

PD-AAX-428

Honduras
Action Plan FY 1987

BEST AVAILABLE

FY 87 ACTION PLAN FOR HONDURAS

INTRODUCTION

As detailed in last year's (May 1984) CDSS and SPS Addendum (November 1984), the Mission's overall objective is to support a traditional trading partner and democratic ally through an economic program that will facilitate sustainable economic recovery accompanied by economic development. The overall strategy to achieve this objective is to assist the GOH in financing an economic program which achieves a balance among the Jackson Plan objectives of economic stabilization and recovery, social equity, and support for democratic institutions. This document is designed to provide a bridge linking the implementation of the strategy as outlined in USAID's CDSS and the SPS Addendum to the proposed FY87 programs. It addresses the USAID plan for implementing the Jackson Plan recommendations and focuses on updated sector strategies and their relation to macroeconomic policy reforms.

The economic assistance package (excluding military) represents over \$150 million per year for the period FY87 to FY89. This figure is impressive when compared to pre-Jackson Plan assistance; the level was approximately \$50 million in FY 82 and is now over \$200 million in FY 85, including the FY 84 Supplemental Appropriation of \$79.8 million. The current and projected U.S. economic assistance levels provide the USG with a unique opportunity to assist Honduras achieve Jackson Plan objectives. A judicious blend of assistance interventions and appropriate policy reforms that could be instrumental in moderating the social adjustments

(austerity , unemployment, etc.) which are associated with addressing the country's short term stabilization problems (fiscal and balance of payments disequilibria), while laying the structural basis for a sustained economic recovery with social equity.

RATIONALE FOR U.S. ASSISTANCE

The rationale for U.S.G. support to Honduras is based interrelated factors. First, as stated in the report of the National Bipartisan Commission on Central America (NBCCA), Honduras is of great strategic importance to the U.S. in its efforts to maintain free, democratic societies in the western hemisphere. Second, Honduras is surrounded by countries whose stability is threatened by externally supported interests hostile to the Honduran and the U.S. way of life. Thus, Honduras wants and needs U.S. assistance to maintain its constitutional democratic form of government and improve its defense capabilities. It is currently cooperating effectively with the U.S. on security matters, and probably more than any other, is an ally on which the U.S. can count for regional cooperation over the long run, as shown by its traditional support of the U.S. in world fora. Finally, assistance to Honduras holds reasonable promise of success. With appropriate and adequate assistance and effective government economic policies, the Honduran economy can be turned around and its traditional steady progress in improving living conditions restored.

MISSION STRATEGY

Using the Jackson Plan recommendations as a point of reference, the Mission's development strategy focuses on inter-dependent short-term and long-term objectives. The short-term objective is to stabilize the economy and reduce current and potential social tension stemming from high unemployment levels. The longer-term objective is to achieve sustainable and equitable economic growth and to strengthen democratic institutions.

To stabilize the economy, we are providing significant levels of balance of payments assistance in support of macroeconomic policy reforms. Economic stabilization will be achieved through GOH implementation of important macroeconomic policy changes aimed at correcting fiscal and balance of payments disequilibria, structural reforms aimed at facilitating sustainable long-term growth based the optimal utilization of the country's human and material resource base.

The Mission's program relates to the Jackson Plan goals through a policy agenda and program implementation effort which includes: Macroeconomic Policy Reforms, Employment Generation, Private Sector Development, Institutional Development institutions, and Promotion of Democratic Education and Community Level Participation. Following is a description

of the Goals and Benchmarks that form the Mission's policy agenda and lead to the specific sectoral goals, benchmarks and negotiating agenda for the proposed sector projects.

OVERVIEW OF GOALS

1985-1987

Our short-term goals are essentially to help Honduras restore economic equilibrium, implement the policy base for long-term growth, and maintain social peace and tranquility during a period of economic adjustment. This will require that the GOH gain effective control over its fiscal affairs through short-term measures designed to significantly reduce the fiscal deficit of the consolidated public sector, and structural reform designed to increase the elasticity of the tax system with respect to economic activity, and to reduce the incidence of public sector participation in productive activities. Where public interest dictates government operation and/or management of production activities, their management and performance should be significantly improved according equal tax treatment and access to credit and foregoing exchange as that accorded to private sector firms. The GOH's basic law and policies regarding investment, tariffs, and export development should be revised to achieve the country's optimal utilization of its competitive

advantage. Informal barriers to investment and exports, such as required government approvals for normal business transactions, should be significantly reduced. In view of the objective set forth above, the short-term stabilization program must represent a reasonable balance between achieving economic stability and structural reform and maintaining political stability, thus, some of our assistance must be aimed at helping the GOH to minimize social unrest during this difficult period. Accordingly, a major effort to increase employment in the short-run forms an integral part of the short-term strategy. Rather than adopting a defensive posture, we propose to collaborate with the GOH in the development of an employment generation program with up to \$100 million of A.I.D. funds to create up to 40,000 person years of employment during this period. Economic stability will be addressed with our ESF program assistance while structural reforms will be the focus of our traditional DA programs combined with conditionality associated with ESF and PL-480 programs.

1985-1990

Over the longer term, a significant increase in investment in those areas with the highest economic rate of return freely achieving modest real GDP growth. This should result in a more equitable distribution of the benefits of economic growth and improved living conditions for the large majority of Hondurans. The goals to which the strategy contributes are:

- an increase in employment by 250,000 jobs by the end of 1990, which will accommodate labor force growth during the CDSS period;
- an increase in average per capita income of the rural poor from \$155 at present to \$200 in 1990;
- an increase in primary school enrollment from 87% of the primary school age group in 1982 to 93% by 1990;
- an increase in access to potable water from 60% to 85% in major cities and from 50% to 70% in rural areas by 1990;
- an increase in the prevalence of contraceptive usage from 27% to 45% of fertile women and a decline in the rate of population growth from 3.5% to 3.0% per year by 1990; and
- continued progress toward permanent institutionalization of democratic electoral and judicial processes.

These goals will be sought by rationalizing sectoral development policies, expanding private sector production through the reduction of government intervention in production activities, fostering technology transfer, reducing price distortions, and developing a stronger human

resources and institutional base. Sectoral emphasis (not in order of importance or priority) will be on private sector and agricultural development; education; health and population; and infrastructure. In our judgment, assistance in these sectors will have the greatest impact on helping Honduras to reach the short and long-term goals of our program. They are the sectors through which the situation of the poor can be improved most directly. They are areas in which both we and the GOH have gained significant expertise through our on-going assistance program. They are logical areas on which to concentrate attention both in terms of Honduras' long-term development needs and the types of assistance available from other sources. Finally, the interrelationships between these sectors are such as to require a fully coordinated and consistent use of our resources on all fronts.

PROGRAM ASSISTANCE

The Mission's ESF Program Assistance for FY86 and FY87 will continue to play a critical role in addressing key economic distortions while attempting to achieve Jackson Plan objectives for a 3% real GDP growth rate. The goal of the program is to achieve internal and external equilibrium in the absence of restrictions of payments and trade, and the initiation of sustainable economic growth in the absence of extraordinary external assistance by 1988. As shown, however, in the summary balance

of payments table below, currently projected ESF assistance is unlikely to be sufficient to achieve the Jackson Plan objective of achieving 3% real growth in 1986 and 1987. This is because in essence, the import requirement of achieving 3% growth are in excess of expected sources of financing, including currently programmed ESF levels. The gaps for 1986 and 1987 are expected to persist in 1986 and 1987 even in the context of current GOH efforts to developed a sound stabilization program.

Honduras: Summary Balance of Payments
(Millions of Dollars)

	<u>1985</u>	<u>1986</u>	<u>1987</u>
Exports G&S	999	1088 <u>3/</u>	1251 <u>3/</u>
Imports G&S	-1397.5 <u>1/</u>	1522 <u>2/</u>	1659 <u>2/</u>
Transfers	29	31	35
Current Account	369.5	403	373
Capital Account (includes DA&PL-80)	222	241	265
Overall Balance	-147.5	-162	-108
ESF	147.5	80	75
Unfinanced gap	-	82	33

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- (1) Imports of goods and services are administratively controlled thus its growth in 1985 will be determined by the availability of ESF balance of payments assistance.
 - (2) Import requirements to sustain 3% real GDP growth rate in 1986 and 3% in 1987.
 - (3) 10% export growth in 1986 and 15% in 1987.

ESF assistance will be provided in direct support of the steps the GOH is taking and will take to develop and implement a program of economic stabilization, recuperation and structural reform. In the area of public finance, these steps include public expenditure restraint and rationalization of public expenditures, a reduction in public sector participation in productive activities, and the rationalization of the overall structure of taxation and fees for public services.

In the area of foreign trade, these steps include the liberalization of administrative restrictions to internal trade and payments. Other structural reforms include the rationalization and management of the country's external debt, the rationalization of domestic credit allocation, the elimination of reduction of administratively controlled prices, and other sector specific policy reforms which may be identified in the Mission's Strategy Planning and Technical Support (SPATS) Project.

The implementation of the foregoing reforms will require that the Mission work closely with the GOH in developing an implementation strategy which is achievable and politically feasible. As with previous efforts, the Joint Economic Working Group (JEWG) will be the principal forum through which policy dialogue will take place. The JEWG has proven an effective mean to achieve high level GOH consensus in support of important policy reforms. The Mission is optimistic about achieving important results in FY86. In January 1986, a

new democratically-elected government will take office, and it is likely to be eager to deliver a sound economic program on an urgent basis. The Mission will be ready to respond to this challenge.

The Mission foresees the following policy reforms and bench marks for FY86 and FY87:

- Phased implementation of a tariff reform program which would replace the current NAUCA system with the Brussels nomenclature. 1st. quarter FY86

- Signing of a foreign debt renegotiation agreement (initiated in late 1984) for selected amounts outstanding through 1984 with private international banks. 1st. quarter FY86

- Implementation of legislation which will permit the privatization, elimination or reduction of GOH participation in the following public sector entities:

Financiera Nacional de la Vivienda (FINAVI), Suplidora Nacional de Productos Básicos (BANASUPRO), Corporación Hondureña del Banano (COHBANA), and the Non-Banking functions of the Banco Nacional de Desarrollo Agrícola (BANADESA).

1st. quarter FY86

- Expansion of international trade transactions covered under the self-financing system and the special payments regime to 80%.

1st. quarter FY86

- Implementation of legislation designed to permit divestiture of public sector commodity producing enterprises.

2nd. quarter FY86

- Reduction in the number of items under price controls.

2nd. quarter FY86

- Implementation of public sector credit law which rationalizes the acquisition and management of public sector external debt.

2nd quarter FY86

- Expansion of international trade transactions covered under the self-financing system and the special payments regime to 40%. 3rd. quarter FY86
- Introduction of fiscal package designed to reduce the overall public sector deficit as a percentage of GDP by three points. 3rd. quarter FY86
- Expansion of international trade transactions covered under the self-financing system and the special payments regime to 60%. 1st. quarter FY87
- Approval of 1987 GOH Budget at a level which reduces financing needs from the banking system with respect to the level approved for the 1986 budget. 1st. quarter FY87
- Expansion of international trade transactions covered under the self-financing system and the special payments regime by 80%. 3rd. quarter FY87
- Full unification of exchange rate 4th. quarter FY87

The Mission foresees allocation of local currency generations for private and public sector activities. In the public sector, the Mission will continue to support high priority investment projects which are consistent with Jackson Plan objectives and which generate dollar disbursements.

Local currency generations for the private sector will be utilized to continue supporting Central Bank credit lines for productive activities, and GOH divestiture efforts. In the latter case, local currency will be utilized to facilitate the transfer of public sector enterprises to the private sector.