0%	9.3%	7.4%
<u>ESF Disbursements As Percentage of:</u>				
Fiscal Deficit of the CNFPS	2.4%	9.3%	14.5%	22.3%
Deficit in the Balance-of-Payments Current Account	6.9%	17.5%	27.6%	38.6%
Merchandise Imports FOB	2.4%	7.7%	10.2%	11.9%
Merchandise Exports FOB	2.6%	9.2%	11.2%	11.9%
<u>External Indicators</u>				
Exports/Imports (G&NFS)	87.8%	79.5%	86.5%	93.3%
Imports of G&NFS as percentage of GDP	30.5%	33.0%	30.5%	29.2%
Exports of G&NFS as percentage of GDP	26.8%	26.7%	26.8%	27.5%
Exports of Goods and Services (Annual Percent Change)	2.5%	7.5%	8.2%	10.5%
Imports of Goods and Services (Annual Percent Change)	1.4%	16.2%	0.9%	4.0%
(Millions of Dollars)				
Total External Debt	1903.1	2229.1	2491.6	2554.9
Medium and Long-Term	1717.0	2041.1	2314.8	2408.1
Short-Term (Excluding the Central Bank)	44.0	47.8	51.4	51.4
Short-Term of the Central Bank	142.1	140.22	125.4	95.4
Total External Debt as percent of GDP	63.5%	68.8%	71.4%	68.2%
Debt-Service Payments as percent of Exports of G&S	27.0%	25.1%	29.3%	30.4%
Accumulation of Arrears	104.0	135.7	167.5	202.6
Net International Reserves of the Central Bank ^{1/}	-83.6	-120.7	-105.0	-89.2
(Millions of Lempiras)				
Credit Expansion of the Banking System, of which, to:	372.8	301.4	289.2	239.8
Public Sector	209.2	89.8	38.0	41.6
Private Sector	163.6	211.6	251.2	198.2
Private Sector Liquidity as Percentage of GDP	37.1%	37.2%	36.5%	37.7%

Source: Central Bank of Honduras, other GOH sources, IMF and Mission staff estimates.

^{1/} Includes deposits for arrears.

Even though real GDP growth has averaged 3 percent since 1984, due to population growth rates outpacing those for real GDP, average real per capita GDP continued to decline in absolute terms over the 1984-1986 period. Since 1979, average per capita GDP in Honduras has dropped 13.5 percent.

In spite of continuing declines in real per capita GDP, significant improvements were registered in the urban open unemployment rate for 1986. Based on a recent survey of Honduras' 16 largest cities, the weighted average open unemployment rate was 12.1 percent in September 1986 (see Statistical Appendix, Tables D.3 and D.4). The rates for individual cities ranged from 5.9 to 15.4 percent. For Honduras' two largest cities, the only two for which comparable 1985 data are available, the open unemployment rate dropped significantly. In Tegucigalpa, Honduras' capital and administrative headquarters, the rate fell from 13.6 percent in March 1985 to 12.3 percent in September 1986. Similarly, the rate in San Pedro Sula, the country's chief commercial and industrial center, declined from 13.2 percent to 11.9 percent over the same period.

C. Stabilization

From the perspective of economic stabilization, Honduras registered clear-cut gains in 1986. For the third consecutive year price inflation was contained to moderate levels. The rise the Consumer Price Index (CPI) was held to 4.4 percent in 1986, higher than the 3.6 increase in 1985 but significantly below the 4.7 percent jump in 1984 and well below the 1980-1983 annual average increase of 11.2 percent. In 1986, prices at the wholesale level rose by 1.4 percent and the GDP deflator increased by 4.2 percent.

Significant improvements were registered in 1986 by Honduras in both the current account deficit in the balance of payments and the overall deficit of the consolidated nonfinancial public sector. With respect to external performance, the current account deficit in the balance of payments as a percent of GDP dropped nearly two full percentage points to 7.4 percent in 1986 compared to 9.3 percent in 1985. This was the second consecutive year of marked improvement as in 1984 the current account deficit as a percentage of GDP peaked at 12 percent.

The 1985-1986 improvement in the current account was paced by price developments for coffee and petroleum. Led by a 74 percent increase in earnings from coffee exports, total merchandise exports earnings rose 12 percent in 1986. This followed a 9 percent increase in 1985 supported primarily by an expanded volume of banana exports and the beginning of what proved to be a short-lived coffee boom. Excluding coffee and bananas, however, total merchandise exports fell 6 percent in 1986 reflecting primarily domestic supply problems with mineral production. When minerals, as well as coffee and bananas are excluded, exports rose 4 percent in 1986.

Table II.2
HONDURAS: SELECTED TRADE CATEGORIES
 (Millions of Dollars)

	1984	1985	Prel. 1986	Annual Percent Change	
				85/84	86/85
<u>Total Merchandise Exports, FOB</u>	737	805	901	9%	12%
Coffee	169	185	322	9%	74%
Bananas	231	274	255	18%	-7%
Minerals	54	63	29	17%	-54%
Other	283	283	295	--	4%
Total Less Coffee	568	620	579	9%	-7%
Total less Coffee and Bananas	337	347	324	3%	-6%
<u>Total Merchandise Imports, CIF</u>	960	953	978	-1%	3%
Fuels and Lubricants	180	164	94	-9%	-43%
Total less Fuels and Lubricants	780	789	884	1%	12%

Source: Statistical Appendix, Table B.1. Sums of components may not exactly equal totals due to rounding.

The value of Honduras' imports of fuels and lubricants dropped 43 percent in 1986. This reflected both reduced domestic demand for petroleum products resulting from the switch from thermal to hydroelectric generation at the new El Cajon facility and sharply lower international prices for petroleum. In absolute terms, this drop in petroleum related imports nearly offset increases registered by all other import categories in 1986 resulting in a 3 percent increase in the value of merchandise imports value overall. Excluding petroleum, merchandise imports rose by 12 percent, identical to the growth rate registered for merchandise exports.

The gains described above in the trade and current accounts in 1985 and 1986 were largely offset by a marked deterioration in the balance-of-payments capital account. Reflecting both higher debt amortization payments and lower levels of loan disbursements, net capital inflows (excluding ESF balance-of-payments support) dropped to \$122 million in 1986 compared to \$181 million in 1985 and \$276 million in 1984. In order to finance the declining but still substantial current account deficit, Honduras resorted to a variety of extraordinary financing techniques. These included the continuing accumulation of arrears on publicly guaranteed, private external debt payments (currently under renegotiation) and the rescheduling of short-term Central Bank liabilities to long-term liabilities. In spite of reduced capital inflows in 1986, Honduras was able to reduce lempira deposits awaiting delivery of foreign exchange for imports, i.e., "deposits for arrears", by \$17 million (see footnote 2 in Table III.1 on page 9). This, in combination with developments in the balance of payments, had the effect of improving the

net international reserves position of the Central Bank by over \$15 million. Nevertheless, on a balance-of-payments basis, i.e., excluding deposits for arrears, Central Bank net international reserves fell by \$1.7 million.

Regarding fiscal performance, the deficit of the consolidated nonfinancial public sector as a percent of GDP fell for the third consecutive year to 6.4 percent in 1986. This compares to 8.9 percent in 1985, 11.3 percent in 1984 and 12.3 percent in 1983. However, as evident in Statistical Appendix Tables A.3 and A.4, much of the drop for 1986 can be attributed to sharp reductions in public sector investment. Current expenditures rose in both 1985 and 1986. Current revenues, which had increased by 15 percent and 17 percent, respectively, in 1984 and 1985 reflecting renewed economic growth and a GOH fiscal package included as part of the FY 1984 ESF program, rose only 7 percent in 1986. Had the GOH succumbed to strong political pressures to reduce the coffee export tax and lower the domestic price of petroleum, the 7 percent current revenue growth in 1986 would have been almost completely wiped out. Reflecting this, tax revenue performance was very weak in 1986.

With respect to monetary developments, 1986, as was the case a year earlier, marked a year of adequately controlled credit expansion accompanied by greater availability of banking system credit for the private sector. As evident in Table A.5, banking system credit overall expanded by 6.8 percent in 1986, significantly below the 7.4 percent increase in nominal GDP and well below the 10 percent average rate of domestic credit expansion during 1984-85. In 1986 credit to private sector increased 8.2 percent, while net credit outstanding to the consolidated nonfinancial public sector rose 3.9 percent.

III. PERFORMANCE UNDER THE FY 1986 ESF PROGRAM

A. Summary

As noted in the Program Summary, the macroeconomic performance gains registered in 1986, and briefly reviewed above, were broadly in line with the outcomes and performance expectations under the monetary and structural reform components of the 1986 ESF program. This, in turn, reflected a policy performance by the GOH that was well within the ceilings/targets established for measuring compliance with the monetary program. Moreover, the GOH turned in a reasonably credible performance on a structural reform program that was both comprehensive in addressing Honduras economic problems and that was extraordinarily demanding in terms of the time and technical expertise that was devoted to its implementation by the GOH and USAID.

B. Monetary Program Component

The monetary program was designed to support a GOH economic program aimed at achieving immediate stabilization and recovery objectives including moderate growth, lower fiscal and current account deficits, low inflation and an improved net international reserve position. The instruments to achieve these goals consisted of the following: (1) an overall credit limit designed to hold credit creation to levels consistent with containing pressures on inflation and the balance of payments while simultaneously permitting moderate growth, (2) a subceiling on credit to the consolidated nonfinancial public sector to reserve the majority of available credit to finance private sector production and investment, and (3) quarterly targets for increases in net international reserves. As detailed in Table III.1, the quarterly ceilings and targets of the 1986 monetary program were largely met.

TABLE III.1
GOH 1986 MONETARY PROGRAM LIMITS/TARGETS AND ACTUAL PERFORMANCE
 (MILLIONS OF LEMPIRAS)

	Quarterly Limits/Targets Established in 1986						<u>1/</u>
	<u>GOH Monetary Program</u>			<u>Actual Performance</u>			
	<u>6-30</u>	<u>9-30</u>	<u>12-31</u>	<u>6-30</u>	<u>9-30</u>	<u>12-31</u>	
Credit Expansion of Consolidated Banking System from 12-31-85							
1. Overall	160	240	320	6	37	240	
2. To Consolidated Nonfinancial Public Sector Only	30	45	60	-59	-44	42	
Accumulation in Net International Reserves of the Central Bank from 12-31-85 <u>2/</u>	0-20	0-35	10-50	37	36	31	

Sources: Amendatory Agreement No. 3 to Economic Stabilization Facility Program (522-0283) and Statistical Appendix Tables A4 and A5.

1/ These figures have been substantially revised from the preliminary estimates presented to AID/W in the Mission's ESF Concepts Paper in February.

2/ Includes deposits for arrears. These represent lempira deposits made by those holding valid import permits and approved requests for foreign exchange who are waiting the delivery from the Central Bank of the foreign exchange equivalent of their deposits. Such deposits, which represent a liability of the Central Bank, are considered in the monetary accounts as short-term external liabilities by the IMF in the calculation of the Central Bank's net international reserve position (NIR). The total value of these deposits, i.e., short-term external liabilities of the Central Bank, declined L34.8 million from December 31, 1985 to December 31, 1986.

While from the perspective of the monetary accounts such deposits are considered as short-term external liabilities and thus included in the calculation of NIRs, from the perspective of the balance of payments they are excluded by the IMF from NIRs. This exclusion in the balance-of-payments accounts is because these lempira funds have been deposited by importers waiting for foreign exchange to purchase imports which have not yet entered the country and therefore have not been included in the merchandise imports figure listed in the balance-of-payments current account.

Credit extended by the banking system was well below the quarterly ceilings established in the program. While the change in net international reserves was not at upper level of the quarterly target ranges, they were well above the target floor in every quarter. Less than ideal performance was caused by adverse changes in Honduras' commodity export prices which resulted in foreign exchange earnings losses that more than explained the shortfall.

C. Complementary Structural Reform Program Component

Complementing the monetary program and directly related to creating the conditions for a sustainable recuperation in economic activity, the GOH economic program also contained 29 structural adjustment measures designed to improve economic performance beyond 1986. GOH performance throughout the year produced good progress towards reaching midterm goals for: (1) rationalizing public sector operations, (2) enhancing export competitiveness, (3) promoting private sector investment, and (4) restoring internal and external confidence in the Honduran economy. Advances were made on both legislative and executive actions required to implement the program. With respect to legislation, the GOH fully complied with the requirement that all items requiring legislative actions be submitted to Congress. A summary of the progress made for each of the Structural Reform Measures is set forth in tabular form in Annex IV.

Regarding rationalizing public sector operations, a calendar and work plan for the pilot introduction of zero base budgeting was completed (Measure 1). Initial formats were developed for establishing revenue and expenditure controls in the execution of the budgets of the decentralized institutions (Measure 2) and for the submission of quarterly financial operations and economic efficiency statements to the Central Government (Measure 3). These formats should contribute toward containing expenditure growth. A work plan and implementation calendar were also developed to raise tax revenue without imposing new taxes, raising tax rates, or expanding the tax bases of existing taxes (Measure 11). This work plan should help reduce the fiscal deficit without cutting essential expenditures or imposing new taxes. Finally, but not exhaustively, the GOH completed a work plan and calendar designed to quantify the fiscal costs and assess the economic benefits and costs of the existing system of tax exemptions (Measure 27). The results of this should lead to tax system improvements based on three criteria: (1) economic efficiency, (2) equity, and (3) administrative simplicity. It is expected that a direct benefit of the study will be the elimination of a host of anti-export, pro-import biases in the tax system. This is reflected in a very high level of effective protection accorded to domestic industry resulting from a combination of tax breaks on intermediate import requirements with high tariffs on final outputs.

With respect to promoting private sector investment, key pieces of legislation designed to provide investment tax credit (Measure 20) and tax loss carry-overs (Measure 21) were submitted to the National Congress. One divestiture action was successfully completed in 1986 and prospects are good for up to seven more in 1987 (Measure 6). One additional divestiture has been completed already in 1987, and the political will of the GOH continues to be strongly behind the process. A study designed to reduce preferences accorded

to the public sector with respect to taxation and access to and cost of credit was completed (Measure 19). A private sector commission on capital market development was established to develop the framework of private self regulation and suggested legal initiatives that would facilitate the availability of private savings for real private sector capital formation (Measure 22).

An equally good start was made in achieving the midterm goal of expanding exports. Export processing zone legislation submitted to Congress in 1986 was passed by Congress on April 2, 1987 (Measure 17). Legislation was also passed that will provide tax reimbursement to exporters for virtually all import taxes they are required to pay (Measure 13), to reduce bureaucratic procedures affecting the drawback industries (Measure 14) and to reduce the marginal tax rates on banana exports (Measure 15). An award program for promoting exports was established (Measure 18) and periodic cabinet level reviews were set up to evaluate developments in Honduran export performance (Measure 16).

Very positive developments were accomplished in the area of restoring internal and external confidence in the economy. As a result of advances achieved in 1986, the prospects for the establishment of a career judicial system were significantly improved (Measure 28). The implementing regulations for the system were developed and a budget increase for the judiciary should help meet the budgetary requirements for a career judicial system. The importance of these developments should not be underestimated. Neither Hondurans nor foreigners want to risk investing or maintaining production in an environment where the protection of property rights is not adequately assured. Similarly, neither foreign banks nor private nonbank firms are likely to offer foreign credits to a country that does not have a good track record in meeting past foreign obligations. Thus, the good forward movement on the external debt renegotiations achieved in 1986 is a highly positive sign (Measure 29).

IV. FY 1987 ESF PROGRAM

A. Overview of GOH Economic Program

In essence, the proposed FY 1987 ESF Program represents a continuation into 1987 of the support for the GOH Economic Program that was initiated by the new Azcona Administration in 1986 with USAID technical and financial assistance. Reflecting this, the FY 1987 ESF agreement, like the FY 1986 agreement, supports a GOH economic program that consists of two components: a monetary program and a complementary program of structural reforms.

The 1987 monetary program is designed to prevent a major deterioration from the sharp gains in stabilization and growth outcomes that were recorded in 1986. This orientation for the monetary program reflects a reversal in 1987 of external coffee and petroleum price developments that were strongly favorable to Honduras in 1986, both with respect to fiscal and balance-of-payments performance. Viewed in the context of the less favorable external circumstances facing Honduras in 1987, the 1987 monetary program and, in particular, the fiscal package that has had to be developed to support it, represents a reasonable effort to pursue stabilization objectives.

The 1987 structural reform program places strong emphasis on carrying to completion/taking further concrete steps in the implementation of the structural reforms initiated in 1986. In addition, a limited set of additional structural reforms will be initiated within the context of the GOH 1987 Economic Program. These additional reforms are keyed to explicit recommendations that have been made by the IMF and World Bank. As with the measures themselves, the primary goal of the structural reform program remains unchanged — substantial improvement in the efficiency with which the Honduran economy allocates the resources available to it. It is anticipated in the 1987 structural reform program (set forth below) that the National Congress will approve the package of measures submitted to it in 1986. We are reasonably confident that this GOH goal will be achieved.

Reflecting the progress on the structural reform program since May 1986, we anticipate some positive impacts in 1987 on the macroeconomic aggregates they were designed to affect. In particular, some of the plans for improved tax administration that were developed as part of the 1986 GOH program are being implemented in 1987 and are directly in support of the fiscal package developed to meet the implicit limit on the fiscal deficit contained in the monetary program. It should be strongly emphasized, however, that the impacts to date of the structural reform program on such key macroeconomic policy targets as growth, inflation, employment, fiscal and the balance of payments are still, at this stage, quite small. The principal reason for this should also be noted. It reflects the slow pace at which structural reforms both can be implemented and can be expected to take effect. While implementation of the structural reforms by the GOH in 1986 certainly could have been more agile, even discounting for this would not have resulted in large impacts on key macroeconomic policy targets in 1986.

B. Monetary Program Component

1. Credit Limits and International Reserve Targets

In 1986, highly favorable external circumstances enabled the GOH to develop and implement a monetary program that produced a reconciliation of stabilization and growth objectives. In contrast, the monetary program for 1987, set forth in Table IV.1, is more appropriately characterized as producing a realistic compromise between growth and stabilization objectives.

TABLE IV.1

GOH MONETARY PROGRAM: CREDIT LIMITS AND NET
INTERNATIONAL RESERVE TARGETS
(Millions of Lempiras)

	Level as of December 31, 1986 ^{1/}	Cumulative Change from December 31, 1986			Cumulative change from Dec. 31, 1985 to Dec. 31, 1986
		June 30 1987	Sept. 30 1987	Dec. 30 1987	
Overall Credit Limit ^{2/3/}	3746	120	180	240	240
To Public Sector ^{3/}	1119	15-20	10-20	15-30	42
To Private Sector	2627	105-100	170-160	225-210	198
Net International Reserves ^{4/}	-179	0-5	0-10	0-20	31

^{1/} Preliminary.

^{2/} Consolidated banking system and consolidated nonfinancial public sector, both in accordance with IMF definitions.

^{3/} The conversion of public or publicly guaranteed external debt into lempiras may result in an upward adjustment not to exceed L50 million.

^{4/} Central Bank of Honduras, in accordance with IMF definition; includes deposits for arrears (See footnote 2 in Table III.1 on page 9).

As reflected in Table IV.1, the GOH monetary program is tight. The overall ceiling on credit growth, 240 million lempiras, limits credit growth to 6.4 percent over the level recorded at the end of 1986. Within the overall ceiling, a tight subceiling on net credit expansion to the consolidated nonfinancial public sector, 30 million lempiras, will reserve the vast majority of credit for private sector investment and production.

The target range for the change in net international reserves is adequate. In spite of the reversal in coffee and petroleum prices, the Central Bank has resolved, at a minimum, not to permit any reduction in net international reserves. The Central Bank has further resolved to seek to improve net international reserves by around \$10 million, if this proves feasible within the framework of achieving a realistic compromise between growth and stabilization objectives.

As reflected in Table IV.2, we estimate that the monetary program is compatible with: (1) real GDP growth in the range of 1 to 3 percent, (2) a current account deficit in the balance of payments of between 7.8 and 8.8 percent of GDP, and (3) a deficit of the consolidated nonfinancial public sector of between 6.4 and 7.2 percent of GDP. If the current account deficit in the balance of payments is held to the lower figure in its range, the outcome will be less than one-half of one percentage point of GDP above the deficit recorded in 1986 and about one and one-half percentage points of GDP below the 1985 deficit. If the overall deficit of the consolidated nonfinancial public sector is held to the lower figure in its range, the outcome will fully preserve the sharp gains recorded in 1986.

TABLE IV.2

HONDURAS: MACROECONOMIC OUTCOMES FOR 1985, 1986
AND OUTLOOK FOR 1987

	<u>1985</u>	<u>Prel.</u> <u>1986</u>	<u>Proj.</u> <u>1987</u>
Real GDP Growth Rate Annual Percent Change	2.9	3.0	1.0 to 3.0
Fiscal Deficit of Consolidated Nonfinancial Public Sector In Millions of Lempiras as % of GDP ^{1/}	622 8.9	482 6.4	482-616 6.0-7.2
Fiscal Deficit of Central Government: In Millions of Lempiras As % of GDP ^{1/}	652 9.3	546 7.3	546-673 6.8-8.4
Current Account Deficit of the Balance of Payments: In Millions of Lempiras as % of GDP ^{1/}	652 9.3	557 7.4	627-704 7.8-8.8
Net International Reserves of the Central Bank--Annual Change In Millions of Lempiras ^{2/}	31	31	0-20

^{1/}For 1987, percentage of GDP estimates were calculated based on nominal GDP growth of 6.6 percent (4.5 percent increase in GDP deflator and 2.0 percent real growth).

^{2/}Includes deposits for arrears.

2. Complementary Fiscal Package

As suggested by the range given for the fiscal deficit in Table IV.2, especially that for the Central Government, the exact size of the fiscal deficit will depend heavily on the implementation of an adequate fiscal package. The "story" behind the fiscal deficit is worth recounting briefly.

Early this year, the fiscal deficit of the Central Government was projected at 673 million lempiras, approximately 130 million lempiras greater than the preliminary figure recorded for 1986. This projection, made by the joint GOH-USAID technical group, galvanized the GOH political leadership into a recognition of the need to take timely corrective action. In particular, the projection highlighted the fact that the monetary program and projected fiscal deficit were mutually inconsistent. Specifically, containing credit growth to the levels required by the monetary program to reach the attainable real growth rate without simply generating additional pressure on prices and the balance of payments would require a major fiscal effort. This, however, posed a dilemma for the GOH. Confronted on the one hand by an unwillingness on the part of the President to raise taxes and on the other hand by a National Congress that would make passage of any tax package that the President might propose a doubtful proposition at best, GOH technicians developed a fiscal package of expenditure cuts/improvements in tax administration that totals 100 - 130 million lempiras. If fully and successfully implemented, this package would result in a Central Government fiscal deficit equal to 6.8 percent of projected 1987 GDP, i.e., substantially below the 1986 actual outcome.

The Mission believes that the fiscal package developed by the GOH is credible and realistic. A good deal of care and effort has gone into its qualitative content and its quantification, both from the perspective of political realism and technical feasibility. The Mission, nevertheless, believes - and the GOH fully concurs - that the success of the fiscal package depends on the timely implementation of the concrete steps contained in the plan. The GOH also concurs in the belief that a tracking system must be set up to ensure that the intra-year course of the fiscal deficit is "on track" with respect to reaching the deficit reduction target for the year as a whole. Finally, the GOH also concurs in the need to develop and implement a contingency plan should the tracking system suggest that the deficit reduction target is unlikely to be substantially achieved. Reflecting this concurrence and, as set forth further on, a condition precedent to the first disbursement under the FY 1987 ESF program is the presentation to USAID of a mutually acceptable tracking system and contingency plan which would be implemented should the tracking system suggest that further fiscal actions would be required to achieve the deficit reduction target.

3. Complementary Exchange Rate Policy

In typical elliptical language, the monetary program calls for maintenance of official parity of the lempira at L2 = \$1 within an operational framework that continues to enhance the flexibility of the actual exchange rate regime governing international trade, service and capital account transactions. As such language suggests, from a practical point of view, the "self-financing" (autofinanciamiento) market is as much a part of the current exchange rate regime as the official market.

For 1987, additional steps have already been taken to institutionalize autofinanciamiento. On a selective basis, as distinct from a universal basis, agreements have been reached that will permit exporters of nontraditional products to sell a percentage of the dollar earnings from their exports directly to foreign companies that are residents of Honduras and that wish to repatriate their lempira profits. This will have two effects. First, it will, on a "voluntary" basis, shift profit repatriations into autofinanciamiento to avoid the delays in Central Bank delivery of foreign exchange. Second, it will effectively and legally allow nontraditional exporters to convert export dollar earnings into lempiras at the exchange rate that prevails in the autofinanciamiento market.

In another step illustrative of the trend towards flexibility, the GOH should shortly approve an explicit legal framework for converting dollar debt into lempiras. That will effectively enable companies that wish to invest in Honduras in certain eligible activities (e.g., production for export, purchase of state-owned companies that the GOH is seeking to privatize, etc.) to obtain the exchange rate prevailing in the autofinanciamiento market for their dollars. In brief, private foreign banks currently hold about \$220 million in publicly guaranteed claims on Honduran private companies. In many cases, the banks holding this debt are willing to sell it at a discount, e.g., saving cents on the dollar. Under the new GOH legal framework, an eligible company wanting to invest in Honduras would buy the dollar debt at, say seventy cents on the dollar and be able to convert the dollar debt at its face value in dollars into lempiras at the official exchange rate. (The illustration corresponds to an effective rate of exchange of \$1.00 = L2.857). It should be emphasized that the Mission does not regard the mode or character of introducing flexibility in the exchange rate regime as praiseworthy.

The current system is not ideal. It is discriminatory -- different rules apply to different products/exporters/importers. It lacks transparency -- the rules of the game are by no means clearly spelled out. It is open to fraud and abuse and, by its very nature, creates incentives for fraud and abuse. It is economically efficient neither in generating foreign exchange earnings nor in allocating foreign exchange among competing claimants. As such, the Mission will continue the policy dialogue on exchange rate issues. In this connection, two of the vehicles for this dialogue are continued into the 1987 structural reform program -- the semi-annual reports on export performance and price competitiveness that will be reviewed at the Cabinet level and the exporters conferences that will be held under the auspices of the "Year of the Exporter" activity.

C. Structural Reform Program Policy Component

The 1987 structural reform program builds on the progress made, and more importantly, the experience that was gained in developing and implementing the 1986 structural reform program. As a result of both these factors, the Mission anticipates good progress on a structural reform program that, beginning around 1990, should significantly improve Honduras' economic performance.

With respect to building on progress made in 1986, the 1987 structural reform program anticipates approval by the National Congress of the legislative package presented to the National Congress in 1986. We believe that this program goal will be fully achieved. The GOH program also anticipates completion of seven divestiture actions in 1987. This should also be possible. As these two "follow-ups" illustrate, the 1987 structural reform program should produce concrete results, as distinct from movement toward concrete results. Table IV.3 below provides a summary statement of the final target for 1987 for each of the structural reform measures, while Table IV.4 provides an intra-year quarterly implementation plan for the structural reform measures which the Mission regards as of special significance. It should be emphasized that both Tables IV.3 and IV.4 are summary. The complete structural reform program, covering the details of the final targets, as well as the details of the quarterly implementation calendar for each of the structural reform measures, is set forth in Annex II.

In essence, Tables IV.3, IV.4 and Annex II, from which Tables IV.3 and IV.4 are derived, reflect and incorporate the experience gained in developing and implementing the 1986 structural reform program. The 1987 structural reform program has been the product of detailed discussions at technical and political level working groups within the GOH and between the GOH and USAID. The result of these discussions -- and their goal -- has been the development of implementation calendars and targets for structural reforms to which the GOH is fully committed both at the technical and political levels. The Mission believes this objective has been achieved. As such, the Mission is confident that the ambitious goals and intra-year progress benchmarks will be substantially achieved.

TABLE IV.3

SUMMARY STATEMENT OF FY 1987 STRUCTURAL REFORM MEASURES

MEASURE BY MAJOR CATEGORY

TARGETS FOR 1987

A. Rationalize Public Sector Operations

1. Zero base budgeting (ZBB).
 - Information and accounting system adequate for the introduction of ZBB in three decentralized institutions implanted.
 - Plan to extend information and accounting system for ZBB to additional GOH institutions based on results from pilot program prepared.
- 2.a. Development and implementation of budget control systems in each decentralized institution.
 - Two sets of budget control reports submitted.
- 2.b. Quarterly submission of financial operation statements to Central Government by decentralized institutions in accordance with generally accepted accounting practices.
 - Two sets of quarterly financial operation statements submitted.
3. Development and submission of quarterly reports on economic and operational efficiency to Central Government by decentralized public institutions.
 - Two sets of quarterly efficiency reports submitted.
4. Independent annual audits of decentralized institutions.
 - First set of audits complete.
5. Expansion of municipal tax base.
 - Congressional approval expected.
6. Transfer to private sector of state participation in activities that can be run by the private sector.
 - Seven divestiture actions completed.
7. Legislation adopting Customs Co-operation Council Nomenclature (CCCN) and converting the present system of specific and mixed rates to ad valorem rates.
 - Congressional approval expected.

- 8. Customs Valuation Law. - Congressional approval expected.
- 9. Customs Procedures Law. - Congressional approval expected.
- 10. Introduction of tolls on improved roads. - Toll collection implemented in eight selected stations.
- 11. Improve tax administration. - Program designed and implemented to reduce gap between potential and realized tax collections for foreign trade, income and the production-consumption-sales tax.

B. Enhance Export Competitiveness

- 12. Temporary Import Law. - Implementing regulations issued.
- 13. Export Promotion Law. - Congressional passage expected. Implementing regulations issued.
- 14. Industrial Export Processing Zones Law. - Implementing regulations issued.
- 15. Banana Export Incentives Law. - Congressional approval expected. Implementing regulations issued.
- 16. Submit to the Economic Cabinet periodic evaluations of export performance and price competitiveness. - Two evaluations studied and discussed by Economic Cabinet.
- 17. "Year of the Exporter - 1987". - One-stop center for completion of required export documentation established.
- National Council for Export and Investment Promotion established.
- Two exporters' conferences completed.

C. Promote Private Investment

- 18. Reduction of preferences accorded to public sector in fiscal and monetary matters. - Information base and calendar developed for the elimination of exemptions from income tax of income earned on GOH bonds.
- 19. Investment tax credit. - Congressional approval expected. Implementing regulations approved.
- 20. Tax loss carry-overs. - Congressional approval expected. Implementing regulations approved.

TABLE IV.4
KEY IMPLEMENTATION TARGETS/DISBURSEMENT CRITERIA
FOR FY 1987 STRUCTURAL REFORM MEASURES

A. First Disbursement (July 31, 1987)

<u>Measure No. and Brief Statement of Content</u>	<u>Specific Actions to be Completed by July 31, 1987</u>
2-4 Budget control, quarterly financial and efficiency reports, and independent annual audits of public sector decentralized institutions.	<ul style="list-style-type: none">- Inaugural conference presenting goals and content of measures to heads of decentralized institutions completed.- Personal responsibilities within GOH agencies for technical assistance and implementation assigned.- Inter-institutional group of experts to facilitate implementation designated and in operation.
6. Privatization.	<ul style="list-style-type: none">- Preparations completed for divestiture of 4 companies.
7. Tariff reform.	<ul style="list-style-type: none">- Legislative review completed.
8. Customs Valuation Law.	<ul style="list-style-type: none">- Legislative review completed.
9. Customs Procedures Law.	<ul style="list-style-type: none">- Legislative review completed.
10. Tolls on improved roads.	<ul style="list-style-type: none">- Toll collection implemented on following road sections: Cerro de Hule, and Tamara.
12. Temporary Import Law.	<ul style="list-style-type: none">- Implementing regulation approved.
13. Export Promotion Law.	<ul style="list-style-type: none">- Legislative approval expected.- Implementing regulations approved.
14. Industrial Export Processing Zone Law.	<ul style="list-style-type: none">- Legislative approval expected.- Implementing regulations approved.
15. Banana Export Incentives Law.	<ul style="list-style-type: none">- Legislative approval expected.- Implementing regulations approved.

<u>Measure No. and Brief Statement of Content</u>	<u>Specific Actions to be Completed by July 31, 1987</u>
16. Export competitiveness assessment.	- First assessment for 1987 delivered to and discussed by Economic Cabinet.
17. "Year of the Exporter - 1987".	- One-stop window for completion of required export documentation established. - National Council for Export and Investment Promotion (CONAFEXI) established. - First exporters' conference completed. - National export development plan published.
19. Investment tax credit.	- Legislative approval expected.
20. Tax loss carry-overs.	- Legislative approval expected.
22. Expand private sector participation in export marketing of lumber.	- Publicly owned lumberyard operations divested or leased to private sector.
23. Reduce effective rate of tariff protection.	- First seminar conducted.
24. Foreign investment in seacoast tourism.	- Legislation presented to Congress.
27. Renegotiation of external debt.	- Continue good faith negotiations.
B. <u>Second Disbursement (October 31, 1987)</u>	

<u>Measure No. and Brief Statement of Content</u>	<u>Specific Actions to be Completed by October 31, 1987</u>
5. Expand municipal tax base.	- Legislative approval expected.
6. Privatization.	- Preparations completed for divestiture of an additional 3 companies.
7. Tariff reform.	- Legislative approval expected.

<u>Measure No. and Brief Statement of Content</u>	<u>Specific Actions to be Completed by October 31, 1987</u>
8. Customs Valuation Law.	- Legislative approval expected.
9. Customs Procedures Law.	- Legislative approval expected.
10. Tolls on improved roads.	- Toll collection implemented on following additional road sections: -Olancho, -Zamorano, and -Choloma.
17. "Year of the Exporter - 1987".	- Second exporters' conference completed.
19. Investment tax credit.	- Implementing regulations approved.
23. Effective rate of tariff protection.	- Study updated using new tariff system. - Second seminar completed.
24. Foreign investment in seacoast tourism.	- Legislative approval expected.
26. Career judicial system.	- Supreme Court approval of implementing regulations expected.
C. <u>Third Disbursement (December 31, 1987)</u>	

<u>Measure No. and Brief Statement of Content</u>	<u>Specific Actions to be Completed by December 31, 1987</u>
1. Zero base budgeting.	- Information and accounting system for introduction of ZBB in three decentralized institutions implanted. - ZBB extension program completed and adopted by President.
5. Expand municipal tax base.	- Implementing regulations approved.
6. Privatization.	- 7 divestiture actions completed.
10. Tolls on improved roads.	- Toll collection implemented on following additional road sections: -La Lima, -Tela, and -Caracol.

<u>Measure No. and Brief Statement of Content</u>	<u>Specific Actions to be Completed by October 31, 1987</u>
11. Improve tax administration.	- Study completed.
16. Export competitiveness assessment.	- Second assessment for 1987 delivered to and discussed by the Economic Cabinet.
17. "Year of the Exporter - 1987".	- Award ceremony completed.
21. Capital market development.	- Final report and recommendations delivered to President and Congress.
24. Foreign investment in seacoast tourism.	- Implementing regulations approved.
25. Consolidation, elimination and rationalization of system of tax exemptions.	- Draft legislation completed.

D. Tranching of Disbursements in Accordance with Performance

As indicated in Table IV.5, three disbursements are proposed. The disbursements are tranching in accordance with compliance with the quarterly monetary program targets set forth in Table IV.2. and substantial compliance with the quarterly implementation plan established for each of the structural reform measures included in the 1987 structural reform program. The two initial disbursements are for \$30 million and the final disbursement is for \$40 million. The final disbursement will involve an overall qualitative assessment of compliance with both the structural reform and monetary program components of the GOH Economic Program. Experience has indicated that there may be some slippage between the time the required actions are taken by the GOH, and the time at which the GOH provides proper documentation to the Mission. Accordingly, target dates for completion of all required actions have been scheduled so that all required documentation will have been available and evaluated by the target dates for review indicated in Table IV.5.

TABLE IV.5

DISBURSEMENT TRANCHES, DATES AND PERFORMANCE CRITERIA

<u>TARGET DATE FOR DISBURSEMENT</u>	<u>AMOUNT</u>	<u>TARGET DATE FOR REVIEW</u>	<u>PERFORMANCE CRITERIA</u>
July 31	\$30 million	July 15	(1) Compliance with June 30 monetary program limits/targets. (2) Substantial compliance with implementation calendar for structural reform program.
October 31	\$30 million	October 15	(1) Compliance with September 30 monetary program limits/targets. (2) Substantial compliance with implementation calendar for structural reform program.
December 31	\$40 million	December 15	(1) Compliance with December 30 monetary program limits/targets based on mid-December projections. (2) Substantial compliance with implementation calendar for structural reform program. (3) Qualitative review of overall progress on economic program.

E. U.S. Assistance Requirements for Implementation of GOH 1987 Economic Program

1. Proposed Policy Planning Project

The Mission plans to launch a Policy Planning Project in 1987. Specifically, the Project will enhance the GOH's ability to carry out its 1987 Economic Program. Experience gained in developing and implementing the GOH Economic Program initiated in 1986 clearly illustrates the need for such a project. Although there is a pool of talented and experienced public and private sector economists in Honduras, it is very small in number and limited in specializations. To address the long-run aspect of the problem, the Project will finance long-term professional training of economic talent, both in the public and private sectors. In the immediate term, the Project will supplement the existing economic talent with foreign professionals who will

work with Honduran counterparts on specific policy development and implementation problems related to the execution of the 1987 GOH Economic Program. The Project will have two components. The public sector component will provide assistance in the design and implementation of specific measures in the 1987 GOH Economic Program. The private sector component will increase the capability of the Honduran private sector to formulate, better understand and suggest economic policies for consideration by the GOH.

2. Privatization of State-Owned Enterprises Project (522-0289)

Support for the privatization component of the 1987 structural reform program is being provided through a specific USAID project intervention, the Privatization of State-Owned Enterprises Project (522-0289). Through this project, the Mission is providing financial resources and technical assistance to support GOH efforts to divest a number of publicly owned/controlled operations that can be run by the private sector. AID assistance has been instrumental in the development and ultimate passage of the Honduran Divestiture Law, passed by Congress in October 1985, which provided the legal basis for divestiture activities currently being conducted by the GOH. The absence of such a law represented a major obstacle to divestiture of state-owned enterprises. Current efforts through the project are directed at performing appraisals of public firms to be divested, completing legal and financial clean-ups of these enterprises, and preparing prospectuses on companies to be auctioned to the private sector.

F. Utilization of Dollar Resources

Separate account(s) will be established by the Central Bank of Honduras at commercial banks in the United States chosen by the Central Bank as its correspondent bank(s). Dollar funds provided by AID for balance-of-payments support will be deposited into the separate account(s) in the designated correspondent bank(s). The separate account(s) may be interest bearing account(s). However, any interest earned on the funds deposited in the separate account(s) will be used in the same manner and for the same purposes as the balance-of-payments support disbursements.

The use of the separate account(s) is to comply with U.S. law and will provide accountability for the funds and preclude the co-mingling of balance-of-payments support with the Central Bank's other foreign exchange resources. Funds deposited in the separate account(s) and interest earnings generated by such funds may be used for financing transactions from one or more of the following eligible categories:

1. CIF value of commodities of U.S. source and origin falling in the following classifications:
 - a. agricultural inputs,
 - b. capital goods,
 - c. intermediate goods,

- d. spare parts, and
 - e. petroleum products;
2. crude petroleum and its derivatives imported from Mexico and Venezuela; and
 3. debt service payments due on direct and guaranteed loans under AID, PL 480, the Housing Guarantee, and the TCIP (AID-EXIM) Programs.

The Central Bank will be required to establish and maintain files for each transaction funded from the separate account(s). Each file will contain documents which support the transaction's eligibility, establish that payment has been effected, and demonstrate that commodities have been cleared through customs and have entered the economy. The Central Bank will make reimbursements from the separate account(s) using letters of credit, reimbursement to Honduran importers or their banks, direct payments, and other methods as specified in implementation letters.

The documentation supporting the disbursements from the special accounts will be subject to review by the authorized representatives of USAID. The Central Bank will furnish the Mission quarterly reports detailing the use of the dollars deposited and interest, if any, generated. The quarterly report will be verified by the USAID Office of the Controller personnel.

G. Utilization of Local Currency Resources

1. Strategy

The ESF local currency programming strategy is to support priority areas of GOH/USAID concern, including support for private sector initiatives directly and indirectly associated with Mission programs. In this regard, programming of local currency fully supports the Central American Initiative objectives as indicated in Table IV.6.

Upon disbursement of ESF U.S. dollar assistance, the GOH deposits an equivalent amount of funds in lempiras into the Central Bank's Special Account for Development Activities, established under the Economic Recovery Program (522-0230). The Economic Recovery Program disbursed U.S. \$131,000,000 and, to date, the Economic Stabilization Facility (522-0283) has disbursed U.S. \$208,748,000.

In line with the local currency strategy, the Special Account is divided into two major components: (1) Public Sector Activities, and (2) Private Sector/Special Activities. Funding is split equally between the two components in accordance with our ESF Agreement. Local currency resources are programmed through program implementation letters, co-signed by USAID, the Ministry of Finance and Public Credit and the Central Bank. The division between public and private sector uses and amounts programmed appears in Table IV.7.

a. Public Sector Activities

Within the public sector, the Mission assigns the following priority to funding considerations:

1. USAID project counterpart,
2. counterpart for projects funded by other international financial institutions (IFIs),
3. GOH public sector programs that support GOH development strategies and complement AID goals and objectives,
4. "projectized" GOH budget support in which AID is involved in project design and/or implementation (i.e., the Employment Generation Program), and
5. GOH contributions to Honduran private and voluntary organizations (PVOs).

In addition, local currency counterpart funds provide an important facilitating mechanism to ensure timely implementation of GOH/AID projects through rotating funds. Rotating funds are initially funded with local currency generations and reimbursed with project funds. In this manner, projects have a continuous "advance" of funds to finance critical project activities, without delays that often result from programming or other GOH budget allocation procedures. Moreover, this system eliminates DA funded advances. Currently ten projects have rotating funds. The funds are used to pay project personnel, per diem expenses, and project-related purchases. To date, 15,800,000 lempiras have been programmed for rotating funds.

The type of GOH programs and projects funded through local currency include labor intensive public works activities such as potable water projects, and road and school construction, as well as budget assistance to GOH public entities. Examples of counterpart to IFI projects (mostly IDB and IBRD) include agricultural programs, public works activities and feasibility studies for future IFI programs.

Under the Economic Recovery Program (522-0230) and the Economic Stabilization Facility (522-0283), a total of 339,748,000 lempiras have been deposited in the Central Bank's Special Account for public sector activities. Of this amount 298,500,000 lempiras has been programmed. The remaining 41,248,000 lempiras is currently being negotiated with the Ministry of Finance and Public Credit. Counterpart for AID-financed projects represents 13.5% of the amount programmed, while support to GOH programs represents 14% of the total programmed (See Table IV.7).

b. Private Sector and Special Activities

Under Private Sector and Special Activities, the Mission's strategy is to fund the following activities in order of priority:

1. USAID Trust Fund (special activities),
2. USAID-related credit programs,
3. USAID-related private sector initiatives,
4. private and voluntary organizations, and
5. other programs in the private sector and special activities, including contingency funds for special programs such as emergency assistance.

In the last ESF programming PIL (No. 87, October 17, 1986), the private sector account was split into two parts: (1) Private Sector Activities, and (2) Special Activities. The Special Activities programming category was established to better reflect the purposes for which funds are allocated. With the exception of the AID Trust Fund (which covers Mission operating expenses, a technical support fund, the Peace Corps Special Project Program, and accounts for financial reviews), activities under this new category are non-Central Government activities that most often are carried out by PVOs. In addition to the Trust Fund the activities thus far funded under Special Activities are the Emergency Relief Assistance Fund and the PVO component of the Employment Generation Program.

Specialized credit lines are one of the largest components of the private sector account. The rediscount lines of credit provided through the Central Bank for onlending to commercial banks amount to \$72,600,000 and include the following:

	AMOUNT PROGRAMMED (U.S. \$000)
Housing Support Credit	7,500
Agricultural Land Sale Fund	2,000
Rural Technologies Credit	900
Working Capital/Small-Medium Size Companies	26,200
Industrial Investment and Production	4,000
Basic Grains Production/BANADESA - Regional Cooperatives	2,250
Coffee Production Investment	5,000
Export Development and Services	24,000
Agricultural Diversification Fund	750
	<u>72,600</u>

Other private sector activities supported by local currency include: shelter upgrading; support for private initiatives (economic growth and investment, educational services, and PVOs); and credit and support services for the privatization of state-owned enterprises.

The Emergency Relief Assistance Fund was established by the GOH and AID to respond quickly to emergency situations. The fund was established under the Private Sector and Special Activities Component because it was anticipated that most activities financed through the program would be carried out by PVOs. The first activity financed with this fund was a training program for regional community leaders in managing natural disasters. The training is being carried out by the National Emergency Relief Council (COPEN). Other activities funded to date include a food distribution and community works program for displaced persons and an agricultural improvement program and food distribution for the drought stricken southern region of Honduras.

2. Endowment Program

As discussed in the USAID/Honduras Action Plan, the Mission is currently in the process of analyzing a program of endowments to support private sector

entities. This program will inter alia, provide financial support for certain private sector institutions that produce economic benefits in excess of the fees that they can charge for the services they provide. These "public good" producing institutions are, for example, in the areas of agricultural research, education and the like. The proposals for endowments will originate with the interested private sector entity, be passed through the GOH for concurrence, with final approval authority resting with the Mission. All endowments will be managed by the recipient institution's board of directors or financial advisors according to guidelines established for this purpose.

3. Program Monitoring

Once programmed and disbursed, funds are monitored by both the Ministry of Finance and Public Credit (MFPC) and the USAID Controller's office. Based on documentation submitted by the MFPC, the Controller's office issues a monthly status report of the ESF Program.

The report provides information on the complete portfolio of local currency resources. The report identifies amounts approved, programmed, disbursed, bank reserves (funds committed but not disbursed), and funds available for programming.

In addition to the monthly reports, the Controller's office makes spot checks on the vouchers maintained by the GOH for public sector institutions and for private sector organizations that receive GOH support. Operating Program Grants (OPGs) with institutions also require yearly independent financial reviews of the local currency programs.

In general, AID's role in monitoring public sector local currency is limited to ensuring that appropriate institutions receive the funds and that disbursements are made on a timely basis, particularly for USAID project counterpart.

The Mission closely monitors private sector funds. To reduce the Mission's management burden, a fiduciary account system was initiated with selected local commercial banks. Under this system, private sector recipients of local currency project funding (primarily PVOs) are required to sign a fiduciary agreement with a local commercial bank. This arrangement places the direct disbursement, management and monitoring burden in the hands of private banks. For a fee, the banks will disburse funds and manage each project's finances, implementation and accounting, with related reports submitted to AID on a quarterly basis.

TABLE IV.6

LOCAL CURRENCY USES

<u>LOCAL CURRENCY USE</u>	<u>CORRESPONDING USAID OBJECTIVES</u>	<u>CORRESPONDING NBCCA GOALS</u>
I. Public Sector Activities		
A. Counterpart for AID and IFI Projects	- Improve Macroeconomic Performance	- Economic Stabilization
B. Budget Support for GOH Programs Related to Mission's Programs	- Improve Agricultural Production	- Laying the Basis for Long-term Growth
	- Increase Export Earnings	- Equity and Broad Participation in Development
	- Generate Productive Employment	- Democratic Institutions and Human Rights
	- Reduce the Population Growth Rate	
	- Provide Improved Shelter and Services	
	- Improve Primary Education	
	- Increase Life Expectancy	
	- Consolidate Democratic Processes	
C. Employment Generation	- Generate Productive Employment	- Laying the Basis for Long-term Growth - Equity and Broad Participation in Development
D. Democratic Initiatives	- Provide Scholarships for Study in U.S.A. to Honduras	- Equity and Broad Participation in Development
	- Consolidate Democratic Processes	- Democratic Institutions and Human Rights
II. Private Sector Activities		
A. Working Capital Credit for Small and Medium Enterprises	- Improve Macroeconomic Performance - Increase Export Earnings - Generate Productive Employment	- Economic Stabilization - Laying the Basis for Long-term Growth
B. Divestiture of Public Enterprises Fund	- Improve Macroeconomic Performance - Increase Export Earnings - Generate Productive Employment	- Economic Stabilization - Laying the Basis for Long-term Growth
C. Investment Capital for Nontraditional Exports	- Improve Macroeconomic Performance - Increase Export Earnings - Generate Productive Employment	- Economic Stabilization - Laying the Basis for Long-term Growth

TABLE IV.6
LOCAL CURRENCY USES (Continued)

LOCAL CURRENCY USE	CORRESPONDING USAID OBJECTIVES	CORRESPONDING NBCCA GOALS
D. Support for PVOs	<ul style="list-style-type: none"> - Increase Agricultural Production - Increase Export Earnings - Generate Productive Employment - Increase Life Expectancy - Reduce Population Growth Rate - Provide Improved Shelter and Services 	<ul style="list-style-type: none"> - Economic Stabilization - Laying the Basis for Long-term Growth - Equity and Broad Participation in Development

TABLE IV.7.

SUMMARY OF GLOBAL PROGRAMMING OF LOCAL CURRENCY RESOURCES
(U.S. Dollar Equivalent in Thousands)

	522-0230	522-0283	TOTAL
<u>TOTAL PROGRAMMING</u>	<u>131,000.0</u>	<u>167,500.0</u>	<u>298,500.0</u>
I. <u>PUBLIC SECTOR</u>	<u>65,500.0</u>	<u>83,750.0</u>	<u>149,250.0</u>
A. Counterpart-AID	29,019.4	11,198.7	40,218.1
1. Ag. & Rural Development Projects	15,073.4	4,308.9	19,382.3
2. Education	4,827.5	1,500.0	6,327.5
3. Health & Nutrition	6,925.0	5,389.8	12,314.8
4. Others	2,193.5		2,193.5
B. USAID Project Revolving Funds	3,700.0	2,800.0	6,500.0
C. IFI Projects	15,595.5	23,604.0	39,199.4
D. PVOs GOH Budget	3,693.6	1,389.0	5,082.6
E. GOH Budget Support	7,864.1	33,426.0	41,290.0
F. Employment Generation	5,277.5	8,407.5	13,685.0
G. INVA Emergency Housing Program		50.0	50.0
H. AID Counterpart Reserve 1987		2,500.0	2,500.0
I. AID Trust Fund/Training	350.0		350.0
J. Reserve Fund		375.0	375.0

TABLE IV.7 (Continued)

SUMMARY OF GLOBAL PROGRAMMING OF LOCAL CURRENCY RESOURCES
(U.S. Dollar Equivalent in Thousands)

	<u>522-0230</u>	<u>522-0283</u>	<u>TOTAL</u>
II. <u>PRIVATE SECTOR AND SPECIAL ACTIVITIES</u>	<u>65,500.0</u>	<u>83,750.0</u>	<u>149,250.0</u>
A. <u>Private Sector</u>	<u>62,925.0</u>	<u>70,600.0</u>	<u>133,525.0</u>
1. Private Initiative Support Fund			
Economic Growth and Investment		7,500.0	7,500.0
Educational Services		7,500.0	7,500.0
PVOs	9,325.0	7,500.0	7,500.0
2. Divestiture of Public Enterprises Fund	2,500.0	9,500.0	12,000.0
3. Credit Programs			
a. Agric. Mortgage Rediscout Fund	500.0	1,500.0	2,000.0
b. Coffee Prod. Investment	5,000.0		5,000.0
c. Export Promotion and Services	12,000.0	12,000.0	24,000.0
d. Agric. Diversification Fund	750.0		750.0
e. Rural Technologies Credit	400.0	500.0	900.0
f. Basic Grains Production (Regional Cooperatives)	2,250.0		2,250.0
g. FONDEI/FIA	4,000.0		4,000.0
h. Small/Med.-Sized Businesses (Working Capital)	26,200.0		26,200.0
i. Housing Support Credit		7,500.0	7,500.0
j. Small Farmer Organization Strengthening		5,000.0	5,000.0
4. Free Zone Expansion Program		2,000.0	2,000.0
5. Reserve Fund		10,100.0	10,100.0
B. <u>Special Activities</u>	<u>2,575.0</u>	<u>13,150.0</u>	<u>15,725.0</u>
1. AID Trust Funds			
a. Operating Expenses	2,025.0	5,500.0	7,525.0
b. Technical Support Fund	500.0	2,450.0	2,950.0
c. Training		400.0	400.0
d. Financial Reviews		175.0	175.0
e. Peace Corps-Honduras SDA Prog	50.0	225.0	275.0
2. Emergency Assistance Relief Fund		2,500.0	2,500.0
3. Rotating Funds		1,400.0	1,400.0
4. Employment Generation - PVO		500.0	500.0

NOTE: Resources to cover additional rotating fund needs are on loan from the Private and Special Activities Account to the Public Sector Account.

V. CONDITIONS AND COVENANTS

A. Conditions Precedent to the Initial Disbursement

Prior to the initial disbursement of \$30.0 million, the Grantee shall provide to AID, in form and substance satisfactory to AID:

1. a written opinion of the Attorney General of Honduras that the Agreement is legal and binding;
2. specimen signature of the individual(s) empowered to act on behalf of the Government for this program;
3. evidence that the Grantee is in compliance with the June 30, 1987 ceiling on overall net domestic credit expansion, sub-ceiling on net domestic credit expansion to the consolidated nonfinancial public sector and the target change in net international reserves;
4. evidence that the GOH has substantially completed those specific actions required by July 15, 1987 as specified in the structural reform component of the GOH Economic Program attached in Annex II of this PAAD; and
5. development of a contingency plan and tracking system designed to insure compliance with GOH fiscal deficit target; and
6. establish a separate account(s) in the United States for ESF dollar disbursements as specified in Section IV.F of this PAAD.

B. Conditions Precedent to the Second Disbursement

Prior to a second disbursement of \$30.0 million, the Grantee shall provide to AID, in form and substance satisfactory to AID:

1. evidence that the Grantee is in compliance with the September 30, 1987 ceiling on overall net domestic credit expansion, the sub-ceiling on net domestic credit expansion to the consolidated nonfinancial public sector, and the target change in net international reserves; and
2. evidence that the GOH has substantially completed those specific actions required by October 15, 1987 as specified in the structural reform component of the GOH Economic Program attached in Annex II of this PAAD.

C. Conditions Precedent to the Third Disbursement

Prior to a third disbursement of \$40.0 million, the Grantee shall provide to AID, in form and substance satisfactory to A.I.D:

1. evidence that the Grantee is in compliance with the December 30, 1987 ceiling on overall net domestic credit expansion, the sub-ceiling on net domestic credit expansion to the public sector, and the target change in net international reserves;
2. evidence that the GOH has substantially completed those specific actions required by December 15, 1987 as specified in the structural reform component of the GOH Economic Program attached in Annex II of this PAAD; and
3. based on an overall review of GOH performance on the complementary structural reform program contained in Annex II of this PAAD, evidence that satisfactory progress has taken place.

D. Covenants

The cooperating country shall covenant that, unless AID otherwise agrees in writing, it will:

1. deposit in the Central Bank of Honduras, upon each ESF dollar disbursement, an amount of lempiras equal to the U.S. dollars disbursed at the highest legally obtainable rate of exchange on the date of disbursement. These lempiras will be programmed for such purposes as will be mutually agreed upon in writing by the Grantee and AID within 120 days from the dates of the deposits; and
2. maintain current its interest payments and installments of principal, or any other payment required under any other loan, guaranty, other agreement between the Government of Honduras or any of its agencies and the Government of the United States of America or any of its agencies.

REPORT TO THE HOUSE APPROPRIATIONS COMMITTEE ON ESF
CONDITIONALITY AND ON PROJECTED DISBURSEMENTS

This annex responds to the House Appropriations Committee request in House Report No. 99-747 that:

"Prior to obligating FY 1987 funds allocated to Honduras, AID is to provide a report to the Committee on the economic reforms being sought in Honduras and the projected timing for release of FY 1987 funds."

A. Antecedents

The USAID/Honduras' ESF Program serves two main objectives. The first is to have an immediate favorable impact on the level of income and employment. This objective is accomplished by providing financing for imports of intermediate inputs essential for the maintenance of production and employment at socially acceptable levels. We estimate that the \$100 million in FY 1987 ESF projected to be disbursed during 1987 will generate income in Honduras equal to 687 million lempiras, an amount equal to 8.6 percent of projected 1987 Honduran GDP. This income, in turn, will provide support for approximately 72,000 jobs, equal to 5.2% of projected 1987 employment.

Second, the ESF Program is designed to support the development and implementation of an economic program in Honduras that will permit both growth and stabilization objectives to be achieved over the longer term without the need for permanent injections of ESF balance-of-payments assistance. Reflecting the second objective, in 1986 the GOH initiated, with technical and financial support by USAID, a comprehensive program of economic stabilization, recuperation and structural reform. On balance, the two components of this program were successfully implemented.

The monetary program component of the GOH economic program was designed to reconcile growth and stabilization objectives within a coherent economic policy framework. Full compliance with the monetary program component of the FY 1986 ESF Program was instrumental in enabling Honduras to achieve real GDP growth of 3 percent, to reduce the urban open unemployment rate by over one full percentage point, to contain inflation to 4.4 percent and, simultaneously, to reduce both the fiscal deficit and the current account deficit in the balance of payments by approximately 2 percentage points of GDP.

A reasonably good start was also made on the implementation of the structural reform component of the FY 1986 ESF Program. This component consisted of 29 measures designed to raise GDP, employment and investment over the midterm by improving the efficiency with which the economy allocates the resources available to it. To this end, the structural reforms were grouped under four major headings:

- (1) rationalizing public sector operations,
- (2) enhancing export competitiveness,
- (3) promoting private sector investment, and
- (4) restoring internal and external confidence in the economy.

The importance of the structural reform component of the FY 1986 ESF Program, while not of immediate impact on the macroeconomic aggregates that are the ultimate policy targets, should not be underestimated. This merits a brief illustration. The establishment of a career judicial system, by providing greater assurances on the protection of human and property rights, should reduce the perceived risk of private sector investment in Honduras. The renegotiation of the publicly guaranteed, private external debt should measurably enhance Honduras' creditworthiness in the eyes of the international financial community. The passage of legislation designed to provide investment tax credit and tax loss carry-overs should stimulate private sector investment. The privatization of state-owned enterprises and activities should place these enterprises/activities under significantly more efficient management while simultaneously reducing the drain on the limited fiscal resources available to the Government. These five examples are only illustrative, as distinct from exhaustive, of the breadth and significance of the structural reforms that were initiated with the FY 1986 ESF Program.

B. Outline of Proposed FY 1987 ESF Program

In essence, the proposed FY 1987 ESF Program represents a continuation into 1987 of the support for the GOH Economic Program that was initiated in 1986 with USAID technical and financial assistance.

Reflecting this, the FY 1987 ESF Agreement supports a GOH Economic Program that consists of two components and associated objectives: (1) a monetary program designed to prevent a major deterioration from the sharp gains in stabilization and growth outcomes that were recorded in 1986, and (2) a structural reform program designed to produce significant midterm improvements in prospects for growth, employment and investment through improving the efficiency with which resources are allocated in Honduras.

With respect to the monetary program, the external circumstances that clearly favored Honduras' economic prospects and outcomes for 1986 have sharply reversed in 1987. This is particularly so with respect to coffee prices, but is also reflected in rising petroleum prices and higher external debt-service obligations. We estimate that the monetary program is compatible with: (1) real GDP growth in the range of 1 to 3 percent; (2) a current account deficit in the balance of payments between 7.8 and 8.8 percent of GDP; and (3) a deficit of the consolidated nonfinancial public sector between 6.4 and 7.2 percent of GDP. If the current account deficit in the balance of payments is held to the lower figure in its range, the outcome will be about one-half of one percentage point of GDP above the deficit recorded in 1986. If the overall deficit of the consolidated nonfinancial public sector is held to the lower figure in its range, the outcome will fully preserve the sharp gains recorded

in 1986. Major efforts have been undertaken to develop fiscal and exchange regime policy packages that are consistent with the monetary program and supportive of containing the fiscal and current account deficits to the lower figures in their respective ranges. Thus, in order to hold the line on the fiscal deficit as a percent of GDP, the GOH has developed and begun to implement a fiscal package that should produce budget savings of 110 to 130 million lempiras relative to the deficit that had been projected in March of 1987. With respect to the foreign exchange regime, new measures have been or are being introduced to expand the coverage of trade, services and capital account transactions under a liberalized exchange rate regime. In this same connection, we believe that the net international reserve target in the monetary program will require further steps towards enhancing the role of exchange rate flexibility in producing a viable balance-of-payments position.

With respect to the structural reform component of the GOH economic program for 1987, the emphasis will be placed upon carrying to completion/taking further concrete steps in the implementation of the structural reforms initiated in 1986. A limited set of additional structural reforms will also be initiated, these being keyed to explicit recommendations made in recent IMF and World Bank economic reports. We are reasonably confident about the prospects for passage in 1987 of the legislative package associated with the structural reform program. The Industrial Export Processing Zone Law was passed by Congress on April 2, 1987. The prospects look good for the tariff reform, perhaps the single most contentious component of the package.

As with the FY 1986 ESF Program, disbursement of FY 1987 ESF assistance will be tranching in accordance with quarterly performance targets related to implementation goals. For the monetary program, these consist in quarterly targets/ceilings on overall net domestic credit, on net domestic credit to the public sector and on net international reserves (NIRs) of the Central Bank. For the structural reform program, the corresponding quarterly implementation targets have been established in the form of a detailed implementation calendar that has been developed for each structural reform measure. Reporting on implementation of the structural reforms will be periodically consolidated under the four major sub-goals of the reforms: (1) rationalizing public sector operations, (2) promoting private sector investment, (3) enhancing export competitiveness, and (4) restoring internal and external confidence in the economy. Disbursements are programmed to take place on July 31 for \$30 million, on October 31 for \$30 million, and on December 31 for \$40 million, for a total disbursement of \$100 million.

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GOH ECONOMIC PROGRAM

Letter from President Azcona to Ambassador Briggs that transmits GOH Economic Program and requests ESF assistance.

- A. Letter and annexes, presenting Structural Reform Program, in Spanish.
- B. Translation of letter and annexes.



Presidencia de la República
Honduras, C. A.

Tegucigalpa, D.C., 7 de mayo, 1987.

Estimado señor Embajador:

El propósito de la presente es hacerle llegar el Programa Económico del Gobierno de Honduras para 1987 y a la vez por su medio, solicitarle al Gobierno de los Estados Unidos de América "Fondos de Apoyo Económico (ESF)" para la implementación de nuestro Programa.

Como es de su conocimiento, el Programa Económico iniciado por el Gobierno de Honduras en 1986, con el apoyo financiero de su país, tuvo un éxito considerable. Los logros alcanzados en la economía hondureña se reflejan claramente a través de lo siguiente: El producto Interno Bruto real creció en 3 por ciento, la tasa de desempleo abierto urbano se redujo en 1 por ciento, la inflación se mantuvo en 4.4 por ciento y las reservas monetarias internacionales netas del Banco Central de Honduras aumentaron en US \$ 15 millones. Simultáneamente, tanto el déficit en cuenta corriente de la balanza de pagos como el déficit del sector público^{NO} financiero, bajaron en aproximadamente 2 puntos como proporción del Producto Interno Bruto. La mejora en la economía hondureña en 1986 se refleja también en el progreso sustantivo en la implementación de las medidas iniciadas por el Gobierno para mejorar el comportamiento económico a mediano plazo, particularmente en las áreas de la racionalización de las operaciones del sector público, mejorando las inversiones del sector privado, promoviendo las exportaciones y restaurando la confianza interna y externa en la economía.

En gran parte, las mejoras en la economía hondureña en 1986, son producto de los esfuerzos de mi Gobierno para cumplir con la letra y el espíritu del Programa que iniciamos en mayo de 1986 y que, fue incorporado en el Convenio de Apoyo Económico (ESF) del año 1986. El total cumplimiento del Programa Monetario como compo



Presidencia de la República
Honduras, C. A.

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nente básico del Programa Económico del Gobierno, fue fundamental para alcanzar los resultados favorables en los indicadores de crecimiento y estabilización arriba delineados. El Gobierno de Honduras además, cumplió exitosamente con el calendario de acciones - presentado en nuestro programa de reformas estructurales, aunque aspirábamos que el progreso sería más rápido y uniforme a lo ocurrido.

Me place informarle que el Programa Económico para 1987, representa la continuación de nuestros esfuerzos para ejecutar un programa monetario diseñado para armonizar los objetivos inmediatos de estabilización y crecimiento, dentro del contexto de un programa de reformas estructurales orientado a mejorar en forma significativa los prospectos económicos en el mediano plazo.

Mi Gobierno está consciente de que nuestro reto más difícil lo constituye la reducción del déficit del sector público ante elementos desestabilizadores del sector externo. A este respecto, deseo enfatizar que para 1987, mi Gobierno está realizando esfuerzos adicionales para mantener el déficit del sector público como porcentaje del Producto Interno Bruto en la misma proporción registrada en 1986. No obstante, reconozco que una reducción sería deseable y nos esforzaremos por alcanzarla. Entiendo que este compromiso será considerado de mucha importancia al momento de que su Gobierno revise nuestra aplicación de "Fondos de Apoyo Económico".

Nosotros creemos que el Programa resumido a continuación y presentado en detalle en los Anexos de esta carta, amerita el apoyo continuo del Gobierno de los Estados Unidos de América. Además, creo que nuestro Programa Económico para 1987 es un programa que puede utilizarse como una base sólida para buscar ayuda adicional, particularmente, del FMI y del Banco Mundial, dentro de este contexto, mi Gobierno esta considerando solicitar, en su oportunidad, que el Fondo Monetario Internacional envíe a Honduras un representante re

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sidente. Conforme esto, representantes de mi Gobierno planean presentar nuestro Programa a ambas instituciones tan pronto como se fijen las fechas convenientes. Apreciaríamos grandemente el apoyo que su Gobierno pueda prestarnos, en la búsqueda adicional de apoyo especialmente ante los Organismos Financieros Internacionales.

I. Resumen del Programa Económico del Gobierno de Honduras para 1987

A. Programa Monetario

En 1986, circunstancias externas favorables permitieron al Gobierno de Honduras desarrollar y ejecutar un programa monetario dentro de los objetivos de estabilización y crecimiento. El Programa Monetario de 1987, está enmarcado en los mismos objetivos, pese al demejoramiento previsto para el presente año en los precios internacionales del café, el alza en los precios del petróleo y la incipiente tendencia ascendente de las tasas de interés en el mercado financiero internacional.

CUADRO 1

PROGRAMA MONETARIO DEL GOBIERNO DE HONDURAS: LIMITES DE CREDITO Y METAS PARA LAS RESERVAS INTERNACIONALES (Millones de Lempiras)

	Diciembre 31 1986	Cambio acumulado			
		<u>Cambio acumulado/87</u>	dic.31, 1986 a	dic. 31, 1987	
		Jun 30	Sep.30	Dic.31	
Límite de Crédito 1/2/	3746	120	180	240	240
Al Sector Público 2/	1119	15-20	10-20	15-30	42
Al Sector Privado	2627	105-100	170-160	225-210	198
Reservas Internacionales Netas 3/	- 179	0-5	0-10	0-20	20

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- 1/ Sistema bancario consolidado y sector público no financiero, ambos de acuerdo con las definiciones del FMI.
- 2/ La conversión a lempiras de la deuda pública externa o garantizada por el sector público, podría resultar en un ajuste hacia arriba que no excederá de L. 50 millones.
- 3/ Del Banco Central de Honduras, de acuerdo con la definición del FMI.

Como se puede observar en el Cuadro I, el Programa Monetario del Gobierno de Honduras es muy ajustado. El límite general en el crecimiento crediticio de L. 240 millones, limita el crecimiento crediticio a 6.4 por ciento sobre el nivel registrado a finales de 1986. Dentro de los límites generales, un sublímite muy ajustado en la expansión crediticia neta al sector público consolidado no financiero de L. 30 millones, deja la mayor proporción del crédito bancario adicional para financiar la producción e inversión del sector privado.

A pesar de la reversión desfavorable de los precios del café y del petróleo, el Banco Central de Honduras ha fijado como meta mínima no permitir ninguna reducción en las reservas monetarias internacionales netas en 1987. Además, el Banco Central de Honduras, ha resuelto fortalecer en las reservas monetarias internacionales netas en unos US \$. 10 millones, siempre que esto sea posible dentro del marco de lograr un compromiso realista entre los objetivos de crecimiento y estabilización.

El Banco Central de Honduras estima que el Programa Monetario es compatible con un crecimiento real en el Producto Interno Bruto en 2 ó 3 por ciento; un déficit en cuenta corriente de la balanza de pago de 8 por ciento del PIB; y un déficit en el sector público consolidado no financiero de un 6.4 por ciento del PIB. Así mismo, aunque estas proyecciones para los indicadores de crecimiento y estabilización no representen una mejoría sobre los resultados de 1986, sí reflejan la decisión de evitar previenen un mayor deterioro de dichos logros, ante las perspectivas desfavorables que presenta el sector externo de la economía. Más aún, y tal como se



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indicó anteriormente, mi Gobierno está realizando mayores esfuerzos para mantener la relación del déficit fiscal PIB al menos igual a lo registrado en 1986. Para lograr esto, se ha requerido el desarrollo de una serie de medidas orientadas a mejorar los ingresos y reducir los gastos en una magnitud de L. 110 a L. 130 millones (en la base de datos del Anexo No.1 no aparece este ajuste). Mi gobierno - ya comenzó a ejecutar estas medidas y se les dará seguimiento en el transcurso del año, previniéndose medidas contingentes que entrarían en vigencia si las circunstancias sugieren que las metas fiscales no se están cumpliendo en una magnitud significativa. Se hará todo el esfuerzo posible para sobrepasar, en vez de simplemente alcanzar la meta de reducir el déficit a un nivel igual al alcanzado en 1986.

Dentro del objetivo de preservar la estabilidad cambiaria, se tomarán las medidas apropiadas tendientes a flexibilizar los mecanismos de control cambiario, con efectos positivos en el sector exportador, repatriación de utilidades y la inversión directa extranjera en la economía. El Banco Central de Honduras está estudiando además, las formas apropiadas para aumentar la objetividad y simplificación del actual sistema de regulación cambiaria.

B. El Programa de Reformas Estructurales para 1987

El programa de reformas estructurales de 1987 se basa en el progreso realizado, y más importante aún, en la experiencia obtenida durante el desarrollo y ejecución del programa de reformas estructurales de 1986. Como resultado de ambos factores, mi Gobierno anticipa un progreso significativo en el programa de reformas estructurales que, con efectos iniciales en 1988, deberá mejorar substancialmente el comportamiento de la economía hondureña.

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En relación al progreso realizado en 1986, el programa de reforma estructural de 1987 anticipa la aprobación por parte del Congreso Nacional de las medidas que requieren acción Legislativa y que fueron presentadas a ese Organismo en 1986. Mi Gobierno cree que esta meta del programa será alcanzada en su totalidad. El programa del Gobierno de Honduras también contempla en 1987 la aceleración general del proceso de privatización. Esperamos que el programa de reformas estructurales de 1987 producirá resultados aún más concretos, que el de 1986. El programa de reformas estructurales completo, cubriendo las metas finales así como el calendario de ejecución trimestral para cada una de las medidas de reformas estructurales está detallado en el Anexo No.2 de esta carta.

Me gustaría enfatizar que el programa de reformas estructurales de 1987 ha sido el producto de amplias discusiones de grupos de trabajo a nivel político y técnico dentro del Gobierno de Honduras. El resultado de estas discusiones y su meta ha sido el desarrollo de calendarios de ejecución y metas para las reformas estructurales a las cuales el Gobierno de Honduras se ha comprometido tanto a nivel técnico como político. Mi Gobierno tiene la confianza que aún cuando las metas dentro del año son muy ambiciosas, serán realizadas en forma substancial. Sin embargo, deseo también enfatizar, que Honduras, como los Estados Unidos, es una democracia. El Poder Ejecutivo propone, pero el Poder Legislativo dispone. Como tal, yo solamente puedo asegurarle que el Poder Ejecutivo hará todo esfuerzo para buscar la aprobación por parte del Congreso Nacional, de las medidas legislativas contenidas en el Programa de 1987.

A fin de mejorar la coordinación intragubernamental y acelerar la ejecución del Programa de Reformas Estructurales, planteamos solicitar a la AID financiamiento para un paquete complementario de asistencia técnica y de recursos para capacitación para las dependencias claves involucradas en la implementación del Programa. Mi Gobierno también está solicitando asistencia técnica del FMI y del BIRF.



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Finalmente, Honduras desafortunadamente permanece como uno de los países menos desarrollados en América Latina. Estamos luchando por consolidar nuestro sistema democrático y demostrar que una sociedad libre es el único medio legítimo para satisfacer las necesidades sociales y económicas de nuestros ciudadanos con los más bajos ingresos. Al mismo tiempo Honduras está confrontando precios del café extremadamente bajos lo que significará más de US \$. 100 millones menos en divisas en 1987 en comparación con 1986. Nosotros creemos que estas consideraciones, más nuestra exitosa ejecución del Programa Económico en 1986, las medidas de estabilización y de ajuste estructural en 1987, ameritan niveles más altos de asistencia de toda la comunidad financiera internacional.

Anticipadamente agradezco a usted, transmitir a su Gobierno la información arriba proporcionada, así como los anexos a la presente, para su debida consideración.

Atentamente,

JOSE SIMON AZCONA HOYO
PRESIDENTE CONSTITUCIONAL
DE LA REPUBLICA

Al señor
Embajador de los Estados Unidos de América
Everett Ellis Briggs
SU DESPACHO

ANEXO No.1

Los datos incluidos en este anexo, no incluyen los últimos ajustes, particularmente el paquete fiscal introducido en abril de 1987 y en algunos componentes de la Balanza de Pagos, ajustes tendentes a armonizar estas políticas con el Programa Monetario.

(COVER SHEET ONLY)

A N E X O No. 2

PROGRAMACION DE MEDIDAS ECONOMICAS DEL GOBIERNO DE HONDURAS

REFORMAS ESTRUCTURALES
PLAN DE TRABAJO PARA 1987

CONTENIDO:

- A. Racionalizar las Operaciones del Sector Público
1. Introducción del Presupuesto Base Cero (PBC) por el Gobierno de Honduras incluyendo instituciones descentralizadas.
 - 2a. Desarrollar y ejecutar un sistema de control presupuestario en cada institución descentralizada.
 - 2b. Entrega trimestral de la ejecución de las cuentas financieras al Gobierno Central de acuerdo con prácticas de contabilidad generalmente aceptadas.
 3. Desarrollo y entrega al Gobierno Central por instituciones descentralizadas de informes trimestrales sobre eficiencia operacional y económica del sector público.
 4. Auditorías anuales independientes de las instituciones descentralizadas del sector público.
 5. Expansión de la base tributaria de los municipios.
 6. Transferencia al sector privado de la participación del estado en actividades que deben ser efectuadas por la empresa privada.
 7. Arancel de aduanas.
 8. Ley de Valoración aduanera.
 9. Ley de Aduanas.
 10. Introducción del peaje en caminos mejorados.
 11. Continuar el mejoramiento del sistema administrativo de los tributos.

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B. Acrecentar la Competitividad de las Exportaciones

12. Ley de Importación Temporal.
13. Ley de Fomento a las Exportaciones.
14. Ley de Zonas Industriales de Procesamiento.
15. Ley de Incentivos a la Exportación de Bananos.
16. Presentar al Gabinete Económico evaluaciones periódicas de las exportaciones y competitividad de precios.
17. Año Nacional de las Exportaciones 1987.

C. Promover la Inversión Privada

18. Reducción del tratamiento preferencial al sector público en materia fiscal y monetaria.
19. Crédito tributario sobre inversiones.
20. Reconocimiento de las pérdidas de operación para la determinación de la renta gravable.
21. Desarrollo de un mercado de capitales.
22. Aumentar la participación del sector privado en comercialización de la madera al exterior.
23. Estudio final de protección efectiva y reducción del promedio y dispersión de los niveles de las tasas de protección efectiva.
24. Promoción de la inversión directa extranjera en turismo en áreas costeras.

D. Otros

25. Consolidación, eliminación y racionalización del actual sistema de exención de impuestos.
26. Establecimiento del sistema de la carrera judicial.
27. Renegociación de la deuda externa.

MEDIDA 1: INTRODUCCION DEL PRESUPUESTO BASE CERO (PBC) POR EL GDEH, INCLUYENDO INSTITUCIONES DESCENTRALIZADAS.

META PARA 1987: 1. Implantación de un sistema de información y contabilidad adecuado para la introducción de PBC en tres instituciones descentralizadas. (INA, INVA y SANAA).
2. Preparación de un plan de extensión del sistema de información y contabilidad adecuado para PBC a las otras instituciones del Gobierno, en base de los resultados obtenidos en las instituciones piloto.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Junio 1987 1. Presentación por la Comisión de Evaluación y Control Financiero de las Instituciones Descentralizadas del Programa de medidas económicas del Gobierno de Honduras al sector público descentralizado e indicación de:

- a. Los propósitos generales del programa;
- b. Intención de las medidas en cuanto a racionalizar las operaciones del sector descentralizado;
- c. Actividades que serán desarrolladas para cumplir con el Programa;
- d. El Grupo Técnico que asesorará en la ejecución de la medida al personal que designen las instituciones piloto;
- e. Asistencia que el Grupo Técnico proveerá a los entes descentralizados en la ejecución de sus trabajos;

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f. Papel de las Juntas Directivas en función de su responsabilidad frente al Gobierno y pueblo hondureño.

2. La presentación será precedida por las siguientes actividades:

- a. Designación de los expositores;
- b. Selección de los participantes en la presentación, teniendo cuidado en asegurar que las Juntas Directivas, administración superior y unidades responsables de contabilidad y presupuesto de las instituciones descentralizadas estén plenamente representadas.

3. Adopción por las Juntas Directivas y/o funcionarios ejecutivos, de las instituciones descentralizadas, de lo siguiente:

- a. Definición de las actividades consideradas como prioritarias relacionadas con la medida para la institución;
- b. Aprobación de las acciones que, conforme al plan de trabajo elaborado por el Grupo Técnico con la participación de las descentralizadas y aprobadas por la Comisión, les corresponda cumplir;
- c. Designación del personal que será responsable por la ejecución de la medida;
- d. Aprobación y puesta en ejecución de un plan de trabajo y calendario.

4. Preparación por el Grupo Técnico de los términos de referencia para la contratación de la asistencia técnica externa en materia de PBC, incluyendo capacitación tanto para el Grupo Técnico como para el personal de las instituciones descentralizadas.

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5. Preparación por el Grupo Técnico de un calendario complementario para las demás actividades necesarias para cumplir la meta.

15 Julio 1987

15 Agosto 1987 1. Actividades de la Comisión y Grupo Técnico en ejecución conforme a sus planes de trabajo y calendarios.

2. Avance de actividades en instituciones piloto conforme a planes de trabajo y calendarios.

15 Octubre 1987

1. Actividades de la Comisión y Grupo Técnico en ejecución conforme a sus planes de trabajo y calendarios.

2. Avance de actividades en instituciones piloto conforme a planes de trabajo y calendarios.

15 de Diciembre

1. Decisión tomada sobre la adopción de un PBC y preparativos hechos para su ejecución en INA, INVA y SANAA.

2. Plan para extensión del PBC a otras instituciones del Gobierno preparado y decisión sobre el mismo, adoptada por el Presidente de la República.

NOTAS EXPLICATIVAS/COMENTARIOS

La meta para 1987 podrá ser revisada de acuerdo a los resultados de la asistencia técnica que se espera del FMI.

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MEDIDA 2, 3 y 4:

- 2a. DESARROLLAR Y EJECUTAR UN SISTEMA DE CONTROL PRESUPUESTARIO EN CADA INSTITUCION DESCENTRALIZADA.
- 2b. ENTREGA TRIMESTRAL DE LA EJECUCION DE LAS CUENTAS FINANCIERAS AL GOBIERNO CENTRAL DE ACUERDO CON PRACTICAS DE CONTABILIDAD GENERALMENTE ACEPTADAS.
3. DESARROLLO Y ENTREGA AL GOBIERNO CENTRAL POR INSTITUCIONES DESCENTRALIZADAS DE INFORMES TRIMESTRALES SOBRE EFICIENCIA OPERACIONAL Y ECONOMICA DEL SECTOR PUBLICO.
4. AUDITORIAS ANUALES INDEPENDIENTES DE LAS INSTITUCIONES DESCENTRALIZADAS DEL SECTOR PUBLICO.

META PARA 1987:

Sistemas aprobados y en ejecución.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Junio 1987

1. Presentación por la Comisión de Evaluación y Control Financiero de las Instituciones Descentralizadas del Programa de medidas económicas del Gobierno de Honduras al sector público descentralizado e indicación de:
 - a. Los propósitos generales del programa;
 - b. Intención de las medidas en cuanto a racionalizar las operaciones del sector descentralizado;
 - c. Actividades que serán desarrolladas para cumplir con el Programa;
 - d. El Grupo Técnico que asesorará en la ejecución de la medida al personal que designen las instituciones descentralizadas;

- 2 -

- e. Asistencia que el Grupo Técnico proveerá a los entes descentralizados en la ejecución de sus trabajos;
 - f. Papel de las Juntas Directivas en función de su responsabilidad frente al Gobierno y pueblo hondureño.
2. La presentación será precedida por las siguientes actividades:
- a. Designación de los expositores;
 - b. Selección de los participantes en la presentación, teniendo cuidado en asegurar que las Juntas Directivas, administración superior y unidades responsables de contabilidad y presupuesto y auditoría de las descentralizadas estén plenamente representadas.
3. Adopción por las Juntas Directivas y/o funcionarios ejecutivos de las instituciones de lo siguiente:
- a. Definición de las actividades consideradas como prioritarias relacionadas con las medidas para la institución;
 - b. Aprobación de las acciones que, conforme al plan de trabajo elaborado por el Grupo Técnico con la participación de las descentralizadas y aprobadas por la Comisión, les corresponda cumplir;
 - c. Designación del personal que será responsable por la ejecución de la medida;
 - d. Aprobación y puesta en ejecución de un plan de trabajo y calendario.

- 3 -

4. Preparación del Grupo Técnico de un calendario complementario para las demás actividades necesarias para cumplir la meta.

15 Julio 1987

15 Agosto 1987

1. Diseño y aprobación de los formatos a ser utilizados para la ejecución de las medidas y su entrega conjuntamente con el contenido aprobado para los informes de auditoría a sus Juntas Directivas, al Presidente de la República, al Ministerio de Hacienda y Crédito Público y al Ministerio de Planificación, Coordinación y Presupuesto.

2. Introducción de los formatos en los sistemas de control presupuestario, cuentas financieras y eficiencia operacional y económica del sector público.

30 Agosto 1987

1. Diseño por el Grupo Técnico y aprobación por la respectiva Junta Directiva de un sistema para que las relaciones entre las firmas auditoras y las instituciones a ser auditadas, se efectúen en forma tal que se asegure la independencia, objetividad e imparcialidad de las auditorías.

2. Contratación de auditorías con firmas independientes.

30 Septiembre 1987

1. Presentación por el Grupo Técnico a la Comisión, de los primeros informes preparados con base en los formatos aprobados, sobre:

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- a) Control presupuestario;
- b) Cuentas financieras;
- c) Eficiencia operacional y económica;

2. Presentación por el Grupo Técnico a la Comisión, del primer informe sobre el estado de avance de las auditorías independientes.

15 Octubre 1987

1. Revisión por la Comisión de los primeros resultados para probar la efectividad de las acciones.

2. Incorporación de ajustes y recomendaciones para mejorar la calidad del trabajo.

15 Diciembre 1987

1. Presentación por el Grupo Técnico a la Comisión, de los segundos informes con base en los formatos aprobados sobre:

- a) Control presupuestario;
- b) Cuentas financieras;
- c) Eficiencia operacional y económica;

2. Presentación por el Grupo Técnico a la Comisión de lo siguiente:

- a) Segundo informe sobre el estado de avance de las auditorías independientes.
- b) Informes de las primeras auditorías practicadas a instituciones descentralizadas.

30 Diciembre 1987

1. Examen de las medidas por la Comisión con las instituciones descentralizadas para evaluar resultados.

2. Incorporación de ajustes y recomendaciones para mejorar la calidad del trabajo.

MEDIDA 5: EXPANSION DE LA BASE TRIBUTARIA DE LOS MUNICIPIOS.

META PARA 1987: Emisión de la nueva legislación para el Impuesto Vecinal, Impuestos sobre Producción, Consumo y Ventas, Impuesto sobre Bienes Inmuebles y Contribución por Mejoras que cobrarán las Municipalidades.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

15 Julio 1987

15 Septiembre 1987

30 Octubre 1987 Aprobación esperada por parte del Congreso Nacional de la nueva Ley de Impuesto Vecinal, Impuestos sobre Producción, Consumo y Ventas, Impuesto sobre Bienes Inmuebles y Contribución por Mejoras que cobrarán las Municipalidades.

30 Noviembre 1987 Borrador de los Proyectos de Reglamento para la aplicación de los diferentes impuestos y de la Contribución por Mejoras.

15 Diciembre 1987 Aprobación esperada por parte del Poder Ejecutivo de los Reglamentos para la aplicación de los diferentes impuestos y de la contribución por mejoras.

MEDIDA 6: TRANSFERENCIA AL SECTOR PRIVADO DE LA PARTICIPACION DEL ESTADO EN ACTIVIDADES QUE DEBEN SER EFECTUADAS POR LA EMPRESA PRIVADA.

META PARA 1987: Realizar por lo menos siete privatizaciones.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

<u>15 Julio 1987</u>	Paquete completo para cuatro privatizaciones, que incluye evaluación, saneamiento legal y financiero, perspectivas, etc.
30 Agosto 1987	Dictamen de la Comisión de Avalúos y aprobación de la Comisión de Privatización y de la Junta Directiva de la institución respectiva de los avalúos y condiciones de venta o arrendamiento de las cuatro privatizaciones.
<u>15 Septiembre 1987</u>	Paquete completo para tres privatizaciones adicionales, que incluye evaluación, saneamiento legal y financiero, perspectivas, etc.
<u>15 Octubre 1987</u>	
30 Octubre 1987	Dictamen de la Comisión de Avalúos y aprobación de la Comisión de Privatización y de la Junta Directiva de la institución respectiva de los avalúos y condiciones de venta o arrendamiento de las tres privatizaciones adicionales.
<u>15 Diciembre 1987</u>	Realización esperada de por lo menos siete privatizaciones.

MEDIDA 7: ARANCEL DE ADUANAS.

META PARA 1987: Aprobación del nuevo Arancel de Aduanas.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Abril 1987	Concluir negociaciones del Poder Ejecutivo con el sector privado.
30 Mayo 1987	Presentación de la versión revisada del nuevo Arancel de Aduanas ante el Congreso Nacional.
<u>15 Julio 1987</u>	Reunión de la Comisión Técnica Arancelaria del Poder Ejecutivo con la Comisión de Dictamen del Congreso Nacional.
30 Agosto 1987	Aprobación esperada del Arancel de Aduanas por parte del Congreso Nacional.
<u>15 Octubre 1987</u>	
<u>15 Diciembre 1987</u>	

NOTAS EXPLICATIVAS/COMENTARIOS

El 26 de marzo de 1987 se concluyeron las negociaciones sobre tarifas, entre la Comisión Técnica Arancelaria del Poder Ejecutivo y el sector privado, quedando pendiente únicamente los casos relacionados con la industria textil y el rubro de almidones y aprestos.

MEDIDA 8: LEY DE VALORACION ADUANERA.

META PARA 1987: Emisión y aplicación de la nueva Ley de Valoración aduanera y su respectivo Reglamento.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Mayo 1987	Presentación de la versión revisada de la nueva Ley de Valoración Aduanera ante el Congreso Nacional.
<u>15 Julio 1987</u>	Reunión de la Comisión Técnica Arancelaria del Poder Ejecutivo con las Comisiones de Dictamen del Congreso Nacional.
30 Agosto 1987	Aprobación esperada de la Ley de Valoración Aduanera por parte del Congreso Nacional.
30 Septiembre 1987	Borrador del Proyecto del Reglamento de la Ley.
<u>15 Octubre 1987</u>	
30 Noviembre 1987	Aprobación esperada por parte del Poder Ejecutivo del Reglamento de la Ley.
<u>15 Diciembre 1987</u>	

MEDIDA 9: LEY DE ADUANAS.

META PARA 1987: Emisión y aplicación de la nueva Ley de Aduanas y su respectivo Reglamento.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Mayo 1987	Presentación de la versión revisada de la nueva Ley de Aduanas ante el Congreso Nacional.
<u>15 Julio 1987</u>	Reunión de la Comisión Técnica Arancelaria del Poder Ejecutivo con las Comisiones de Dictamen del congreso Nacional.
30 Agosto 1987	Aprobación esperada de la Ley de Aduanas por parte del Congreso Nacional.
30 Septiembre 1987	Borrador del Proyecto del Reglamento de la Ley.
<u>15 Octubre 1987</u>	
30 Noviembre 1987	Aprobación esperada por parte del Poder Ejecutivo del Reglamento de la Ley.
<u>15 Diciembre 1987</u>	

MEDIDA 10: INTRODUCCION DEL PEAJE EN CAMINOS MEJORADOS.

META PARA 1987: Cobrar el peaje en las ocho estaciones escogidas.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Mayo 1987 Definición del nivel de tarifas a cobrarse.

1 Julio 1987 Implementación del sistema de peaje en:
a. Cerro de Hula y
b. Támara.

15 Julio 1987

1 Agosto 1987 Implementación del sistema de peaje en Olancho.

1 Octubre 1987 Implementación del sistema de peaje en:
a. Zamorano y
b. Choloma.

15 Octubre 1987

1 Noviembre 1987 Implementación del sistema de peaje en:
a. La Lima,
b. Tela y
c. Caracol.

15 Diciembre 1987

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MEDIDA 11: CONTINUAR EL MEJORAMIENTO DEL SISTEMA ADMINISTRATIVO DE LOS TRIBUTOS.

META PARA 1987: Plan de acción elaborado y ejecutado para los principales impuestos.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

- | | |
|--------------------------|---|
| <u>30 Mayo 1987</u> | Diseñar planes de trabajo específicos y calendarizarlos para reducir la brecha entre las recaudaciones potenciales y realizadas de las siguientes leyes: (1) Impuestos sobre Comercio Exterior, (2) Impuesto sobre la Renta, (3) Impuesto sobre Producción, Consumo y Ventas. |
| <u>15 Julio 1987</u> | Ejecución de las medidas calendarizadas de acuerdo con los planes de trabajo arriba mencionados. |
| <u>15 Octubre 1987</u> | Ejecución de las medidas calendarizadas de acuerdo con los planes de trabajo arriba mencionados. |
| <u>15 Diciembre 1987</u> | <ol style="list-style-type: none">1. Ejecución de las medidas calendarizadas de acuerdo con los planes de trabajo arriba mencionados.2. Evaluación del ingreso adicional debido a las medidas tomadas. |

MEDIDA 12: LEY DE IMPORTACION TEMPORAL

META PARA 1987: Emisión del Reglamento de la Ley de Importación Temporal.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Mayo 1987

Aprobación por parte del Poder Ejecutivo del Reglamento de la Ley de Importación Temporal.

15 Julio 1987

15 Octubre 1987

15 Diciembre 1987

MEDIDA 16: PRESENTAR AL GABINETE ECONOMICO EVALUACIONES PERIODICAS DEL COMPORTAMIENTO DE LAS EXPORTACIONES Y COMPETITIVIDAD DE PRECIOS.

META PARA 1987: Discusiones dentro del Gabinete Económico y recomendaciones de política.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

31 Mayo 1987	Entrega de la primera evaluación de 1987 al Gabinete Económico.
30 Junio 1987	1. Discusiones dentro del Gabinete Económico sobre la primera evaluación de 1987. 2. Recomendaciones de política.
<u>15 Julio 1987</u>	
<u>15 Octubre 1987</u>	
31 Octubre 1987	Entrega de la segunda evaluación de 1987 al Gabinete Económico.

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30 Noviembre 1987

1. Discusiones dentro del Gabinete Económico sobre la segunda evaluación de 1987.
2. Recomendaciones de política.

15 Diciembre 1987

MEDIDA 17: AÑO NACIONAL DE LAS EXPORTACIONES 1987

META PARA 1987: Desarrollo de una estructura institucional y una política económica favorable a las exportaciones.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

- | | |
|----------------------|--|
| 30 Abril 1987 | <ol style="list-style-type: none">1. Creación del Centro Unico de Trámite de Exportaciones (CENTREX).2. Creación del Consejo Nacional de Fomento a las Exportaciones e Inversiones (CONAFEXI).3. Primer Congreso para el Exportador, en San Pedro Sula y comienzo del Concurso para el Exportador. |
| 30 Mayo 1987 | <ol style="list-style-type: none">1. Elaboración del perfil del Plan Nacional de Exportaciones. |
| 30 Junio 1987 | Curso sobre mercadeo orientado a la exportación, en Tegucigalpa. |
| <u>15 Julio 1987</u> | |
| 30 Julio 1987 | Segundo Congreso para el Exportador, en Tegucigalpa. |

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30 Agosto 1987 Foro de los exportadores, en Tegucigalpa.

30 Septiembre 1987 Feria exposición de productos hondureños para la exportación, en San Pedro Sula.

15 Octubre 1987

30 Octubre 1987 Feria exposición de productos hondureños para la exportación, en Tegucigalpa.

15 Noviembre 1987 Foro de los exportadores, en San Pedro Sula.

30 Noviembre 1987 Termina el Concurso para el Exportador, otorgando premios a los mejores exportadores.

15 Diciembre 1987

MEDIDA 18: REDUCCION DE PREFERENCIAS OTORGADAS AL SECTOR PUBLICO
EN MATERIA FISCAL Y MONETARIA.

META PARA 1987: Elaborar base de información y calendario para la eli-
minación de la exención del impuesto sobre la renta pa-
ra los intereses acumulados por los bonos del Gobierno.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

15 Julio 1987

15 Octubre 1987

15 Diciembre 1987

Estudio finalizado; calendario desarrollado y apro-
bado.

MEDIDA 19: CREDITO TRIBUTARIO SOBRE INVERSIONES

META PARA 1987: Emisión de la ley que establece el crédito tributario sobre inversiones.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Mayo 1987	Revisión del Anteproyecto de Ley por parte del Poder Ejecutivo.
15 Junio 1987	Presentación de la versión revisada del Proyecto de Decreto ante el Congreso Nacional.
<u>15 Julio 1987</u>	
30 Julio 1987	Aprobación esperada por parte del Congreso Nacional del Decreto estableciendo el Crédito Tributario sobre Inversiones.
15 Agosto 1987	Borrador del Reglamento de la Ley de Crédito Tributario sobre Inversiones.
30 Septiembre 1987	Aprobación esperada por parte del Poder Ejecutivo del Reglamento de la Ley de Crédito Tributario sobre Inversiones.

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15 Octubre 1987

15 Diciembre 1987

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MEDIDA 20: RECONOCIMIENTO DE LAS PERDIDAS DE OPERACION PARA LA DETERMINACION DE LA RENTA GRAVABLE.

META PARA 1987: Emisión del Decreto que modifique la Ley de Impuesto sobre la Renta para permitir el reconocimiento de pérdidas de operación.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Mayo 1987 Revisión del Anteproyecto de Ley por parte del Poder Ejecutivo.

15 Junio 1987 Presentación de la versión revisada del Proyecto de Decreto ante el Congreso Nacional.

15 Julio 1987

30 Julio 1987 Aprobación esperada por parte del Congreso Nacional del Decreto, estableciendo el reconocimiento de pérdidas de operación para la determinación del Impuesto sobre la Renta.

15 Octubre 1987

15 Diciembre 1987

MEDIDA 21: DESARROLLO DE UN MERCADO DE CAPITALS

META PARA 1987: Entrega del informe final y recomendaciones de la Comisión de Mercado de Capitales al Presidente, al Congreso Nacional y a organizaciones del sector privado e iniciación de gestiones en el sector privado, Poder Ejecutivo, Congreso Nacional basadas en las recomendaciones.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Mayo 1987

1. Tabla de contenido y lineamiento del informe final de la Comisión de Mercado de Capitales realizada y aprobada por los miembros de la Comisión.
2. Calendario preparado y aprobado de reuniones/discusiones/deliberaciones sobre los temas a tratar/resolver en el informe final.
3. Asignación de responsabilidades a personas y/o Comité para la preparación de los borradores de los temas que serán incluidos en el informe final. Calendarización para la revisión de los borradores por la Comisión en pleno.
4. Presupuesto para las actividades de la Comisión preparado y aprobado.
5. Director y personal de apoyo contratados.

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6. Presidente de la Comisión nombrado.

7. Presupuesto del Comité establecido.

15 Julio 1987

30 Julio 1987

1. Borradores preliminares completos de todos los capítulos del informe final.

2. Comenzar revisión de los borradores preliminares por la Comisión en pleno.

15 Agosto 1987

Mesa redonda inicial, con testimonio de participantes potenciales claves del sector privado en el Mercado de Capitales.

15 Septiembre 1987

Primer borrador del informe final listo para revisión por parte de la Comisión.

15 Octubre 1987

Discusiones sobre el primer borrador del informe con personas claves del sector privado, Poder Ejecutivo, Congreso Nacional, Poder Judicial y con organizaciones internacionales y del sector privado extranjero.

15 Noviembre 1987

Revisión del borrador del informe final.

15 Diciembre 1987

Entrega del informe final.

MEDIDA 22: AUMENTAR LA PARTICIPACION DEL SECTOR PRIVADO EN LA COMERCIALIZACION DE LA MADERA EN EL EXTERIOR.

META PARA 1987: Traspasar todo el manejo de la madera para exportación al sector privado (a excepción de CORFINO).

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

15 Julio 1987

Cesar en la zona norte las operaciones de manejo de madera por parte del Estado a través de la venta o arrendamiento al sector privado de los patios de Servicios Madereros, S.A. de C.V. (SEMSA).

15 Octubre 1987

15 Diciembre 1987

MEDIDA 23: ESTUDIO FINAL DE PROTECCION EFECTIVA Y REDUCCION DEL PROMEDIO Y DISPERSION DE LOS NIVELES DE LAS TASAS DE PROTECCION EFECTIVA.

META PARA 1987: Determinación y análisis del promedio de los niveles de protección efectiva y del grado de dispersión existente.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

15 Junio 1987

Primer seminario sobre Protección Efectiva para representantes del COHEP, Poder Ejecutivo y del Congreso Nacional para analizar el impacto de la política arancelaria en la canalización de recursos.

15 Julio 1987

30 Agosto 1987

Presentación del Estudio Revisado sobre Protección Efectiva.

30 Septiembre 1987

1. Segundo Seminario sobre Protección Efectiva para representantes del COHEP, Poder Ejecutivo y del Congreso Nacional para analizar el impacto de la política arancelaria en la canalización de recursos.

2. Informe sobre el avance de los trabajos relacionados con el cálculo y análisis de los niveles de protección efectiva.

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15 Octubre 1987

15 Diciembre 1987

Determinación y análisis dentro del contexto económico del promedio de los niveles de protección efectiva y del grado de dispersión existente.

MEDIDA 24: PROMOCION DE LA INVERSION DIRECTA EXTRANJERA EN TURISMO EN AREAS COSTERAS.

META PARA 1987: Emisión de la legislación necesaria que permita la inversión directa extranjera en turismo de las áreas costeras.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Junio 1987 Presentación del Proyecto de Ley ante el Congreso Nacional.

15 Julio 1987

30 Septiembre 1987 Aprobación esperada por parte del Congreso Nacional.

15 Octubre 1987

30 Octubre 1987 Borrador del Proyecto de Reglamento de la Ley.

30 Noviembre 1987 Aprobación esperada por parte del Poder Ejecutivo del Reglamento de la Ley.

15 Diciembre 1987

MEDIDA 25: CONSOLIDACION, ELIMINACION Y RACIONALIZACION DEL ACTUAL SISTEMA DE EXENCION DE IMPUESTOS.

META PARA 1987: Estudio completo con las debidas recomendaciones y preparados los borradores de los anteproyectos de Decretos que sean necesarios para cumplir con la medida.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Junio 1987

1. Nombramiento de la Comisión Técnica Interinstitucional responsable de las acciones requeridas para cumplir con la medida.

2. Formación de los Grupos de Especialistas que realizarán los estudios técnicos necesarios para la toma de decisiones respecto a la racionalización del sistema de exención de impuestos.

15 Julio 1987

1. Identificación de las bases legales sobre las cuales descansa el sistema actual de exención de impuestos.

2. Construcción de matrices identificando en forma cualitativa y cuantitativa, las exenciones de los siguientes impuestos:

- a) Impuesto sobre la Renta;
- b) Impuesto sobre Ventas;
- c) Impuesto sobre la Tradición de la Propiedad;

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- d) Impuestos y cargos sobre importaciones;
- e) Impuestos y cargos sobre exportaciones;
- f) Impuesto sobre consumo de productos derivados de petróleo.

30 Septiembre 1987

1. Cuantificación para un período de 5 años, cuando la información lo permita, del sacrificio fiscal anual de cada una de las diferentes leyes que conceden exenciones de impuestos, indicando el efecto en:

A. Recaudación del Impuesto sobre la Renta (exención total o parcial, deducciones especiales Art. 18, deducción de la renta neta gravable por reinversión de utilidades) y

B. Recaudación de Impuestos de Importación.

2. Cuantificación para un período de 5 años, cuando la información lo permita, del sacrificio fiscal de la exención o reducción de las tarifas arancelarias de los Tratados de Comercio.

3. Comparación del régimen actual que permite importar con franquicias aduaneras, insumos que el Arancel tiene gravados con tarifas relativamente altas, con un nuevo sistema de supresión de franquicias y rebaja simultánea de dichas tarifas a niveles que permitan el funcionamiento de las empresas.

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15 Octubre 1987

30 Octubre 1987

1. Informe sobre la investigación de la política pasada y actual de los incentivos fiscales en el resto de Centroamérica y hacer el análisis comparativo con el caso de Honduras.

2. Identificar las leyes inoperantes y las que duplican incentivos que puedan ser modificadas o derogadas.

3. Estudiar cuáles de las leyes, reglamentos e instructivos que conceden exoneraciones fiscales y que fueron emitidas con fines sociales, políticos, reciprocidad internacional, etc. podrían ser derogadas.

30 Noviembre 1987

1. Cuantificación para un periodo de 5 años, cuando la información lo permita, del sacrificio fiscal de la sustitución de importaciones gravadas con bienes de producción nacional.

2. Presentación del estudio que evalúa el beneficio de los incentivos fiscales en la economía del país, por sectores económicos: agrícola, manufactura, turismo, transporte, etc. cuantificando su efecto en los últimos 5 años, cuando la información lo permita, en las siguientes variables:

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- A. Nivel y composición de la inversión total.
- B. Valor bruto de la producción y valor agregado al costo de factores.
- C. Valor incorporado de origen nacional, indicando separadamente lo correspondiente a materias primas nacionales.
- D. Destino de la Producción (consumo, bienes intermedios y exportaciones).
- E. Ahorro neto de divisas.
- F. Empleo.

30 Diciembre 1987

1. Utilizando la investigación sobre el sacrificio fiscal y el efecto económico, realización del análisis costo-beneficio de los incentivos fiscales, presentando las correspondientes conclusiones para racionalizar el sistema de exenciones de acuerdo a los criterios siguientes:

- a) eficiencia económica
- b) equidad
- c) agilidad administrativa

2. Borradores de los Anteproyectos de Decretos que sea necesario emitir para racionalizar el actual sistema de exenciones de impuestos.

MEDIDA 26: ESTABLECIMIENTO DEL SISTEMA DE CARRERA JUDICIAL.

META PARA 1987: Implementación de la ley de carrera judicial.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Junio 1987	Análisis del impacto presupuestario del establecimiento del sistema de carrera judicial.
<u>15 Julio 1987</u>	Dictamen de la Comisión de Magistrados sobre los reglamentos de la Ley de Carrera Judicial.
30 Julio 1987	Contratación de experto para asesorar el proceso de implementación de la Ley de Carrera Judicial.
30 Septiembre 1987	Aprobación esperada de los reglamentos de la Ley de Carrera Judicial por parte de la Corte Suprema de Justicia.
<u>15 Octubre 1987</u>	
<u>15 Diciembre 1987</u>	

MEDIDA 27: RENEGOCIACION DE LA DEUDA EXTERNA.

META PARA 1987: Continuar con las negociaciones de buena fe.

PROGRAMA DE EJECUCION

CALENDARIO:

ACCIONES A CUMPLIR:

30 Junio 1987: Continuar con las negociaciones de buena fe.

15 Julio 1987

15 Octubre 1987

15 Diciembre 1987

ANEXO No.3MEDIDAS ADICIONALES DE REFORMAS ESTRUCTURALES EN ESTUDIO

Para la segunda quincena de diciembre de 1987, se espera un informe de los avances en estas medidas y en su caso los borradores de informes y las recomendaciones respectivas.

OBJETIVOSACCION

- | | |
|--|--|
| <p>I. Racionalizar operaciones del sector público.</p> | <ol style="list-style-type: none"> 1. Establecimiento de un plan de trabajo para racionalizar el uso de los servicios públicos de agua, luz, teléfono proporcionados al Gobierno Central. 2. Estudiar la viabilidad económico-financiera del Instituto Hondureño de Seguridad Social. 3. Estudiar la viabilidad económico-financiera de BANADESA. 4. Continuar la racionalización y simplificación de la actual estructura de líneas de crédito del Banco Central de Honduras. 5. Continuar en el proceso de eliminación gradual de las facilidades de garantía de recompra automática de los bonos del Gobierno Central. |
| <p>II. Promover la inversión del sector privado.</p> | <ol style="list-style-type: none"> 1. Garantizar y promover la inversión privada en el sector agropecuario con el fin de aumentar el empleo y la producción. 2. Estudiar la eliminación gradual de las exenciones al impuesto sobre la renta de los ingresos obtenidos por intereses sobre los fondos del Gobierno. |

TRANSLATION

Ambassador Everett E. Briggs
Embassy of the United States of America
Tegucigalpa, D.C.

Dear Mr. Ambassador:

The purpose of this letter is to transmit to you the 1987 Economic Program of the Government of Honduras and to request U.S. Economic Support Funds (ESF) to assist us in implementing our program.

As you know, the economic program that the GOH initiated in 1986 with financial support from the U.S. met with considerable success. The gains made by the Honduran economy are clearly reflected in the statistical record. Real GDP grew by 3%, the urban open unemployment rate fell by one percentage point, inflation was held to 4.4% and net international reserves of the Central Bank rose by about US \$15 million. Simultaneously, both the current account deficit in the balance of payments and the overall deficit of the consolidated nonfinancial public sector fell by approximately two percentage points of GDP. The gains made by the Honduran economy in 1986 are also reflected in the substantive progress that has been made in implementing the measures that the GOH initiated in 1986 to improve economic performance over the mid term, particularly in the areas of rationalizing public sector operations, enhancing private sector investment, promoting exports and restoring internal and external confidence in the economy.

In no small measure, the important gains made by the Honduran economy in 1986 were due to the successful efforts that my Government made to comply with the letter and the spirit of the Economic Program we initiated in May 1986 and which was incorporated in the 1986 ESF Agreement. Full compliance with the monetary program component of the GOH Economic program was instrumental in achieving the favorable results in growth and stabilization indicators that were outlined above. The GOH also successfully complied with the calendar of actions set forth in our structural reform program, although I had hoped that progress would be even more rapid and uniform than actually occurred.

I am pleased to inform you that the GOH Economic program for 1987 represents a continuation of our efforts to implement a monetary program designed to harmonize immediate objectives for stabilization and growth within the context of persevering with a structural reform program designed to significantly improve economic prospects in the mid term.

My entire government recognizes that our most difficult challenge is to reduce further the public sector deficit in spite of destabilizing external factors. In this connection, I want to emphasize that my Government has made a major effort to hold the public sector deficit as a percentage of GDP in 1987 to equality with the figure recorded in 1986. Nevertheless, I recognize that a further reduction would be highly desirable and will strive to achieve a further reduction. I understand that this commitment will be an important consideration when our ESF application is reviewed by your government in Washington.

We believe that the program which is summarized below and set forth in detail in the Annex to this letter fully merits a continuation of U.S. support. I also believe that our 1987 Economic Program is an economic program that should serve as a solid basis for seeking additional support from, in particular, the IMF and the World Bank. Reflecting this, representatives from my Government plan to present our program to both institutions as soon as mutually agreeable dates can be worked out, and to request that the IMF send a resident representative to Honduras. We would greatly appreciate all the help that your Government could provide us in seeking additional financial assistance, specially from international financial institutions.

1. Summary of 1987 GOH Economic Program

A. Monetary Program

In 1986, highly favorable external circumstances enabled the GOH to develop and implement a monetary program that achieve objectives of stabilization and growth objectives. The monetary program for 1987, establishes the same objectives, in spite of the fall of international coffee prices, the rise in petroleum prices and the incipient trend towards increasing interest rates in international financial markets.

TABLE I
GOH MONETARY PROGRAM: CREDIT LIMITS AND NET
INTERNATIONAL RESERVE TARGETS
(Millions of Lempiras)

	December 31, 1986	Cumulative Change			Cumulative change from Dec.31,1986 to Dec.31,1987
		June 30 1987	Sept. 30 1987	Dec. 31 1987	
Overall Credit Limit <u>1/</u> <u>2/</u>	3746	120	180	240	240
To Public Sector <u>2/</u>	1119	15-20	10-20	15-30	42
To Private Sector	2627	105-100	170-160	225-210	198
Net International Reserves <u>3/</u>	-179	0-5	0-10	0-20	31

- 1/ Consolidated banking system and consolidated nonfinancial public sector, both in accordance with IMF definitions.
- 2/ The conversion of public or publicly guaranteed external debt into lempira may result in an upward adjustment not to exceed L50 million.
- 3/ Central Bank of Honduras, in accordance with IMF definition.

As reflected in Table I, the GOH monetary program is tight. The overall ceiling on credit growth, L240 million, limits credit growth to 6.4% over the level recorded at the end of 1986. Within the overall ceiling, a tight subceiling on net credit expansion to the consolidated nonfinancial public sector, L30 million, will reserve the vast majority of the additional credit that can be made available to finance private sector investment and production.

In spite of the reversal in coffee and petroleum prices, the Central Bank has resolved at a minimum not to permit any reduction in net international reserves in 1987. The Central Bank has further resolved to seek to improve net international reserves by around \$10 million if this proves feasible within the framework of achieving a realistic compromise between growth and stabilization objectives.

The Central Bank estimates that the monetary program is compatible with real GDP growth on the order of 2 to 3 percent; a current account deficit in the balance of payments of about 8 percent of GDP; and a deficit of the consolidated nonfinancial public sector of about 6.4 percent of GDP. While these projections for growth and stabilization indicators do not represent improvement over the 1986 outcomes, they do prevent a major deterioration from the quite sharp gains achieved in 1986 in spite of the unfavorable external factors facing the economy. Moreover and as noted above, my government has made a major effort to hold the 1987 fiscal deficit as a percentage of GDP to equality with the outcome achieved in 1986. To do this has required the development of a package of revenue enhancements/expenditure reductions in the range of L110-L130 million (this adjustment does not appear in the data base presented in Annex 1). My government has already begun implementation of the fiscal package, will track the success of the package throughout the year and will shortly develop a contingency plan that will be put into effect should circumstances suggest that the fiscal target will not be substantially achieved. Every effort will be made to surpass rather than simply achieve the target for deficit reduction to a level lower than that of 1986.

Within the framework of maintaining the official parity of the lempira steps will be taken to further enhance flexibility in the exchange rate regime. These steps will have the effect of liberalizing the exchange regime for export earnings, profit repatriation and direct foreign investment in the Honduran economy. The Central Bank is further exploring appropriate ways to enhance the objectivity and transparency of the exchange rate regime.

B. 1987 Structural Reform Program

The 1987 structural reform program builds on the progress made, and more importantly, the experience that was gained in developing and implementing the 1986 structural reform program. As a result of both these factors, my Government anticipates good progress on a structural reform program that, beginning around 1988, should significantly improve Honduras' economic performance.

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With respect to building on progress made in 1986, the 1987 structural reform program anticipates approval by the National Congress of the Legislative package presented to the National Congress in 1986. My government believes that this program goal will be fully achieved. The GOH program also contemplates an overall acceleration of our privatization process. We expect that the 1987 structural reform program will be more productive of concrete results, than 1986. The complete structural reform program, covering the details of the final targets as well as the details of the quarterly implementation calendar for each of the structural reform measures is set forth in the Annex 2 to this letter.

I would like to emphasize that The 1987 structural reform program has been the product of detailed discussions at technical and policy level working groups within the GOH. The result of these discussions - and their goal - has been the development of implementation calendars and targets for structural reforms to which the GOH is fully committed both at the technical and political levels. My Government is confident that the ambitious goals, and intra-year progress benchmarks, will be substantially achieved. I would also like to emphasize, however, that Honduras, like the United States is a democracy. The executive branch proposes, but the legislative branch disposes. As such, I can only assure you that the Executive Branch will make every effort to seek approval by the National Congress of the legislative measures contained in the 1987 program.

In order to enhance intra governmental coordination and accelerate implementation of the structural reform program, we plan to request AID funding for a complementary package of technical assistance and training resources for the key agencies involved in program implementation. My Government is also requesting technical assistance from the IMF and IBRD.

Finally, Honduras unfortunately remains one of the least developed countries in Latin America. We are struggling to consolidate our democratic system and demonstrate that a free society is the only legitimate way to meet the pressing social and economic needs of our lowest income citizens. At the same time Honduras is confronting extremely low coffee prices that will mean over \$100 million less in foreign exchange in 1987 compared to 1986. We believe that these considerations plus our successful implementation of our 1986 Economic Program and our continued stabilization and structural adjustment measures in 1987 merit higher levels of assistance from the entire international financial community.

I would appreciate it if you could transmit the above information and attachments to your government for appropriate consideration.

Sincerely,

José Simón Azcona Hoyo
President of the Republic

- ANNEXES: 1. Data Base and Projections
2. Structural Reform Measures

ANNEX NO. 1

GOH STATISTICAL DATA BASE

The GOH Statistical Data Base annex to President Azcona's Letter is virtually identical to the data base presented in the Statistical Appendix to this PAAD.

The cover note to the annex states that the data included in the annex do not reflect adjustments in fiscal and balance of payments policies that were made in April 1987 to harmonize these policies with the GOH monetary program. Thus, the overall deficit of the Central Government for 1987 is forecast in the data set annex at 673 million lempiras, a figure that has now been reduced to around 543 million lempiras.

TRANSLATION
ANNEX NO. 2
PROGRAMMING OF GOH ECONOMIC MEASURES
STRUCTURAL REFORMS
WORK PLAN FOR 1987

CONTENTS:

A. Rationalize Public Sector Operations

1. Introduction of zero base budgeting (ZBB) by the GOH including decentralized institutions.
- 2a. Develop and implement a budget control system in each decentralized institution.
- 2b. Quarterly submission to the Central Government of financial operation statements in accordance with generally accepted accounting practices.
3. Development and submission to the Central Government by decentralized institutions of quarterly reports on economic efficiency.
4. Independent annual audits of decentralized institutions.
5. Expansion of municipal tax base.
6. Transfer to the private sector of state participation in activities that can be run by the private sector.
7. Tariff system.
8. Customs Valuation Law.
9. Customs Procedures Law.
10. Introduction of tolls on improved roads.
11. Continue with the improvement in tax administration system.

B. Enhance Export Competitiveness

12. Temporary Import Law.
13. Export Promotion Law.
14. Industrial Export Processing Zone Law.
15. Banana Export Incentives Law.
16. Submit to the Economic Cabinet periodic evaluations of export performance and price competitiveness.
17. "Year of the Exporter - 1987."

C. Promote Private Investment

18. Reduction of preferential treatment to the public sector in fiscal and monetary matters.
19. Investment tax credit.
20. Tax loss carry-overs.
21. Development of a Capital Market.
22. Enhance private sector participation in export marketing of lumber.

23. Final study on effective tariff protection; reduction in the average rate of effective tariff protection and in the dispersion about the average rate.
24. Promotion of foreign direct investment in tourism in seacoast areas.

D. Others

25. Consolidation, elimination and rationalization of the current system of tax exemptions.
26. Establishment of a judicial career system.
27. Renegotiation of external debt.

MEASURE: 1 INTRODUCTION OF ZERO BASE BUDGETING (ZBB) BY THE GOH INCLUDING DECENTRALIZED INSTITUTIONS.

- TARGET FOR 1987:
1. Implantation of an information and accounting system for the introduction of ZBB in three decentralized institutions, INA, National Agrarian Institute; INVA, National Housing Institute; and SANAA, National Water and Sewer Service.
 2. Preparation of a plan for extending the information and accounting system for ZBB to other government institutions based on results in the pilot institutions.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

- June 30, 1987
1. Presentation of the GOH Program of Economic Measures to the decentralized public sector by the Commission for Evaluation and Financial Control of the Decentralized Institutions, including:
 - a. general purpose of the Program,
 - b. intent of this measure to rationalize the operations of the decentralized public sector,
 - c. activities to be developed to comply with the Program,
 - d. the Technical Group that will advise the personnel assigned by the pilot institutions on the implementation of the measure,
 - e. assistance to be provided by the Technical Group to the decentralized entities for the implementation of their tasks, and
 - f. the role of the boards of directors of the decentralized institutions according to their responsibility to the people and the GOH.
 2. The presentation will be preceded by the following activities:
 - a. designation of speakers, and
 - b. selection of participants in the presentation, assuring that the boards of directors, the

executive management and the responsible accounting and budget units of the decentralized institutions be fully represented.

3. Adoption by the boards of directors and/or executive officers of the pilot institutions of the following:
 - a. definition of activities related to the measure considered as priority for the institution,
 - b. approval of actions to be implemented according to the work plan prepared by the Technical Group with the participation of the decentralized institutions and approved by the Commission,
 - c. designation of personnel that will be responsible for the implementation of the measure, and
 - d. approval and implementation of a work plan and calendar.
4. Preparation by the Technical Group of the scope of work for the contracting of external technical assistance for the implementation of ZBB, including training for both the Technical Group and the personnel of the decentralized institutions.
5. Preparation by the Technical Group, of a complementary calendar for the other activities required to achieve the goal.

July 15, 1987

- August 15, 1987
1. Activities of the Commission and Technical Group being implemented according to work plans and calendars.
 2. Progress of activities in pilot institutions according to work plans and calendars.

October 15, 1987

1. Activities of the Commission and Technical Group being implemented according to work plans and calendars.
2. Progress of activities in pilot institutions according to work plans and calendars.

December 15, 1987

1. Decision on ZBB adoption taken and preparations made for its implementation in INA (National Agrarian Institute), INVA (National Housing Institute) and SANAA (National Water and Sewer Service).
2. Plans for extending ZBB to other government institutions prepared and decision on the same adopted by the President of the Republic.

EXPLANATORY NOTES/COMMENTS:

The target for 1987 may be revised depending on developments resulting from the expected IMF technical assistance.

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- MEASURES: 2, 3 and 4
- 2a. DEVELOP AND IMPLEMENT A BUDGET CONTROL SYSTEM IN EACH DECENTRALIZED INSTITUTION.
 - 2b. QUARTERLY SUBMISSION TO THE CENTRAL GOVERNMENT OF FINANCIAL OPERATION STATEMENTS IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRACTICES.
 3. DEVELOPMENT AND SUBMISSION TO THE CENTRAL GOVERNMENT BY DECENTRALIZED INSTITUTIONS OF QUARTERLY REPORTS ON ECONOMIC EFFICIENCY.
 4. INDEPENDENT ANNUAL AUDITS OF DECENTRALIZED INSTITUTIONS.

TARGET FOR 1987: Systems approved and implemented.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

June 30, 1987

1. Presentation of the GOH Program of Economic Measures to the decentralized public sector by the Commission for Evaluation and Financial Control of the Decentralized Institutions, including:
 - a. general purpose of the Program,
 - b. intent of these measures to rationalize decentralized public sector operations,
 - c. activities to be developed to comply with the Program,
 - d. the Technical Group that will advise the personnel assigned by each decentralized institution on the implementation of the measure,
 - e. assistance to be provided by the Technical Group to the decentralized entities for the implementation of their tasks, and
 - f. role of the boards of directors of the decentralized institutions according to their responsibility to the people and the GOH.
2. The presentation will be preceded by the following activities:
 - a. designation of speakers, and

- b. selection of participants in the presentation, assuring that the boards of directors, executive management and the responsible accounting and budget units of the decentralized institutions be fully represented.
3. Adoption by the boards of directors and/or executive officers, of the decentralized institutions of the following:
 - a. definition of all activities related to the measure considered as priority for the institution,
 - b. approval of actions to be implemented according to the work plan prepared by the Technical Group with the participation of the decentralized institutions and approved by the Commission,
 - c. designation of personnel that will be responsible for the implementation of the measure, and
 - d. approval and implementation of a work plan and calendar.
 4. Preparation by the Technical Group of a complementary calendar for the other necessary activities required to achieve the goal.

July 15, 1987

August 15, 1987

1. Design and approval of the formats to be utilized in the implementation of the measures and delivery, together with the approved contents for the audit reports, to the boards of directors of the decentralized institutions, President of the Republic, Ministry of Finance and Public Credit and Ministry of Planning, Coordination and Budget.
2. Introduction of the formats for the budgetary control systems, quarterly financial operations statements, and quarterly reports on operational and economic efficiency of the decentralized institutions.

August 30, 1987

1. Design by the Technical Group and approval by the corresponding boards of directors of a relationship system between the audit firms and institutions to be audited that will be capable of ensuring independence, objectivity and impartiality of the audits.

September 30, 1987

2. Contracting of audits with independent firms.
1. Presentation to the Commission by the Technical Group of the first reports based on the approved formats on:
 - a. budgetary control,
 - b. financial operations, and
 - c. operational and economic efficiency.

October 15, 1987

2. Presentation to the Commission by the Technical Group of the first progress report regarding independent audits of the decentralized agencies.
1. Revision by the Commission of the initial results which will be used to test the effectiveness of actions.

December 15, 1987

2. Incorporation of adjustments and recommendations to improve the quality of work.
1. Presentation to the Commission by the Technical Group of the second reports based on the approved formats on:
 - a. budgetary control,
 - b. financial operations, and
 - c. operational and economic efficiency.

December 30, 1987

2. Presentation to the Commission by the Technical Group of the following:
 - a. second progress report regarding independent audits, and
 - b. reports of the first audits delivered to the decentralized institutions.
1. Review of the Measures by the Commission together with the decentralized institutions to evaluate results.
2. Incorporation of adjustments and recommendations to improve the quality of work.

MEASURE: 5

EXPANSION OF MUNICIPAL TAX BASE.

TARGET FOR 1987:

Issuance of the new legislation for municipal income and/or head tax; production, consumption and sales taxes; real estate tax; and charges for improvements.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

July 15, 1987

September 15, 1987

October 30, 1987

Expected approval by the National Congress of the municipal income and/or head tax; production, consumption and sales taxes; real estate tax; and charges for improvements.

November 30, 1987

Draft of the proposed implementing regulations for the application of the different taxes.

December 15, 1987

Expected approval by the Executive Branch of the implementing regulations for the application of the different taxes.

MEASURE: 6 TRANSFER TO THE PRIVATE SECTOR OF STATE PARTICIPATION
IN ACTIVITIES THAT CAN BE RUN BY THE PRIVATE SECTOR.
TARGET FOR 1987: Minimum of seven divestiture actions.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

July 15, 1987 Complete package for the divestiture of four enterprises including appraisal; legal and financial clean-ups, i.e., freeing of encumbrances; and drafting of prospectuses.

August 30, 1987 Approval by the Assessment Commission, the Privatization Commission, and the board of directors of each respective institution of the appraisal and conditions of sale for each of the four enterprises.

September 15, 1987 Complete package for the divestiture of three additional enterprises including appraisal; legal and financial clean-ups, i.e., freeing of encumbrances; and drafting of prospectuses.

October 15, 1987

October 30, 1987 Approval by the Assessment Commission, the Privatization Commission, and the board of directors of each respective institution of the appraisal and conditions for sale for each of the three additional enterprises.

December 15, 1987 Divestiture of at least seven enterprises expected.

MEASURE: 7 TARIFF SYSTEM.
TARGET FOR 1987: Approval of the new tariff system.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

April 30, 1987	Conclude negotiations between the Executive Branch of the GOH with the private sector.
May 30, 1987	Presentation to the National Congress of the revised legislation for the new tariff system.
<u>July 15, 1987</u>	Meeting of the Executive Branch technical working committee with the Congressional advisory committee.
August 30, 1987	Expected approval by the National Congress of the new tariff system.
<u>October 15, 1987</u>	
<u>December 15, 1987</u>	

EXPLANATORY NOTES/COMMENTS:

On March 26, 1987 the tariff negotiations between the technical working groups of the Executive Branch and the private sector were concluded. At that time, the only line items for which full agreement between the two groups had not been reached were textiles and starch products.

MEASURE: 8 CUSTOMS VALUATION LAW.
TARGET FOR 1987: Issuance and application of the new Customs Valuation Law and its respective implementing regulations.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

May 30, 1987	Presentation of the revised version of the new Customs Valuation Law to the National Congress.
<u>July 15, 1987</u>	Meeting of the Executive Branch technical working committee with the Congressional advisory committee.
August 30, 1987	Expected approval of the new Customs Valuation Law by the National Congress.
September 30, 1987	Draft of the proposed implementing regulations for the Law.
<u>October 15, 1987</u>	
November 30, 1987	Expected approval of the implementing regulations by the Executive Branch.
<u>December 15, 1987</u>	

MEASURE: 9 CUSTOMS PROCEDURES LAW
TARGET FOR 1987: Issuance and application of the new Customs Procedures Law and its respective implementing regulations.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

May 30, 1987	Presentation of the revised version of the new Customs Procedures Law to the National Congress.
<u>July 15, 1987</u>	Meeting of the Executive Branch technical working committee with the Congressional advisory committee.
August 30, 1987	Expected approval of the new Customs Procedures Law by the National Congress.
September 30, 1987	Draft of the proposed implementing regulations for the Law.
<u>October 15, 1987</u>	
November 30, 1987	Expected approval of the implementing regulations by the Executive Branch.
<u>December 15, 1987</u>	

MEASURE: 10 INTRODUCTION OF TOLLS ON IMPROVED ROADS.
TARGET FOR 1987: Toll collection implemented in eight selected stations.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

May 30, 1987 Determination of toll rates to be charged.

June 1, 1987 Implementation of the toll system in:
a. Cerro de Hule, and
b. Támara.

July 15, 1987

August 1, 1987 Implementation of the toll system in Olancho.

October 1, 1987 Implementation of the toll system in:
a. Zamorano, and
b. Choloma.

October 15, 1987

November 1, 1987 Implementation of the toll system in:
a. La Lima,
b. Tela, and
c. Caracol.

December 15, 1987

MEASURE: 11 CONTINUE WITH THE IMPROVEMENT IN TAX ADMINISTRATION SYSTEM.

TARGET FOR 1987: Action plan prepared and implemented for the principal taxes.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

May 30, 1987 Design specific work plans and calendars to reduce the differences between the potential and realized collections of the following: (1) taxes on international trade, (2) the income tax, and (3) the production, consumption and sales taxes.

July 15, 1987 Implementation of the scheduled measures according to the work plans mentioned above.

October 15, 1987 Implementation of the scheduled measures according to the work plans mentioned above.

December 15, 1987

1. Implementation of the scheduled measures according to the work plans mentioned above.
2. Evaluation of additional tax revenues obtained as a result of the measures implemented.

MEASURE: 12

TEMPORARY IMPORT LAW.

TARGET FOR 1987:

Issuance of the implementing regulations for the
Temporary Import Law.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

May 30, 1987

Approval by the Executive Branch of the implementing
regulations for the Temporary Import Law.

July 15, 1987

October 15, 1987

December 15, 1987

MEASURES: 13, 14, 15

13. EXPORT PROMOTION LAW.
14. INDUSTRIAL (EXPORT) PROCESSING ZONE LAW.
15. BANANA EXPORT INCENTIVES LAW.

TARGET FOR 1987:

Issuance and application of the three laws and their respective implementing regulations.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

June 15, 1987

Expected approval by the National Congress of:

- a. the Export Promotion Law,
- b. the Industrial (Export) Processing Zone Law, and
- c. the Banana Export Incentives Law.

June 30, 1987

Draft of the implementing regulations for each of the three laws.

July 15, 1987

Executive Branch approval of the respective implementing regulations for each of the three laws.

October 15, 1987

December 15, 1987

MEASURE: 16 SUBMIT TO THE ECONOMIC CABINET PERIODIC EVALUATIONS OF EXPORT PERFORMANCE AND PRICE COMPETITIVENESS.

TARGET FOR 1987: Discussions within the Economic Cabinet and policy recommendations.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

May 31, 1987 Delivery to the Economic Cabinet of the first evaluation for 1987.

- June 30, 1987
1. Discussions within the Economic Cabinet on the first evaluation for 1987.
 2. Policy recommendations.

July 15, 1987

October 15, 1987

October 31, 1987 Delivery to the Economic Cabinet of the second evaluation for 1987.

- November 30, 1987
1. Discussion within the Economic Cabinet on the second evaluation for 1987.
 2. Policy recommendations.

December 15, 1987

MEASURE: 17 "YEAR OF THE EXPORTER 1987".
TARGET FOR 1987: Development of an institutional structure and economic policy favorable to exports.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

April 30, 1987	1. Creation of the one-stop center for completion of required export documents. 2. Creation of the National Council for the Promotion of Exports and Investment (CONAFEXI). 3. First "Congress for Exporters" in San Pedro Sula and initiation of the "Contest for Exporters".
May 30, 1987	Preparation of the outline for the National Plan for Exports.
June 30, 1987	Marketing course oriented to exports conducted in Tegucigalpa.
<u>July 15, 1987</u>	
July 30, 1987	Second Congress for Exporters conducted in Tegucigalpa.
August 30, 1987	Forum for Exporters conducted in Tegucigalpa.
September 30, 1987	Trade fair/exposition of Honduran export products conducted in San Pedro Sula.
<u>October 15, 1987</u>	
October 30, 1987	Trade fair/exposition of Honduran export products conducted in Tegucigalpa.
November 15, 1987	Forum for Exporters conducted in San Pedro Sula.
November 30, 1987	"Contest for Exporters" completed; prizes awarded to the best exporters.
<u>December 15, 1987</u>	

MEASURE: 18 REDUCTION OF PREFERENCES ACCORDED TO THE PUBLIC SECTOR IN
FISCAL AND MONETARY MATTERS.

TARGET FOR 1987: Develop information base and calendar for elimination of
exemptions from income tax of income earned on GOH bonds.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

July 15, 1987

October 15, 1987

December 15, 1987 Study completed; calendar developed and approved.

MEASURE: 19 INVESTMENT TAX CREDIT.
TARGET FOR 1987: Issuance of legislation to provide for investment tax credit.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

- May 30, 1987 Revision of the proposed law by the Executive Branch.
- June 15, 1987 Presentation to the National Congress of the revised version of the proposed law.
- July 15, 1987
- July 30, 1987 Expected approval by the National Congress of the Investment Tax Credit Law.
- August 15, 1987 Draft of the proposed implementing regulations for the Investment Tax Credit Law.
- September 30, 1987 Approval by the Executive Branch expected of the implementing regulations for the Investment Tax Credit Law.
- October 15, 1987
- December 15, 1987

MEASURE: 20 TAX LOSS CARRY-OVERS.
TARGET FOR 1987: Issuance of legislation that modifies the Income Tax Law to permit tax loss carry-overs.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

May 30, 1987 Revision of the proposed law by the Executive Branch.

June 15, 1987 Presentation of the revised version of the proposed law to the National Congress.

July 15, 1987

July 30, 1987 Expected approval by the National Congress of legislation to provide for tax loss carry-overs.

October 15, 1987

December 15, 1987

MEASURE: 21

DEVELOPMENT OF A CAPITAL MARKET.

TARGET FOR 1987:

Delivery of the final report and recommendations of the Capital Markets Commission to the President, National Congress, and private sector organizations; initiation of negotiations between the Executive Branch, Congress and the private sector based on the recommendations.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

May 30, 1987

1. Table of contents and outline of final report of the Capital Markets Commission developed and approved by Commission members.
2. Calendar of meetings/hearings/deliberations keyed to issues to be addressed/resolved in final report developed and approved.
3. Individual and/or committee drafting assignments for issues to be addressed in final report established. Schedule set for review of drafts by Commission as a whole.
4. Budget developed and approved for activities of the Commission.
5. Staff director and support staff hired.
6. President/chairman of Commission named.
7. Budget Committee established.

July 15, 1987

July 30, 1987

1. Initial drafts of all chapters in final report completed.
2. Review of initial drafts by Commission as a whole begun.

- August 15, 1987 Initial round of hearings, completed with testimony provided by key potential private sector capital market participants.
- September 15, 1987 Initial draft of final report ready for review by Commission.
- October 15, 1987 Hearings held on initial draft of final report with key representatives of the private sector, Congress, the executive branch, the judicial branch, international organizations, and the foreign private sector.
- November 15, 1987 Revise draft of final report.
- December 15, 1987 Delivery of final report and recommendations to the President, National Congress and private sector organizations.

MEASURE: 22 ENHANCE PRIVATE SECTOR PARTICIPATION IN EXPORT
MARKETING OF LUMBER.

TARGET FOR 1987: Complete transfer to the private sector of GOH
management of export marketing of lumber (except for
those operations currently run by the Olancho Forestry
Corporation (CORFINO)).

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

July 15, 1987

Terminate all GOH operations associated with the export
marketing of lumber products in the northern zone (of
Honduras) through the sale or lease of Servicios
Madereros, S.A. de C.V. (SEMSA) lumberyards.

October 15, 1987

December 15, 1987

MEASURE: 23 FINAL STUDY ON EFFECTIVE TARIFF PROTECTION; REDUCTION
IN THE AVERAGE RATES OF EFFECTIVE TARIFF PROTECTION AND
IN THE DISPERSION ABOUT THE AVERAGE RATES.

TARGET FOR 1987: Determine and analyze the average rate and dispersion
about the average rate of effective tariff protection.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

- June 15, 1987 First seminar on effective protection for
representatives of the Honduran Private Enterprise
Council (COHEP), the Executive Branch and the National
Congress to analyze the impact of tariff reform on
resource allocation.
- July 15, 1987
- August 30, 1987 Presentation of the revised study on effective
protection.
- September 30, 1987
1. Second seminar on effective protection for the
representatives of the Honduran Private Enterprise
Council (COHEP), the Executive Branch and the
National Congress to analyze the impact of tariff
reform on resource allocation.
 2. Progress report on the work related to the
calculation and analysis of the rates of effective
protection.
- October 15, 1987
- December 15, 1987 Determination and analysis, within an economic context,
of the existing rates of effective protection and the
existing level of dispersion about the average rates.

MEASURE: 24

PROMOTION OF FOREIGN DIRECT INVESTMENT IN TOURISM IN SEACOAST AREAS.

TARGET FOR 1987:

Issuance of the necessary legislation that permits foreign direct investment in tourism in seacoast areas.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

June 30, 1987

Presentation to the National Congress of the proposed legislation.

July 15, 1987

September 30, 1987 Expected approval by the National Congress.

October 15, 1987

October 30, 1987 Draft of the proposed implementing regulations for the law.

November 30, 1987 Executive Branch approval of the implementing regulations.

December 15, 1987

MEASURE: 25 CONSOLIDATION, ELIMINATION AND RATIONALIZATION OF THE
CURRENT SYSTEM OF TAX EXEMPTIONS.

TARGET FOR 1987: Complete study with the appropriate recommendations and
the draft legislation required to implement the measure.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

June 30, 1987

1. Naming of the technical inter-institutional commission which will be responsible for the completion of actions required by this measure.
2. Formation of groups of specialists that will prepare the necessary technical studies required prior to selecting alternatives to rationalize the current system of tax exemptions.

July 15, 1987

1. Identification of the legal bases on which the present system of tax exemption relies.
2. Preparation of matrices describing in both a qualitative and quantitative form the exemptions of the following taxes:
 - a. income tax,
 - b. sales tax,
 - c. real estate tax,
 - d. import duties,
 - e. export duties, and
 - f. taxes on petroleum products.

September 30, 1987

1. Quantification for a five-year period, where sufficient information is available, of the annual fiscal sacrifice resulting from each tax exemption and indicating its impact on:

- a. income tax revenue (total or partial exemption, special deductions, and deductions from net income for reinvestment of profits), and
 - b. import tax revenue.
2. Quantification for a five-year period, where sufficient information is available, of the annual fiscal sacrifice resulting from exemptions and/or reductions of customs charges due to provisions of bilateral treaties.
 3. Compare the present tariff exemption system that permits the duty-free importation of inputs which would normally be subjected to relatively high tariff rates with a new system which eliminates exemptions and simultaneously reduces tariff rates on imported inputs to levels that would permit the profitable operation of affected enterprises.

October 15, 1987

October 30, 1987

1. Comparative analysis of past and present fiscal incentives policies of Honduras and Central America.
2. Identification of the ineffective laws and duplicate incentives that could be modified or rescinded.
3. Identify those laws, regulations and instructions granting fiscal exemptions that were issued for social, political or international reciprocity reasons and which could be removed.

November 30, 1987

1. Quantification for a five-year period, where sufficient information is available, of the fiscal sacrifice resulting from the substitution of taxed imports with domestically produced goods.
2. Presentation of the study that evaluates the benefit to the country's economy of the fiscal incentives. The analysis of such benefits should be done by economic sector (agriculture, manufacturing, tourism, transportation, etc.), and, when sufficient information is available, quantify the benefits during the last 5 years in terms of the following variables:
 - a. level and composition of total investment,

- b. gross value of production and value-added measured at factor cost,
- c. value of production of national origin, identifying the portion that represents use of national raw material,
- d. production according to use (consumption, intermediate goods and exports),
- e. net foreign exchange savings, and
- f. employment.

December 30, 1987

1. Based on the study of the fiscal sacrifice and the economic benefits, prepare the cost-benefit analysis of fiscal incentives. The analysis is to present the implications for rationalizing the system of exemptions according to the following criteria:
 - a. economic efficiency,
 - b. equity, and
 - c. administrative agility.
2. Drafts of the proposed legislation required to rationalize the current system of tax exemptions.

MEASURE: 26

ESTABLISHMENT OF A CAREER JUDICIAL SYSTEM.

TARGET FOR 1987:

Implementation of the Career Judicial System Law.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

June 30, 1987	Analysis of the budgetary impact of the establishment of the career judicial system.
<u>July 15, 1987</u>	Resolution from the Commission of the Supreme Court on the regulations for the Career Judicial System Law.
July 30, 1987	Expert contracted to advise on the implementation process of the Career Judicial System Law.
September 30, 1987	Approval expected by the Supreme Court of Justice of the regulations for the Career Judicial System Law.
<u>October 15, 1987</u>	
<u>December 15, 1987</u>	

MEASURE: 27 RENEGOTIATION OF EXTERNAL DEBT.
TARGET FOR 1987: Continue with good faith negotiations.

IMPLEMENTATION PROGRAM

CALENDAR:

ACTIONS TO BE IMPLEMENTED:

June 30, 1987 Continue with good faith negotiations.
July 15, 1987
October 15, 1987
December 15, 1987

ANNEX 3

ADDITIONAL STRUCTURAL REFORM MEASURES UNDER STUDY

A report on the progress in the implementation of these measures is expected to be presented during the second half of December. Drafts of the reports and respective recommendations are also expected during that period.

OBJECTIVES

ACTIONS

- | | |
|---|--|
| I. Rationalize public sector operations | <ol style="list-style-type: none">1. Establishment of a work plan to rationalize the pricing of public services (water, electric energy, telephone) provided to the Central Government.2. Conduct a study of the economic and financial viability of the Honduran Social Security Institute (IHSS).3. Conduct a study of the economic and financial viability of National Agricultural Development Bank (BANADESA)4. Continue with the rationalization and simplification of the current structure of Central Bank credit lines.5. Continue with the process of gradual elimination of the automatic re-purchase guarantee for Central Government bonds. |
| II. Promote private sector investment | <ol style="list-style-type: none">1. Develop recommendations designed to enhance the security of income and job producing real private sector capital formation in the agricultural sector of the economy.2. Study the gradual elimination of income tax exemptions for interest earned on Central Government bonds. |

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ESF PROGRAM HISTORY THROUGH 1986

A. Economic Recovery Program (522-0230)

In September 1982, the GOH and AID signed the first ESF assistance agreement between the two countries for \$35 million of FY82 ESF funds. By providing balance-of-payments support to Honduras, the program aimed at: (1) maintaining an on-going policy dialogue between the GOH and the Mission, (2) sustaining key portions of the GOH's public investment program, and (3) ensuring the availability of credit to private sector producers. The Program was instrumental in substantially achieving the above objectives. A significant portion of the local currency generated by the ESF program was utilized to provide much needed private sector credit, and the rest supported public investment projects financed by AID, as well as other donors.

The initial success of the program was reinforced by amendments in 1983 and 1984 which provided \$56 million and \$40 million of FY83 and FY84 funds, respectively. These amendments continued to support achievement of those objectives specified in the first agreement, and were instrumental in obtaining the following important reforms:

- (1) Enactment of the Export Incentive Law which provides tax credit (for indirect taxes) to exporters of nontraditional products. Subsequent further efforts were needed to enhance such incentives as reflected in the FY 1986 and FY 1987 ESF programs.
- (2) The implementation of a moratorium on Central Government guarantees on external loans to private sector firms. In addition, a limitation on Central Government guarantees on external loans granted to autonomous public sector institutions.
- (3) The formation of an AID/GOH task force which studied impediments to U.S. disbursements and recommended actions to overcome them. The GOH expanded this effort by initiating similar pipeline reviews with other donors.
- (4) The implementation of key tax administration reforms designed to streamline the processing of tax returns by eliminating some steps and redesigning others. These reforms have resulted in significantly greater revenues and improved tax compliance, although subsequent further efforts have been needed as reflected in the FY 1986 and FY 1987 ESF programs.
- (5) Establishment of a Joint Economic Working Group (JEWG), with USG participation in an advisory capacity, to develop a comprehensive economic program and discuss the policy reforms necessary to undertake the program.

- (6) Honduran Congressional approval of Decree Law 85-84 which constituted a comprehensive stabilization package aimed at lowering the Central Government's fiscal deficit and reducing excess liquidity in the banking system.
- (7) Enactment of a Temporary Import Law and its implementing regulations to promote the development of nontraditional exports.
- (8) Approval of a memorandum of understanding which contains the principal terms for the partial renegotiation of the country's external debt.

B. Economic Stabilization Facility (522-0283)

On March 25, 1985 an agreement was signed which established the conditions precedent and covenants linked to the disbursement of \$72.5 million of FY84 supplemental ESF. It provided for the following:

- An immediate \$35 million disbursement.
- \$20 million to be disbursed upon the establishment by the GOH of a Special Payments Regime for Central America (SPRCA) designed to promote exports by permitting Honduran exporters to Central America to maintain deposits in the national banking system denominated in currencies of the particular countries to which they exported.
- \$17.5 million disbursement upon GOH adoption of a structural reform package including: (1) improved government domestic debt instruments, (2) banking legislation designed to improve access to agricultural credit, (3) passage of laws facilitating the divestiture of public sector enterprises, (4) increasing private sector participation in the marketing of forestry products, and (5) tariff reform.

The program was amended on May 21, 1985 adding \$75 million of FY85 ESF and providing for:

- An immediate disbursement of \$25 million.
- Two subsequent \$25 million disbursements linked to GOH compliance with: (1) measures to reduce public sector involvement in specific commercial activities, and (2) July 30 and October 30, 1985 targets for: (a) limits on net domestic credit expansion, and (b) increased coverage of international trade covered by the SPRCA and/or the parallel "autofinanciamiento" foreign exchange market.

Prior to the January 27, 1986 inauguration of the Azcona Administration, of the \$147.5 million obligated under the Economic Stabilization Facility, \$80 million had been disbursed in accordance with the terms and conditions established in the Original Agreement and in Amendment No. 1. Disbursements totaling \$67.5 million had been withheld (\$17.5 million from the Original Agreement and \$50 million from Amendment No. 1) due to GOH noncompliance.

On January 30, 1986 the remaining \$67.5 million was renegotiated to provide \$35 million once the Azcona Administration made a firm commitment to develop a comprehensive stabilization program and \$32.5 million once the GOH submitted to AID an acceptable comprehensive economic stabilization program. The \$35 million was disbursed on January 31, 1986 and the \$32.5 million was disbursed in May 1986.

On June 18, 1986 Amendatory Agreement No. 3 was signed obligating an additional \$61,248,000 to be disbursed in three separate tranches in support of the GOH's 1986 economic program of stabilization, recuperation and structural reform. The program consisted of two components. The monetary program component established an overall ceiling on the expansion of banking system credit to hold credit creation down to levels consistent with containing pressures on inflation and the balance of payments while simultaneously permitting moderate economic growth to be achieved. A subceiling on credit to the public sector was set to reserve the majority of available credit to finance private sector credit and investment, and quarterly targets were set for increases in net international reserves. Complementing the monetary program and directly related to creating the conditions for a sustainable recuperation in economic activity over the medium term, the GOH economic program also contained 29 structural adjustment measures. These measures were designed to improve economic performance beyond 1986 by: (1) rationalizing public sector operations; (2) enhancing export competitiveness; (3) promoting private sector investment; and (4) restoring internal and external confidence in the Honduran economy. Based on successful GOH compliance with the program, all \$61,248,000 in obligated funds were disbursed in three tranches over the August 1986 through January 1987 period.

The following table provides a detailed account of all ESF obligations and disbursements under the Economic Recovery Program and the Economic Stabilization Facility.

USAID/HONDURAS
ESF OBLIGATIONS BY DATE

	GRANT	LOAN	TOTAL
<u>PROJECT 522-0230</u>			
Original Agreement September 24, 1982		35,000,000	35,000,000
Amendment No. 1 March 29, 1983		3,000,000	3,000,000
Amendment No. 2 July 30, 1983	12,750,000	2,250,000	15,000,000
Amendment No. 3 September 30, 1983	6,800,000	1,200,000	8,000,000
Amendment No. 4 September 30, 1983	25,500,000	4,500,000	30,000,000
Amendment No. 7 July 9, 1984	25,500,000	4,500,000	30,000,000
Amendment No. 8 September 29, 1984	8,500,000	1,500,000	10,000,000
Agreement Totals	79,050,000	51,950,000	131,000,000
<u>PROJECT 522-0283</u>			
Original Agreement March 25, 1985	72,500,000		72,500,000
Amendment No. 1 May 21, 1985	69,000,000		69,000,000
Amendment No. 2 July 25, 1985	6,000,000		6,000,000
Amendment No. 3 June 19, 1986	61,248,000		61,248,000
Agreement Totals	208,748,000		208,748,000
GRAND TOTALS	\$287,798,000	\$51,950,000	\$339,748,000

USAID/HONDURAS
ESF DISBURSEMENTS BY DATE

	GRANT	LOAN	TOTAL
<u>PROJECT 522-0230</u>			
September 29, 1982		35,000,000	35,000,000
April 29, 1983		3,000,000	3,000,000
August 1, 1983	12,750,000	2,250,000	15,000,000
March 7, 1984	10,200,000	1,800,000	12,000,000
June 13, 1984	22,100,000	3,900,000	26,000,000
August 22, 1984	25,500,000	4,500,000	30,000,000
February 11, 1985	8,500,000	1,500,000	10,000,000
Agreement Totals	79,050,000	51,950,000	131,000,000
<u>PROJECT 522-0283</u>			
April 1, 1985	35,000,000		35,000,000
April 18, 1985	20,000,000		20,000,000
June 19, 1985	25,000,000		25,000,000
January 31, 1986	35,000,000		35,000,000
May 7, 1986	32,500,000		32,500,000
August 7, 1986	20,000,000		20,000,000
December 17, 1986	20,000,000		20,000,000
January 20, 1987	21,248,000		21,248,000
Agreement Totals	208,748,000		208,748,000
GRAND TOTALS	\$287,798,000	\$51,950,000	\$339,748,000

SUMMARY RECORD OF GOH PROGRESS
ON FY 1986 STRUCTURAL REFORM MEASURES

<u>CATEGORY/MEASURE</u>	<u>SPECIFIC ACTIONS COMPLETED</u>
A. <u>Rationalize Public Sector Operations</u>	
1. Introduction of zero base budgeting.	Executive order issued. Implementation for three agencies begun.
2. Development/implementation of systems of budget control for decentralized institutions.	Executive order issued. Reporting formats developed.
3. Development and submission of reports on efficiency from decentralized institutions.	Executive order issued. IMF technical assistance requested by GOH.
4. Independent annual audits of decentralized public institutions.	Executive order issued. 1987 budget includes line item funding for audits.
5. Expansion of municipal tax base.	Legislation submitted to Congress. Seminars and discussions to build private sector and municipal support held.
6. Transfer to private sector of activities that can be run by private sector.	One divestiture completed. Unforeseen technical and legal problems resolved.
7. Introduce legislation for adopting Customs Co-operation Council Nomenclature and converting the current system of specific and mixed rates to <u>ad valorem</u> rates.	Legislation submitted in December.
8. Introduce legislation for customs valuation changes.	Legislation submitted in December.
9. Introduce legislation to improve customs administrative procedures.	Legislation submitted in December.

10. Introduction of tolls on improved roads.

Plan and implementing regulations approved. Toll booths under construction.

11. Improve control/management of social security and pension funds.

Commission report done. Recommendations adopted which will change Central Bank reserve requirements to encourage banks to offer long-term instruments and funds to invest in them.

12. Improve collection of taxes already on the books.

Implementation plan completed.

B. Enhance Export Competitiveness

13. Introduce legislation to amend Export Promotion Law to improve incentives.

Legislation drafted and introduced.

14. Introduce legislation reducing bureaucratic procedures required by Temporary Import Law.

Legislation introduced and passed. Implementing regulations drafted.

15. Introduce legislation to modify Banana Export Incentive Law/Regulations.

Legislation drafted and introduced.

16. Submit to Joint Economic Working Group periodic assessments of export performance.

First semi-annual report reviewed.

17. Introduce legislation for export processing zones.

Legislation introduced last December and passed April 1987.

18. Inaugurate and implement "Year of the Exporter" Program.

President Azcona inaugurated program in Miami speech Nov. 17 at Caribbean Conference. Awards program established.

C. Promote Private Investment

19. Analysis of need to eliminate monetary and fiscal preferences accorded to the public sector.

Report completed and submitted to economic cabinet for policy actions.

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|--|---|
| 20. Introduce legislation to provide for investment tax credit. | Legislation introduced last December. |
| 21. Introduce legislation to provide for tax loss carry-overs. | Legislation introduced last December. |
| 22. Establish private sector commission on capital market development. | Commission established. Work plan, calendar and budget are ready for consideration by Board. |
| 23. Enhance private sector participation in export marketing of lumber. | GOH parastatal sold off its lumber inventory to private sector in preparation for divestiture. |
| 24. Completion of study on effective rates of tariff protection. | Study completed. Study will help in meeting protectionist arguments against new tariff legislation. |
| 25. Initiate discussion with private sector leading to legislation to reduce tariff protection. | Formal discussions held. |
| 26. Review options to permit foreign direct investment in sea coast tourism and industrial development. | Commission review completed. |
| <u>D. Restore Internal and External Confidence in Economy</u> | |
| 27. Consolidation, elimination and rationalization of current system of tax exemptions -- submit scope of work for detailed study of impact of exemptions on economy and revenues. | Work plan submitted. |
| 28. Establishment of a career judicial system. | Assessment of system completed. Implementing regulations issued. |
| 29. Renegotiation of external private debt. | Negotiations continued in good faith. |

ECONOMIC RATIONALE FOR FY 1987 STRUCTURAL REFORM MEASURES

MEASURE BY MAJOR CATEGORY

EXPLANATION/DISCUSSION

A. Rationalize Public Sector Operations

1. Introduction of zero base budgeting by the GOH including decentralized institutions.
 - Attempt by the GOH to experiment with a budget technique that may be promising from the perspective of efficiently prioritizing budget goals and requirements. As such could eliminate waste in expenditure decisions.
- 2a. Develop and implement a budget control system in each decentralized institution.
 - Budget control systems designed to ensure that expenditures conform to the line items and amounts reserved in the budget throughout the year. In effect, forces execution of the budget to conform to the priorities in the budget.
- 2b. Submission to the Central Government by decentralized institutions of quarterly financial operation statements in accordance with generally accepted accounting practices.
 - Provision of fundamental financial information required to assess operations, particularly from the perspective of taking such remedial action as may be required on an anticipatory basis. Such information would include, inter alia, operational income, adequacy of revenue to cover operating costs, external and internal financing, overall composition of expenditures and revenues, and current savings. Reports of individual agencies will be in a format which would facilitate their use in the development of a consolidated financial statement of the nonfinancial public sector.

3. Development and submission to the Central Government by decentralized institutions of quarterly reports on economic efficiency.
 - Development and submission of quarterly reports providing information on the economic efficiency with which public sector operations are performed, e.g.; rate of return on invested capital and a variety of measures covering the real resource cost per unit of output. Reports would provide the basis for taking action to reduce inefficient use of resources.
4. Independent annual audits of decentralized institutions.
 - Facilitate rational decision-making process through assuring the timely availability of financial and management audits. Reduce possibilities for waste and abuse of public sector funds through public dissemination of financial and management information.
5. Expansion of municipal tax base.
 - Permit decentralized decision-making both with respect to the generation of local tax revenue and the programming of that revenue for public services that are desired locally.
6. Transfer to the private sector of state participation in activities that can be run by the private sector.
 - Place enterprises under more efficient management contributing to expanded income, more efficient production and increased productive employment opportunities. Reduce the current drain on limited fiscal resources required to keep inefficient firms in operation.

7. Replacement of the current tariff nomenclature with the Customs Co-operation Council Nomenclature (CCCN) and the conversion of the present system of specific and mixed rates to ad valorem rates.
 - Adoption of a tariff nomenclature uniformly and throughout the world and which clearly defines the classification of imported merchandise. Conversion to ad valorem rates will prevent the loss of fiscal revenues as the result of inflation. Adoption of CCCN and conversion to ad valorem rates represents a necessary first step toward the subsequent reform of the existing tariff structure, i.e., the reduction in average rate of effective tariff protection and the dispersion about the average rate.
8. Customs Valuation Law.
9. Customs Procedures Law.
 - In sum, these two measures, along with measure 7, will serve to minimize fraud, waste and abuse associated with lack of clear rules with respect to tariff classification, valuation and regime under which goods enter the country. These measures will ensure greater objectivity and consistency in the valuation and classification rules that are applied by customs personnel, and by doing so will significantly reduce the high degree of uncertainty that is currently associated with importing goods into the country.
10. Introduction of tolls on improved roads.
 - Establish principle of fees for services where such fees can be effectively charged; also ensure source of financing for the maintenance of an important part of Honduras' transportation system infrastructure.

11. Continue with the improvement in tax administration system.

- Improve revenue collection without changing the existing legal tax rates or tax base.

B. Enhance Export Competitiveness

12. Temporary Import Law.

- Establishes exemption from import duties of imports destined to be inputs into the production of nontraditional exports, mainly of Section 807 drawback industries. Reduces bureaucratic impediments to the production of nontraditional exports.

13. Export Promotion Law.

- Provides tax credit for producers of nontraditional exports in amounts equal to the indirect taxes paid on inputs used in production.

14. Industrial Export Processing Zone Law.

- Promotes increased foreign and domestic investment in the production of nontraditional exports through establishing geographic locations where legal framework covering operations in Honduras does not contain provisions which inefficiently preclude such investment.

15. Banana Export Incentives Law.

- Contributes to expanded investment and production in Honduras through moving toward the elimination of inefficient taxes on exports. Designed to reduce the marginal tax rate on an individual firm basis for exports over specific amounts for each firm.

16. Submit to the Economic Cabinet periodic evaluations of export performance and price competitiveness.
17. "Year of the Exporter - 1987."
- Provides a key part of the information base required for intelligent policy making; keeps the issue of export competitiveness and export policy under consideration at the highest levels of decision making.
 - Encourage public and private sector leaders to focus more closely on the importance of export development. Provide for a private sector group to effectively lobby GOH for improved economic policies aimed at enhancing export competitiveness and expanding exports.

C. Promote Private Investment

18. Reduce preferences accorded to the public sector in fiscal and monetary matters.
19. Investment tax credit.
- Promote equality of treatment between public and private sectors with respect to taxes and the access to and price paid for credit. Improve efficiency of public sector operations by establishing an effective price system for public sector expenditures which more accurately reflects the true scarcity value of the goods and services consumed by the public sector
 - Contributes to the expansion and modernization of Honduras' existing capital stock through providing a specific stimulus to private sector investment by permitting a percent of eligible investment costs to be deducted from income tax liabilities. Designed as a temporary offset to the high risk perceived by the private sector.

20. Tax loss carry-overs.
- Avoidance of the arbitrariness of a year in determining losses, and, thus, properly enables losses in one year to be deducted against future profits. Should provide strong stimulus to firms and individuals seeking to invest in activities which require especially long gestation periods. Presently, the sizeable losses expected over the first few years make investment in such activities prohibitive.
21. Development of a capital market.
- Expand supply of both debt and equity funds that would be available for private sector investment in the commodity and service producing sectors of the economy. Expands menu of financial instruments which may be purchased by private domestic investors, and should result in increased domestic savings.
22. Enhance private sector participation in export marketing of lumber.
- Elimination of inefficient public sector participation in the export marketing of lumber, particularly with respect to price regulation. Also helps minimize incidence of fraud, waste and abuse in the lumber industry.
23. Final study on effective tariff protection; reduction in the average rate of effective tariff protection and in the dispersion about the average rate.
- Lays out parameters for a tariff system which would reduce the anti-export bias present in the existing system; would lower levels of protection accorded inefficient industries and thereby reduce misallocation of scarce resources.
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24. Foreign direct investment in seacoast tourism.

- Promote private investment through elimination of current prohibition against foreign equity participation in tourism and other industries located within 40 kilometers of the Honduran seacoast/national boundary.

D. Restore Internal and External Confidence to the Honduran Economy

25. Consolidation, elimination and rationalization of the current system of tax exemptions.

- Provide the data base required to effectively assess the economic benefits and cost of the existing system of tax exemptions. Should result in improving the economic efficiency of the current system of exemptions by eliminating a number of anti-export, pro-import biases in the existing tax system. Also should enhance administrative ease and equity of current systems.

26. Establishment of a career judicial system.

- Measure will provide greater assurances on the protection of human and property rights. This will reduce the perceived risk of private sector investment in Honduras leading to expanded foreign and domestic investment in Honduras.

27. Renegotiation of external debt.

- Successful renegotiation of Honduras' publicly guaranteed private external debt will measurably enhance Honduras' creditworthiness in the eyes of the international financial community. As a result, Honduras would be eligible to receive additional loans on more favorable terms.

ESF PROGRAM IMPACT ON BASIC NEEDS: MACROECONOMIC AND
MICROECONOMIC DIMENSIONS

A. Summary

While the ESF Program is popularly called a "balance-of-payments" assistance program, this is a short hand expression which increasingly does not adequately suggest the broad benefits, content, impact and intent of the resource transfers so provided. The Honduras ESF program amply illustrates this statement.

B. Macro Impacts on Production and Employment

One primary objective of the ESF program is to raise the levels of GDP and employment over and above levels that would be attained without the additional import financing provided by quickly disbursing ESF cash transfers. This objective reflects a fundamental fact about the structure of the Honduran economy -- imports are the binding constraint on the level of GDP that can be attained because of the very heavy direct and indirect import content of production. That is, imported intermediate inputs need to be combined with domestic resources in order to produce final outputs. Honduran resources are not being fully used because financing is not available in sufficient quantities to meet the import requirements of fully utilizing them. Reflecting this dependence on imports, the empirical evidence suggests that Honduras' GDP can fairly reliably be forecast as equal to approximately 3 times the level of imports. Thus, the ability to finance imports is key. Without ESF, the ability to finance imports is simply equal to the sum of export earnings, net external capital inflows and the change in net international reserves. With ESF included as an additional source of import financing, the GDP level that can be attained, and the level of employment supported by that GDP, will be correspondingly higher. Table 1 summarizes this impact for Honduras over the period from 1982, when the program began, through 1986. In 1986, for example, \$107.5 million in ESF resources financed an equivalent value of additional imports of intermediate goods, spare parts and raw materials, which, in turn, permitted the attainment of a level of GDP approximately \$368 million higher than would have been the case without these ESF financed imports. As shown in Table 1, had ESF not been available in 1986, GDP would have been about 10 percent lower than the level recorded. Moreover, the higher GDP levels supported the employment of an estimated 81 thousand workers. With ESF, 1986 average per capita GDP was raised by about 82 dollars. This was attained at an ESF cost of 26 dollars per capita, clearly reflecting the cost effectiveness of ESF transfers as a means to generate relatively immediate and favorable impacts on employment and income.

TABLE 1

HONDURAS: IMPACT OF ESF ON GDP, EMPLOYMENT AND THE UNEMPLOYMENT RATE

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>Prel. 1986</u>
ESF Assistance in Millions of Dollars	35	18	68	90	107.5
ESF Disbursements as a Percent of Merchandise Imports, CIF	4.7%	2.2%	7.1%	9.4%	11.0%
Income Generated/Supported by ESF in Millions of Dollars	121	59	206	295	368
Jobs Generated/Maintained by ESF (thousands)	31	15	49	68	81
Increase in Unemployment Rate without ESF	2.1%	1.0%	3.1%	4.0%	4.6%
Average Per Capita GDP in Current Dollars Without ESF	718	733	766	800	834
Difference	688	718	717	732	752
	30	15	49	68	82

NOTES: 1. Based on the traditional relationship between imports and GDP.
2. Based on an employment/income elasticity of .6.

C. Relation of Macro Statement of Impacts to Impacts on Everyday Life in Honduras

The observations above have looked at the impact of quickly disbursing ESF resources on production, income and employment at the level of the macroeconomic aggregates. As such it is highly abstract and clearly needs to be brought down to a more human level. There are literally thousands of examples.

The itinerant Honduran shoemaker who charges 20 lempiras to resole a pair of shoes uses leather which, while originating from Honduran cattle, was tanned with imported chemicals. The soles were applied with imported glue. In round numbers the 5 lempiras that represent the import content of the shoemaker's materials produces the equivalent of 15 lempiras in net income. Thus, without those imports there would be a corresponding loss in income of this amount. The numerous Honduran shops that repair tires use imported rubber patches, glue and tools to perform their repair operations. The approximately 0.50 lempiras in import content produces L1.50 in net income to the repairman. Many small farmers are able to double and, in some cases, even triple and quadruple their yields and incomes using imported fertilizer and pesticides.

Schools depend on imported textbooks, pencils, paper, pens, chalk, and blackboards to provide instruction at levels of effectiveness which otherwise would not be attained and which enable Hondurans to meet the educational requirements of higher paying jobs.

The shops on virtually every street corner in Honduras which sell general supplies and which have an extremely low investment per unit of employment, derive about one-half of their income from the sale of products directly imported or which have a high import content. Honduras' packaging industry, which produces and sells for both the local and export markets, imports about twenty five percent of its production inputs. The Honduran apparel industry, which combines imported buttons, polyester synthetics, machinery and equipment with Honduran cloth and labor represents one of the largest single sources of manufacturing employment in the country. For every dollar's worth of products they produce, they need intermediate imports that cost \$.33. Looked at from the opposite direction, for every \$.33 worth of imported inputs, the textile industry produces \$1.00 worth of output.

These are only illustrative, as distinct from exhaustive, of the channels through which imports financed by the ESF program have a multiplier impact on production, income and employment in Honduras both at the macroeconomic and personal levels. They illustrate the basic point. The ESF Program has the broadest and most immediate impact of all assistance programs on the everyday lives of the Honduran people.

D. Development and Implementation of Policies for Improving Economic Performance

A second objective of the ESF program is to support the development and implementation of sound and coherent economic policies. This is an essential complement to the first goal of immediately raising income and employment. The ESF program would do little permanent good if it were only an international welfare program. Thus, the ESF program is used as a vehicle for policy discussions leading to mutual agreement on an appropriate set of macroeconomic and structural reform measures. The content of these measures is designed to improve economic performance both in the near and midterm. Usually disbursements take place pari passu with the implementation of the agreed policy program. In the case of Honduras, the agreed policy reform program includes improving fiscal discipline, moving towards market determination of the exchange rate, maintenance of real rates of interest and a set of structural reforms designed to: (1) rationalize public sector operation, (2) promote private sector investment, (3) enhance export competitiveness, and (4) restore internal and external confidence in the economy.

E. Programming Local Currency Generation for Basic Needs

The final objective of the ESF program relates to the programming of local currency resources. For every dollar that is transferred under

an ESF grant, a deposit of two lempiras, reflecting the current legal exchange rate, is created. Those lempira deposits are programmed, or if you will, projectized, toward the achievement of specific objectives relating to agriculture, nutrition, health, education and employment, and simultaneously toward the development of additional physical infrastructure, improved management practices and the adoption of improved appropriate technology packages which contribute toward laying the basis for sustained economic growth through the medium and longer term. The ability to influence the selection among the competing possible uses for local currency provides an important means through which total expenditures can be allocated towards objectives within the framework of the GOH budget.

Since the Mission's ESF program was initiated in 1982, 50% of local currency deposits have been programmed to finance high priority public sector activities. This includes the local currency counterpart of AID projects as first priority, and, as a second priority, local currency costs of IBD and IBRD projects. This complements the foreign exchange resources provided by IDB and IBRD in a manner which accelerates the completion of income and social benefit generating investments in Honduras. Thus, for example, the local currency deposits have financed the labor costs of building roads, constructing schools, laying sewage pipe and extending electric transmission lines.

It is true that to the extent these projects are undertaken with the Honduran Government, and are hence included in the Government's budget, they could be financed out of either tax revenue or borrowing. However, financing them through these alternative routes obviously would require increased taxes and/or reduced credit available to support private sector investment and production. The other alternative would be doing nothing at all.

The other 50 percent of ESF local currency resources has been used to support USAID objectives for enhancing the role of the private sector which is broadly defined as including private education, private voluntary organizations (PVOs), as well as private sector entities which produce and sell services for a profit. Two of these institutions in Honduras, for example, are designed to provide technical assistance in production, marketing, and quality control in product areas where Honduras shows potential for exporting to extra-regional markets.

In addition, a portion of ESF local currency resources is programmed through Central Bank rediscount lines toward specialized private sector areas. Such lending is provided within the context of a global credit ceiling, and is intended to produce a demonstration effect to prove to both bankers and policy makers that borrowers in these areas are indeed bankable. That is, that the actual risk in lending to, say, vegetable producers is substantially lower than the risk currently perceived.

1.2

3(A)2 - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1987 Continuing Resolution Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.
2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action ~~will be completed~~ in time to permit orderly accomplishment of purpose of the assistance?
3. FAA Sec. 209. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

Congressional action expired without objection of U.S. Congress.

Program Agreement provides that legislative action will be carried out in such fashion.

No

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA? Yes

b. FAA Sec. 531(e). Will assistance under this chapter be used for military or paramilitary activities? No

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? Yes

d. ISDCA of 1985 Sec. 205. Will ESF funds made available for commodity import programs be used for the purchase of agricultural commodities of United States-origin? If so, what percentage of the funds will be so used? Yes. All

e. ISDCA of 1985 Sec. 801. If ESF funds will be used to finance imports by an African country (under a commodity import program or sector program), will the agreement require that those imports be used to meet long-term development needs in those countries in accordance with the following criteria? N/A

(i) spare parts and other imports shall be allocated on the basis of evaluations, by A.I.D., of the ability of likely recipients to use such spare parts and imports in a maximally productive, employment generating, and cost-effective way;

- (ii) imports shall be coordinated with investments in accordance with the recipient country's plans for promoting economic development. A.I.D. shall assess such plans to determine whether they will effectively promote economic development; N/A
- (iii) emphasis shall be placed on imports for agricultural activities which will expand agricultural production, particularly activities which expand production for export or production to reduce reliance on imported agricultural products; N/A
- (iv) emphasis shall also be placed on a distribution of imports having a broad development impact in terms of economic sectors and geographic regions; N/A
- (v) in order to maximize the likelihood that the imports financed by the United States under the ESF chapter are in addition to imports which would otherwise occur, consideration shall be given to historical patterns of foreign exchange uses; N/A
- (vi)(A) 75 percent of the foreign currencies generated by the sale of such imports by the government of the country shall be deposited in a special account established by that government and, except as provided in subparagraph (B), shall be available only for use in accordance with the agreement for economic development activities which are consistent with the policy directions of section 102 of the FAA and which are the types of activities for which assistance may be provided under sections 103 through 106 of the FAA; N/A

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(B) the agreement shall require that the government of the country make available to the United States Government such portion of the amount deposited in the special account as may be determined by the President to be necessary for requirements of the United States Government.

N/A

f. ISDCA of 1985 Sec. 207. Will ESF funds be used to finance the construction of, or the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such country (1) is a party to the Treaty on the Non-Proliferation of Nuclear Weapons or the Treaty for the Prohibition of Nuclear Weapons in Latin American (the "Treaty of Tlatelolco"), (2) cooperates fully with the IAEA, and (3) pursues nonproliferation policies consistent with those of the United States?

No

g. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

Yes

h. FY 1987 Continuing Resolution. If assistance is in the form of a cash transfer to any country which receives in excess of a total of \$5 million as cash transfer assistance in the current fiscal year: (a) are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? (b) will all local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account to be used in accordance with FAA Section 609 (which requires such local currencies to be made available to the U.S. government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available)?

Yes

11/1

2. Nonproject Criteria for Development Assistance

a. FAA Secs. 102(a), 111, 113, 281(a).
Extent to which activity will (a) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

Approximately 15% of the total of the local currency amount provided by the program is used as a counterpart for activities of other donor projects which address all of the above concerns.

b. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Is assistance being made available (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for assistance, include relevant paragraph for each fund source):

N/A

(1) [103] for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value;

improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

(2) [104] for population planning under Sec. 104(b) or health under Sec. 104(c); if so, extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach.

N/A

(3) [105] for education, public administration, or human resources development; if so, (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

N/A

(4) [106] for technical assistance, energy, research, reconstruction, and selected development problems; if so, extent activity is:

N/A

- (i)(a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;
- (ii) concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;
- (iii) research into, and evaluation of, economic development processes and techniques;
- (iv) reconstruction after natural or manmade disaster and programs of disaster preparedness;
- (v) for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;
- (vi) for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development.

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(5) [120-21] for the Sahelian region; if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multi-donor development plan which calls for equitable burden-sharing with other donors; (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom)?

c. FAA Sec. 107. Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

N/A

d. FAA Sec. 281(b). Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.

The program is in direct support of the Government of Honduras economic stabilization program.

e. FAA Sec. 101(a). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes

INITIAL ENVIRONMENTAL EXAMINATION

Program Location: Honduras

Program Title: 522-0323

Funding: \$65,000,000 Grant Life of Project

Life of Project: One (1) year

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USAID/Honduras

Date: June 17, 1987

Environmental Action Recommended:

It is recommended that a negative determination be made for this Program. Since the Program will provide only balance of payments assistance, in agreement with Environmental Procedures, Regulation 16, Section 216.3(a), no further environmental examination is required.

John A. Sanbrallo
John A. Sanbrallo
Mission Director
USAID/Honduras

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