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

HONDURAS

PROJECT PAPER

ECONOMIC SUPPORT FUND (ESF)
(PAAD)

AID/LAC/P-734

Project Number: 522-0365
Grant Number : 522-K-607B

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number: 522-0365 (Grant 522-K-607B)

2. Country: Honduras

3. Category: CASH TRANSFER

4. Date:

To: AA/LAC, James H. Michel

6. OYB Change Number: N/A

8. OYB Increase

To be taken from: ECONOMIC SUPPORT FUND (ESF)

From: LAC/DR, Peter Bloom

Approval Requested for Commitment of $ $25,000,000

10. Appropriation Budget Plan Code: 72-112/31037 LES292-35522-KG31 (270-65-522-00-50-21)

Type Funding: Loan [ ] Grant [X]

12. Local Currency Arrangement: Informal [ ] Formal [X] None [ ]

13. Estimated Delivery Period: FY 1992/93

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	$25,000,000	Other	

18. Summary Description

The purpose of this program is to provide balance of payments assistance for economic stabilization and recovery in Honduras during CY 1992. The program is conditioned on accelerating agricultural sector reforms, implementing trade and investment laws, expediting financial sector reforms, achieving tariff reforms, progress in the privatization program, and continued efforts in the economic stabilization program.

Program funds will be deposited into a separate, non-comingled ESF account or accounts in the U.S. from which payments for eligible foreign exchange 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. for the productive private sector, as well as the importation of petroleum and its derivatives from the U.S.

Upon disbursement of the dollars, an equivalent amount of local currency will be deposited by the GOH in a separate, non-interest bearing account in the Central Bank of Honduras to be used for mutually agreed upon development purposes consistent with the Foreign Assistance Act, specifically Sections 103 through 106. Methods of implementation, financing, and audit coverage have been provided in accordance with Payment Verification Policy Implementation Guidance.

19. Clearances	Date
LAC/DR/CEN: MSilverman	6/11/92
LAC/DPP: EZallman	6/11/92
GC/LAC: ~~MTittipaldi~~	6/16/92
LAC/CEN: WSRhodes	6/19/92
ARA/ECP: Marrison	6/23/92
M/PFM/A: Musnick	7/30/92
DAA/LAC: AWilliams	

20. Action

[X] APPROVED [ ] DISAPPROVED

Authorized Signature: James H Michel

Date: 8/5/92

Title: ASSISTANT ADMINISTRATOR, LAC

CLASSIFICATION

Approval of Methods of Financing

This PAAD complies with current Agency guidance on methods of financing and has provided adequate audit coverage in accordance with the Payments Verification Policy Implementation Guidance.

Nadia Rosenberg for 6/11/92

Richard C. McClure, Controller, LAC

USAID/HONDURAS

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

Structural Adjustment Program
(522-0365)

USAID

FY 1992

Revised and Final Version

Honduras

PROGRAM ASSISTANCE APPROVAL DOCUMENT

FY 1992

Page Number

ANNEXES

STATISTICAL APPENDIX

LIST OF TABLES IN TEXT

I. RECOMMENDATION AND SUMMARY

A. Recommendation

USAID/Honduras recommends authorization of an Economic Support Fund (ESF) grant of $ 30 million. The grantee will be the Government of Honduras (GOH) acting through the Ministry of Finance and Public Credit.

B. Program Summary

The 1992 GOH Economic Program expands the stabilization and structural reforms initiated in March 1990. ESF support for FY 1992 focuses on structural adjustment reforms in agriculture, trade and investment, and finance (see Annex 1). The agricultural sector reforms are needed to achieve the increases in agricultural production projected in this PAAD (see Annex 2). Agricultural reforms will also expand investment, exports and employment in this sector. The trade and investment reforms are needed to enhance Honduran competitiveness on world markets and to attract the private investment, both foreign and domestic, required for higher growth. The financial sector reforms are key for generating more domestic savings and investment as well as for improving the allocation of credit among economic activities. Reforms in the sectors supported by ESF resources are needed to help Honduras meet modest economic growth and investment targets and, in general, to improve its macroeconomic performance (see Annex 2).

1. Justification for ESF Support

The Mission believes that the GOH needs continued ESF support. Less than $25 million in FY 1992 balance of payments support would, in our opinion, be too little (see the Issue in part C, page 3). ESF support is justified by four factors: the strength of the GOH economic reform program, the deteriorated condition of the Honduran economy, the need to bolster fragile domestic support for the program and a large external financing gap.

2. Background

ESF support in the 1990s has been important to the GOH. In FY 1990, ESF cash grants helped the GOH adopt its far-reaching economic reform program. The ESF program also helped the GOH maintain the reform effort in 1991.

Despite an economic slowdown in early 1991, negative resource flows from the IFIs and widespread political opposition, the GOH managed to maintain the general course of its economic reform program in 1991. Throughout the year, it stayed in close compliance with the stabilization targets specified in its IMF Stand-by Agreement. It made four of its five year-end performance targets (the fifth was waived by the Fund). The GOH added flexibility to its foreign exchange regime. It reduced the maximum import tariff (excluding surcharges) from 40 to 35 percent and raised the minimum tariff from 2 to 4 percent. On January 1, 1992, the tariff range was further compressed to 5-20 percent. Furthermore, the GOH made progress in implementing its ambitious structural reform program.

However, there were slippages in implementing the 1991 GOH Economic Program. A DAEC review held in November 1991 concluded that the GOH complied with conditionality for four of the seven areas supported by the FY 1991 ESF Program (see 91 TEGUCIGALPA 16620). However, it had not yet complied with key conditionality in the other three areas: (1) improvement of agricultural policies, (2) improvement of the investment climate and (3) acceleration of privatization. The DAEC recommended disbursement of one-half the scheduled $34 million second tranche FY 1991 ESF funds in support of the progress made by the GOH up to the time of the review.

The second half of this disbursement was withheld, pending three actions by the GOH: (1) passage of the Agricultural Modernization Law, (2) a total of five privatizations since January 1991 and (3) passage of the Investment Law. The Congress passed the Agricultural Modernization Law on March 4, 1992. In March 1992, the GOH met the privatization target. Although the Congress has not yet passed the Investment Law, the GOH is building the consensus needed for approval. Passage is expected in April 1992.

The GOH obtained broad donor support in 1991. The International Monetary Fund (IMF), World Bank (WB) and Inter-American Development Bank (IDB) developed and expanded major lending programs. After the GOH did not meet its December 31, 1990 stabilization targets, the IMF modified the Stand-by Arrangement and extended its period from August 15, 1991 to February 15, 1992. The WB disbursed $20 million under an IDA supplement to the SAL II in May. It disbursed the $20 million second tranche of the SAL II in November 1991. The Bank also approved a $55 million energy sector loan on October 31. Likewise, the IDB approved cofinancing of this loan in November. However, due to policy slippages in agriculture, the WB and IDB were not able to complete negotiations with the GOH on the key agricultural sector loan in 1991. The USG bolstered the GOH resolve to continue its economic reforms in 1991 through the use of ESF resources and forgiveness of AID and PL-480 debts.

After negative economic growth in 1990 and a continuation of the slump throughout the first half of 1991, the GOH economy picked up during the second half of the year, ending with modest GDP growth of about 2.2 percent. The GOH believes that Honduras can attain GDP growth of 3.5 percent in 1992. The Mission believes that 3.0 percent is more likely and set this as a target for 1992. We targeted an average growth rate of 3.5 percent over the three year period spanned by the SAP. These growth rates are upward revisions of the 2.5 percent growth rate projected for 1992 and the 3.3 percent rate for the three year SAP period which appear in the FY 1992 ESF Concepts Paper. A recovery scenario for the Honduran economy is presented in this PAAD (see Annex 2). Recovery, however, depends on deepening the GOH economic reform program.

3. Highlights of the Proposed FY 1992 ESF Program

The FY 1992 ESF Structural Adjustment Program (SAP) represents a fundamental change in the focus of ESF support to Honduras. Unlike past programs, the SAP supports a multi-year agenda of GOH economic reforms. It emphasizes policy improvements in three key sectors: agriculture, finance, and trade and investment. This PAAD sets the objectives for these sectors, a strategy for achieving them, and a negotiating agenda for 1992. A stabilization component is also included in the ESF program. This is because of: (1) the importance of a sound stabilization program to the structural reform efforts and (2) frequent slippages by the GOH in abiding by its past stabilization commitments. However, the Mission expects the IMF to play the lead donor role in this area.

The FY 1992 ESF Program focuses heavily on implementation of two major pieces of legislation: the agricultural modernization law and a new investment code. During most of 1991, the GOH has been preparing these laws. We expect them to form the cornerstones for economic growth in the mid- to late 1990s.

During the last two years of the Callejas administration, the Mission will help the GOH consolidate its achievements. In January 1992, the Callejas administration entered the second half of its term -- a time when Honduran governments traditionally avoid controversial decisions and turn their attention to politics. The passage of the agricultural and investment laws and approval of their implementing regulations are the most important -- and the most difficult -- actions the Mission expects the GOH to undertake in 1992. We are encouraging the GOH to complete these actions as early as possible this year. This must be done prior to the heightening of the political debate. The FY 1992 ESF Program will also support important, but less controversial, structural adjustment measures. These will encourage major financial sector reforms, continued improvements in trade policy and the privatization of state-owned enterprises.

Overall, the ESF Program supports actions by the GOH to open up the Honduran economy to market forces. As these forces are strengthened, the Honduran people will benefit through more efficient use of their resources, competitiveness on international markets (permitting expanded incomes and employment), better quality goods, more purchasing power (through lower prices relative to incomes), and in general greater economic opportunities for all Hondurans. The latter include women and minority groups.

The Mission knows that the above-mentioned benefits will not occur overnight. In fact, economic reforms almost invariably require painful short-term adjustments. This is the case in Honduras. Through the careful programming of local currency, the Mission is trying to help offset some of the social costs of adjustment.

C. Issue: Will ESF Support in FY 1992 be Enough to Maintain the Momentum of Economic Reforms?

ESF levels for Honduras are tumbling. According to the Congressional Presentation, Honduras' FY 1993 ESF level will be $ 30 million, down from $60 million in FY 1991. This cut and any reduction of the previously programmed $50 million for FY 1992 would come at a bad time.

After years of hesitation and a large ESF investment in Honduran economic reforms, the GOH finally adopted a comprehensive reform in March 1990. ESF made the reforms possible. Large disbursements in FY 1990 ($135 million in balance of payments support -- the equivalent of five percent of Honduran GDP) helped the GOH clear massive arrears to the IFIs, qualify for renewed IFI support, and cushion the difficult adjustments required by years of economic mismanagement. Although the GOH reform program made enormous strides in improving policies, the program is just beginning to show signs of success. Support for the program -- both by Hondurans and by the IFIs -- is fragile. There is, indeed, a major danger that, if we pull out too quickly, GOH resolve to continue the reform effort will waiver. This is why:

- Political pressures against the reform program are powerful and growing. If the GOH cannot soon show positive results from the courageous measures it took over the past two years, the Economic Reform Program may get defeated in the polls in November 1993. The political campaign already started. The reforms are the centerpiece of major debates between candidates vying for the presidency.

  A common theme on the street and in the newspapers is: when are the supposed benefits of the adjustment program going to appear? Former President Azcona recently called for President Callejas to "repent" and reverse the "socially damaging reform process." In his statement, Azcona claimed that the Presidents of both México and Venezuela were reversing their reform programs. Both the Ministers of Finance and Economy responded in the press, defending the adjustment process in Honduras, explaining why circumstances in Honduras differ from those in México and Venezuela. They reaffirmed that the adjustment process will not be reversed. The recent coup attempt in Venezuela is widely believed within Honduras to be a result of the adjustment process. Moreover, public speculation cites the coup attempt as another reason to modify the reform process in Honduras. This kind of attack on reforms is going to continue and intensify as the country approaches the 1993 elections.

  Furthermore, important parts of the industrial sector oppose a more open trade regime. They benefit from protection and fear an inability to successfully compete with outside producers.

  To enable the Government to resist the above-mentioned pressures from both the left and right, and to shore up its own reform convictions, it is important that the GOH believe that its economic reform program has the full political and economic support of the United States. The U.S. must not be seen as withdrawing its support of economic liberalization.

- The Honduran economy has been weak since the initiation of the reforms. This is not surprising. Beneficial effects of reforms typically require several years of difficult adjustments and dislocations before their positive contribution to the economy is evident. The Honduran economy is just beginning to pull out of a deep slump which started in mid-1989.

- ESF support is vital to the Honduran economy. It helps Honduras finance the imports it needs to bolster domestic production and the economy. ESF cushions the impacts of the reforms through local currency expenditures for social safety net activities.

- We want the IFIs to take over leadership of support for the Economic Reform Program. This is slowly taking place, but much slower than we want. The major sectoral reforms taken by the GOH in 1992 were clearly led by the Mission's ESF-supported policy dialogue. The GOH's need for balance of payments support made ESF a driving force behind passage of the Agricultural Modernization Law, preparation of a new investment code and design of a comprehensive financial sector program. The IFIs were (and still are) far behind us in these areas. More time is needed for them to take over a leadership role.

- The IFIs have also been slow in increasing their funding levels. Resource flows from the IFIs to Honduras were negative in 1990 and 1991. Although this may be reversed in 1992, this is still not certain. Honduras is heavily indebted and needs tremendous financial support -- a large part of which has to come from A.I.D. In 1992, for instance, the Mission estimates that Honduras will have an external financing gap equivalent to more than one percent of its GDP. This is after accounting for the effects of: (1) FY 1992 ESF balance of payments support of $ 25 million and (2) all projected 1992 IFI disbursements, which are assumed to be made on time. Honduras' weak balance of payments situation is further exacerbated by low international coffee prices.

- We want to decrease our role of providing balance of payments support. However, we believe it may be disastrous to do so prior to the time other donor flows increase enough to take our place.

Our Action Plan and this PAAD call for major progress on the policy reform process. This includes implementation of the measures contained in the Agricultural and Investment Laws, continued progress on trade liberalization, and implementation of financial sector reforms. Without substantial ESF resources backing up our policy dialogue, we may lose our credibility, send a misleading signal of early U.S. withdrawal and undercut the GOH's resolve to maintain the reform momentum during the difficult period prior to elections.

II. RECENT ECONOMIC PERFORMANCE

A. Overview

Honduran economic performance improved considerably in 1991. Gross Domestic Product (GDP) grew modestly. The GOH exhibited exchange rate flexibility, maintained stable monetary policies, further relaxed interest rate controls and fulfilled its commitment to sharply reduce the fiscal deficit. The latter accomplishment is particularly noteworthy. Unlike past years, the GOH resisted powerful pressures to accelerate year-end expenditures. Throughout 1991, it exercised tight control over expenditure levels. As a result, inflation fell sharply. Good policies helped relieve pressure on the exchange rate. Honduras benefitted from modest capital inflows and a substantial improvement in the economy's net international reserve position. Price liberalization encouraged agricultural investment and production. The GOH virtually eliminated external arrears in 1991. The stock of external debt declined as a result of USG debt forgiveness. Nevertheless, GDP per capita of approximately $547 in 1991 still leaves Honduras among the poorest countries in the western hemisphere.

B. Growth

Preliminary estimates indicate that real GDP grew by 2.2 percent in 1991 (see Table 1). This followed a year of stagnant growth in 1990 and exceeded the targeted growth rate of 1.7 percent in the FY 1991 PAAD. Relatively strong economic performance in 1991 reflected improved macroeconomic policies. Improved price incentives for agricultural producers coupled with realistic exchange rate policies and domestic price liberalization produced a strong supply response from both basic grains producers and nontraditional exporters. Flexibility in exchange rate policies and reduced controls on import financing enhanced Honduras' capacity to finance imports. Manufacturing and construction activity in free zones continued to surge. This is indirectly evidenced by recent data from the U.S. Department of Commerce, indicating that Honduran manufacturing exports to the U.S. rose by 55% during the first 11 months of 1991.

The strongest impetus to renewed growth came from the agricultural sector, which expanded output by 3.4 percent. This growth occurred despite negative exogenous forces which lowered export revenues of the economy's two most important export products. As a result of prolonged labor unrest, banana export production declined by approximately 10 percent. This was despite favorable international prices and expansive investment plans initiated by the major multinationals. The volume of coffee exports fell by almost 15 percent, as the result of speculative retention of output by producers in response to unexpectedly low international prices. However, coffee production rose significantly, contributing strongly to the growth of GDP output in real (physical) terms.

TABLE 1

HONDURAS: SOCIO-ECONOMIC INDICATORS 1986-1991

	1986	1987	1988	1989	1990	1991/p
Real Indicators (Annual Growth Rates)						
Real Gross Domestic Product (GDP)	0.7%	6.0%	4.6%	4.3%	0.0%	2.2%
Real Fixed Capital Formation	-12.1%	1.4%	2.4%	-0.6%	-6.8%	12.0%
Private	2.9%	5.0%	6.8%	-8.0%	-21.7%	18.7%
Public	-24.5%	-2.6%	-2.9%	-12.1%	17.7%	4.8%
Quality of Life Indicators						
Real Per Capital GDP Growth Rate	-2.1%	3.1%	1.7%	1.5%	-2.7%	-0.5%
Population Growth Rate	2.8%	2.8%	2.8%	2.8%	2.8%	2.7%
Infant Mortality Rate (Deaths per 1000 Live Births)	n/a	60.0%	n/a	n/a	n/a	n/a
Life Expectancy at Birth (years)	62.0%	62.0%	n/a	n/a	65.0%	n/a
Literacy Rate	n/a	n/a	67.6%	n/a	n/a	n/a
Primary School-Enrollment Rate	90.0	91.0	91.0	92.0	92.0	n/a
Access to Water						
Urban	n/a	80.7%	85.9%	n/a	n/a	n/a
Rural	n/a	47.5%	45.0%	n/a	n/a	n/a
Total	n/a	62.3%	62.1%	n/a	n/a	n/a
Access to Sanitation						
Urban	n/a	88.5%	87.8%	n/a	n/a	n/a
Rural	n/a	41.8%	38.0%	n/a	n/a	n/a
Total	n/a	59.5%	58.8%	n/a	n/a	n/a
Inflation						
Consumer Price Index	4.3%	2.5%	4.5%	9.8%	23.3%	34.0%
Wholesale Price Index (annual)	2.0%	0.7%	6.0%	18.6%	29.7%	34.6%
GDP Deflator	3.9%	2.8%	6.5%	7.1%	21.3%	28.0%
Financial Indicators (As % of GDP)						
Consolidated Nonfinancial Public Fiscal Deficit	6.2%	6.3%	7.1%	8.4%	8.7%	3.7%
Central Government Fiscal Deficit	7.4%	7.6%	7.4%	7.6%	7.0%	4.1%
Current Account Deficit in the Balance of Payments	6.5%	8.3%	8.1%	9.2%	12.5%	12.5%
ESF Disbursements (As % of)						
Fiscal Deficit of the Consolidated Nonfinancial Public Sector	45.3%	31.3%	35.0%	4.4%	61.9%	37.3%
Current Account Deficit in the Balance of Payments	43.7%	23.5%	30.6%	4.0%	43.1%	11.0%
Merchandise Imports CIF	11.3%	9.1%	9.9%	1.1%	14.2%	4.1%
Merchandise Exports FOB	12.1%	9.8%	10.3%	1.1%	15.9%	4.8%
External Indicators						
Exports FOB/Imports CIF	94.1%	93.8%	92.1%	96.9%	89.2%	84.0%
Imports CIF as % of GDP	24.3%	23.6%	26.2%	33.5%	37.0%	33.8%
Exports FOB as % of GDP	22.9%	20.4%	24.1%	32.5%	33.8%	28.4%
Annual Growth Rates						
Exports FOB	12.8%	-6.5%	5.0%	0.9%	-4.0%	0.0%
Imports CIF	-0.8%	-6.3%	7.0%	-4.1%	4.4%	6.1%
Total External Debt ($ Millions)	2815.0	3060.0	3203.0	3230.0	3409.0	3099.0
Medium and Long Term	2503.0	2816.0	2855.0	2907.0	2990.0	3099.0
Accumulation of Arrears – Public and Publicly Guaranteed Commercial Debt ($ Mil.)	335.0	462.0	413.0	643.0	419.0	0.0
External Debt + Arrears % of GDP	82.9%	86.7%	106.2%	152.1%	169.7%	106.3%
Credit and Monetary Indicators						
Broad Money Supply as % of GDP	32.7%	36.8%	36.3%	39.1%	37.3%	31.9%
Broad Money Supply, Annual Growth Rate	9.7%	17.3%	13.1%	20.4%	15.5%	11.9%
Credit Expansion of the Consolidated Banking System ($ Millions)	132.8	266.3	128.1	132.0	121.0	52.8
of which, to: Public Sector	33.6	69.6	65.1	59.6	34.3 /1	-16.9 /1
Private Sector	99.2	196.7	63.0	72.4	86.7	69.7

/p: Preliminary
/1 Includes Central Bank losses arising from partial assumption of GOH debt service obligations.
SOURCE: Central Bank of Honduras, Other GOH Sources, and Mission Staff Estimates

Agricultural growth was spurred by two major factors in 1991. Domestic grain producers reacted to improved price incentives (wholesale agricultural prices increased by 42 percent more than the overall wholesale price index) through a dramatic expansion in area planted during the spring months (see 91 TEGUCIGALPA 12000). Although abnormally dry weather reduced output from initial projections, the overall harvest of basic grains during the 1991-92 cycle still grew by approximately 4 percent over 1990-91 levels. While the weather problems limited the expansion of corn production to 1 percent, the output of beans and rice increased by 7.1 and 24.4 percent, respectively. In addition, the production of nontraditional agricultural exports expanded significantly in 1991 in response to more favorable exchange rate policies. This was especially noteworthy for shrimp and lobster, the sector's most important nontraditional export products. These exports grew by 27 percent.

The construction industry rebounded from a sharp decline. This reflected accelerated free zone investment activities. It also reflected a partial recovery in residential housing construction in 1991. Following the March 1990 devaluation, housing construction plummeted due to escalating construction costs and a decline in speculative housing demand.

Manufacturing output remained virtually unchanged in 1991. Increased output by free zone companies was offset by declines in the production of previously protected firms, particularly textiles.

The financial sector grew as a result of enhanced profit opportunities for formal and semi-formal financial institutions. This was made possible by the liberalization of interest rates.

The service sector suffered a significant decline in output. This is not surprising. Falling relative prices of nontradeable goods (a common consequence of devaluation) and the liberalization of food prices squeezed service sector activities by raising costs and lowering real wages. It should be noted, however, that Honduran GDP figures are weak in estimating growth in the informal sector.

An expenditure breakdown of GDP indicates that private consumption levels increased marginally in real terms, while public consumption dropped sharply (a result of fiscal retrenchment). Both public and private investment expenditures increased significantly. The former was due to an expansion in both physical (particularly road construction and maintenance) and social infrastructure expenditures, while the latter reflected investment activities in the agricultural sector and in free zones.

C. Stabilization

The Central Bank of Honduras (BCH) improved its management of exchange rate policies in 1991 by exercising greater flexibility than in 1990. It reintroduced a self-financing mechanism which allowed exporters to retain up to 30 percent of their hard currency earnings to finance imports (a similar self-financing mechanism was used in the late 1980's). This sharply curtailed the speculative retention of dollar earnings by exporters, who had responded to the continuing overvaluation of the Lempira in 1990 by retaining foreign exchange outside the commercial banking system.

In addition the BCH legalized dollar-denominated bank accounts, and relaxed restrictions on the use of black market dollars to finance imports. Prior to March 1991, all imports (other than those covered by self-financing arrangements) which exceeded $5,000 could only be paid with dollars purchased through the commercial banking system. This lowered the demand for black market dollars. It also created a lengthy foreign exchange queue in the commercial banking system. As a result of negotiations with the IMF, this limit was raised to $10,000 in April 1991. Later that same month, the GOH unilaterally raised the limit to $25,000. In May it was eliminated.

Throughout most of 1991, the black market rate remained stable. This was despite the BCH's import liberalization policies and its decision to lower its share of interbank foreign exchange receipts from 50 to 40 percent. The GOH had informally agreed with the IMF to devalue if the black market rate exceeded the interbank rate by more than five percent. Stable monetary policies and strong foreign exchange earnings in the first two-thirds of the year kept the black market rate close to the interbank rate.

The Lempira's black market value slipped in the late fall due to a seasonal rise in import demand and a decline in export revenues. Eventually the selling rate for dollars approached six Lempiras -- more than ten percent above the interbank rate. The BCH responded by devaluing the interbank rate from 5.30 to 5.40 on October 31. Subsequently, the black market rate again stabilized, with the selling rate for dollars dropping to 5.7-5.8 by the end of the year.

In summary, the relative stability in the value of the Lempira in 1991 is related to the following factors: (1) stable monetary policies, (2) a decline in the speculative retention of export earnings, (3) a lower share of BCH hard currency purchases, (4) a change in expectations after the anticipated deterioration in the value of the Lempira failed to materialize in mid-1991, and (5) high nominal short-term Lempira interest rates relative to dollar-denominated rates. These factors combined to attract short-term capital inflows to Honduras, thereby reversing a decade-long trend.

The GOH exercised stable macroeconomic policies throughout 1991. This marked a major improvement over 1990 performance, when monetary and fiscal restraint were abandoned during the final quarter. The GOH complied with four of the five year-end performance targets specified in the modified IMF Standby Arrangement. The targets cover cumulative central government expenditures, net domestic financing of the public sector, BCH net domestic assets, BCH international reserves and arrears on external debt.

The only target the GOH did not meet was the limit on net domestic financing of the public sector, caused by a shortfall in projected external financing. Two IDB disbursements totalling $30 million (for cofinancing of the World Bank's Energy Sector and SAL II loans) were unexpectedly pushed back from 1991 into 1992. The IMF Board waived this target on February 14, 1992.

The BCH received a massive increase in dollar inflows during 1991. Net international reserves increased by approximately $90 million -- far more than the $44 million increase targeted in the Standby Agreement. The net international asset position of the BCH also improved significantly (see Table 2). This improvement reflects: (1) more flexible and realistic BCH exchange rate management, (2) high nominal interest rates, and (3) changing short-run expectations regarding the stability of the Lempira.

TABLE 2

Monetary Expansion, 1991
(Millions of Lempiras)

	Dec. 31 1990	Dec. 31 1991/p	Percent Change
A. Central Bank			
Total Net Domestic Credit	4,869.1	4,199.3	-13.8
Public Sector Net Credit	1,027.4	467.5	-54.5
Central Government	1,170.6	603.1	-48.5
Banking Sector	1,055.1	1,108.7	5.1
Net Other Assets	2,786.6	2,623.1	-5.9
Net International Assets	-3,411.3	-2,792.6	--
B. Consolidated Banking Sector			
Total Net Domestic Credit	5,762.7	4,867.3	-15.5
Public Sector Net Credit	1,309.7	1,121.9	-14.3
Central Government	1,911.3	1,802.4	-5.7
Private Sector	3,897.6	4,280.7	9.8
Net Other Assets	555.4	-535.3	--
Net International Assets	-3931.6	-2727.8	--
M1	1831.1	2139.3	16.8
M2	4674.1	5231.1	11.9

Speculative behavior on the part of exporters subsided in 1991. Sound macroeconomic policies generated widespread expectations of exchange rate stability. Some flight capital returned. With prudent monetary and exchange rate management, the economy weathered the traditional year-end surge in import demand without a dramatic deterioration in the Lempira's black market price. In fact, the Lempira's black market value stabilized and then began to strengthen from December 1991 to March 1992.

The BCH exercised conservative overall monetary policies during 1991. It responded with tight monetary policies to the initial inflationary impulse generated by excessive liquidity expansion in late 1990. These policies continued throughout the year (see Table 2). Relatively high rediscount rates and stringent rediscount line management restricted nominal BCH credit to the banking sector to 5.1 percent in 1991 (see Table 2). In this same year, the BCH agreed to enact a joint World Bank/Mission proposal mandating periodic adjustments in the minimum rediscount rate to keep it above the marginal cost to the banking system of mobilizing deposits.

BCH net credit to the public sector declined by over fifty percent during 1991. This, in part, reflected unexpectedly large central government revenues during the year. It also reflected large-scale commercial bank purchases of GOH bonds from the BCH (note that net banking system credit to the public sector fell by a much smaller percentage than did net central bank credit to the public sector). This is explained by excess liquidity in the banking system generated by the expenditure and credit expansion of late 1990 and the massive buildup of international reserves throughout 1991. It also reflected the dampening impact of interest rate hikes, changing inflationary expectations, and falling demand for credit by the depressed components of the Honduran economy.

The consolidated banking system's net other assets fell sharply in 1991. This was an accounting phenomenon related to the exclusion of CONADI (the publicly-owned holding company in the process of liquidation) assets from banking sector financial accounts.

It is noteworthy that the entire rise in the private liabilities of the banking system in 1991 was caused by the buildup of international reserves. Thus, the late year rise which occurred in both the narrowly- and broadly-defined monetary aggregates was not associated with strong downward pressure on the exchange rate. However, this may have a lagged effect on inflation during the first half of 1992.

The GOH maintained responsible fiscal policies during 1991. It complied -- albeit by a small margin -- with the December 31 fiscal target in the Stand-by Agreement. According to preliminary figures, the GOH avoided the last quarter surge in expenditures which wreaked havoc on monetary aggregates in prior years. This was despite intense pressures to increase expenditures in course of the year as the result of: (1) the April passage of a retroactive pay increase for all government employees, (2) an unprogrammed rise in social sector subsidies (most notably urban transport), and (3) a significant increase in spending on physical infrastructure (see Table 3).

TABLE 3

**Central Government Financial Accounts,
1989, 1990 and 1991
(Millions of Lempiras)**

	Jan. 1– Dec. 31 1989	Jan. 1– Dec. 31 1990	Jan. 1– Dec. 31 1991/P	Percent Change 1990–91
Current Revenues	1,532.4	2,021.4	2,837.2	40.4
Current Expenditures	1,893.1	2,391.8	2,966.8	24.0
Current Account Balance	-360.7	-370.4	-129.5	--
Capital Expenditures	406.9	460.1	592.3	28.7
Net Lending to Dec. Inst.	19.3	49.4	-48.9	--
Deficit	-786.9	-879.9	-673.4	--

The GOH maintained fiscal control by holding the line on current expenditures, in particular on goods and services. In nominal terms, expenditures on goods and services declined significantly, implying an even larger reduction in real terms. Whether this is the preferred option for achieving deficit reduction is open to serious question. Deep cuts in real expenditure levels for goods and services could imply a reduction in the quantity and/or quality of social and administrative services provided by the public sector. These cuts are hard to sustain over time.

The GOH could achieve large, sustainable cost savings by reducing the public sector workforce. Notwithstanding its obvious political costs, this approach may be the only viable way to assert permanent control over recurrent costs. The Finance Ministry insists on its commitment to employment reduction and is currently coordinating plans with other ministries to reduce staffing. However, progress on net employment reduction has been slow to date. This is despite the IMF's tacit agreement not to count severance payments to discharged public employees against the cumulative expenditure ceiling.

Expenditure stability in 1991 was complemented by stronger than expected fiscal revenues. Income tax receipts greatly exceeded expectations. The GOH underestimated the fiscal impact of increased income tax rates on medium-sized businesses enacted in 1990. It also underestimated the impact of the recent extension in coverage of the income tax withholding system. In addition trade and sales tax revenues rose moderately in relation to initial projections. The GOH shifted its collection of petroleum revenues toward tax levies and away from a complicated price differential on oil sales to the

TEXACO refinery and distributors. This shift resulted in a lower than projected rise in non-tax revenues. Total petroleum revenues lagged somewhat behind initial projections.

D. Structural Adjustment Policies

In 1991, the GOH made considerable progress in implementing its ambitious structural reform program. However, the adoption of some key elements of the program were delayed by a combination of political and bureaucratic constraints.

As part of satisfying the first tranche conditionality of the FY 1991 ESF program, the GOH gave the Mission a plan for improving agricultural policies. The most important part of the plan called for presentation of a sweeping agricultural modernization law to Congress in July 1991. Conflicts within the executive branch impeded rapid submission of the legislation. Subsequently, the GOH entered into lengthy negotiations with a broad range of producer and campesino groups in an effort to defuse potential opposition to some of the law's more controversial provisions (particularly those related to land tenure). This strategy paid off. The GOH submitted the draft legislation to Congress on December [illegible], 1991. It was passed on March 4, 1992.

The legislation contains many policy reforms Honduras needs to achieve substantial and sustainable economic growth in the 1990s (see TEGUCIGALPA 1268). Key provisions of the law are: (1) eliminate inefficient utilization as a basis for expropriation of privately-held land, (2) legalize land rentals, (3) legalize the titling of small parcels, (4) eliminate existing institutional impediments to the sale of land, (5) facilitate the clarification of legal rights to land whose ownership is under dispute, and (6) facilitate the issuance of fee simple titles to farm families occupying what is now public land.

In addition, the law institutionalizes several other fundamental reforms which liberalized pricing and marketing policies in 1991. It makes permanent the recent administrative removal of restrictions on the marketing of agricultural products. It prohibits the reintroduction of agricultural price controls. It replaces the traditional system of guaranteed prices for basic grains with a flexible price band system based on a variable tariff structure (applied to corn and rice imports in January 1992). In addition, it improves regulations governing ownership and control over forestry resources and prohibits State participation in: (1) logging activities, (2) wood product industries and (3) the marketing of timber and timber products. Complementary legislation will equalize the basic tariffs on all grains prior to the application of the price band.

The legislation also restructures and recapitalizes the financially insolvent public sector agricultural development bank, BANADESA (see 91 TEGUCIGALPA 13269). It sets the basis for the formation of a network of decentralized, privately-held rural financial institutions (*Cajas Rurales*). However, it does not specify either the level or nature of initial financial support these institutions would receive from the public sector. The World Bank, the IDB and the Mission are working with the GOH to come up with a financially viable solution to the rural finance problem which would: (1) restrict BANADESA's role to financing small farmers (while denying it access to any public sector subsidies) and (2) minimize the fiscal cost of new rural financial market development initiatives.

The GOH achieved significant progress in other areas related to agriculture in 1991. As noted above, it broke IHMA's (the State marketing board's) monopoly on the importation and commercialization of basic grains. Most price controls were eliminated. High visibility consumer items such as wheat flour and milk are no longer subject to explicit price controls. Only one relatively minor control now remains on low grade coffee. The GOH eliminated export and import controls on agricultural products. Moreover, IHMA rented four of its 14 grain silos, representing about ten percent of its storage capacity.

Another goal of the 1991 GOH Economic Program called for improving the investment climate. The GOH drafted legislation to improve the investment code and sent it to Congress in October 1991 -- prior to the November target date. Later, the draft law was withdrawn for modifications. At present, the GOH is seeking a private sector consensus in favor of the legislation prior to its resubmission to Congress. The GOH expects congressional approval of the law in April 1992.

The Mission believes this law will help attract the investment Honduras needs for increased exports and economic growth in the 1990s. The earlier version of this law called for liberalizing restrictions on the repatriation of earnings. It streamlined procedures for registering and operating both foreign and domestic businesses.

In 1991, progress on privatization was slower than anticipated. Bureaucratic delays and political controversy stalled the privatization process. In May 1991, the GOH committed itself to five privatizations by year's end. It completed three. The GOH divested its 40 percent ownership in TAN Airlines. This stock was purchased by TACA. The Finca Santa Rosa (agricultural land owned by CONADI) was sold to local investors for four million Lempiras. In addition, CONADI's 25 percent interest in INDECO (a construction firm) was sold to a local investor for L 750,000. A cement company, INCEHSA, was sold to the Military Pension Fund (however we do not count this as a privatization).

However, the privatization process accelerated in 1992. This is due, in large part, to a growing concern by the GOH economic authorities about delays in meeting privatization objectives. They responded by changing the leadership of CONADI. The new leadership started off well. In January, the GOH completed the privatization of the CONADI-owned hotel complex, Villas Telemar, for L 6,500,000. In March, the GOH sold Lácteos Sula, a BANADESA company, for L 17 million. These satisfy the privatization target of five companies supported by the FY 1991 ESF Program. Another BANADESA company, Leche Plahsa, was leased for five years at approximately L 53,000 per year (with increments of about ten percent in later years). In addition, the GOH privatized a manufacturer of steel structures, Aceros Industriales.

The GOH also made progress in privatizing other public sector activities. As noted earlier, IHMA rented some grain silos as a first step toward privatization. In addition, the Ministry of Communications and Transport, SECOPT, shifted most road maintenance to the private sector. Privatization activities have also been initiated in the Ministry of Health and the Ministry of Economy. The latter plans to privatize the Puerto Cortés Free Zone.

The GOH continued to implement a comprehensive tariff reduction program. In March 1990, it dramatically compressed the range of nominal tariffs from 0-90 percent to 2-40 percent. Moreover, it reduced the maximum surcharge from 35 to 15 percent. In addition, the GOH committed itself to further reduce tariff dispersion to 4-35 percent in January 1991 and to 5-20 percent in January 1992. It carried out these actions on schedule. Moreover, with only one minor exception, the GOH stuck to its commitment to eliminate customs exonerations.

Finally, the GOH implemented a number of financial market liberalization measures in 1991. It freed up all agricultural lending rates, other than those for basic grains. In addition, it raised rediscount rates significantly and restricted rediscounting operations.

E. Social Sector Performance

The impact of the GOH economic reform program on vulnerable social groups is an issue of widespread interest. In particular, the dramatic inflationary surge following devaluations and monetary expansion in 1990 sparked debate and controversy. The cost of the basic consumption basket rose by approximately 90 percent between 1989 and 1991. Rises in food prices and lags in nominal wage and salary corrections in the course of an adjustment program aggravate urban poverty. The major losers from price increases are lower and middle class urban consumers. These price shifts can also negatively affect rural families who are net purchasers of foodstuffs.

However, there are some offsetting factors. The improved fiscal and exchange rate policies adopted in 1991 have significantly reduced inflationary pressures. In the past six months, the overall consumer price index increased at an annualized rate of only 6 percent. In addition, the significant rise in relative agricultural prices of the 1990-91 period increased agricultural investment and production, thereby benefitting the poorest Hondurans -- those in rural areas.

With this in mind, we analyzed data from the Honduran Planning Ministry's biannual household survey in order to assess recent poverty trends (see Tables 8 and 9 in the Statistical Appendix). Per capita household income figures from the survey were compared with annual data on the cost of the basic consumption basket. This allowed us to assess changes in both the incidence and intensity of poverty in recent years. The former measures the percentage of the population below the poverty line, while the latter measures the volume of resources which would have to redistributed to them in order to allow them to reach that line (the poverty gap).

Given probable inconsistencies in surveying and data aggregation practices over time, the reliability of the results is subject to some degree of uncertainty. These problems, for example, make it impossible to disaggregate poverty trends among urban and rural households. Nonetheless the aggregate trends revealed by the data are worth reviewing. The figures indicate a significant increase in both the incidence and intensity of poverty in Honduras over the past three years (data for previous years are not available).

The percentage of the population below the poverty line increased from approximately 65 percent in June 1988 to about 74 percent in May 1991. Most of that increase occurred between 1988 and 1990. This is somewhat unexpected, given that the major inflationary surge occurred during 1990 and early 1991. However, data on the size of the poverty gap indicate that the intensity of poverty for those below the poverty line increased most rapidly during the 1990-91 period, when it reached 3.7 percent of GDP.[5] It should be noted that the latest data are from May 1991. This predates the recent deceleration of inflation.

The above indicates that poverty in Honduras has probably worsened over the past few years, both in terms of incidence and intensity. This is not surprising, given that real per capita GDP growth stagnated over the 1988-90 period, while food prices accelerated sharply. Hopefully this trend will reverse itself over the next few years, as the poorer elements of Honduran society begin to experience the benefits of an economic reform program designed to: (1) stabilize prices over the medium term and (2) stimulate a sustainable expansion in employment and earnings opportunities.

In order to partially shelter vulnerable social groups from the negative immediate impacts of its adjustment program, the GOH attempted to stabilize social expenditure levels. The most recent budget figures show that health and education outlays fell slightly as a share of GDP during the 1989-91 period (see Table 7 in the Statistical Appendix). Real per capita expenditures on health and education fell by about 11 percent during the same period. However, the GOH enacted a number of short-term employment generation and income transfer programs in 1990 designed to supplement the income and consumption levels of poverty-prone groups. Thus the percentage of total GOH expenditures devoted to social welfare programs actually increased from 27.5 percent in 1989 to 31.2 percent in 1991. Real per capita expenditures on these programs rose by 4.1 percent during the same period.

In addition, the National Congress approved a series of minimum wage increases. These reversed a decade-long downward trend which reduced the real value of the minimum wage by about 36 percent between 1981 and 1989. During the 1990-91 period, the minimum wage increased by 15 percent in real terms. As a result, the real value of the minimum wage returned to its 1987 level. It should be noted that effective coverage is limited to the public sector and the more highly visible segments of the private formal sector (multi-nationals and larger-scale domestic manufacturing and commercial operations). Nevertheless, the recently legislated increases in the minimum wage represent one component of a social safety net program designed to cushion the real incomes of vulnerable social groups.

Data are not available which would allow us to monitor aggregate and sectoral trends in real wage levels. However, a successful devaluation necessarily implies that real wages fall in terms of tradeable goods and rise in terms of nontradeables (the real effective exchange rate in Honduras fell by approximately 23 percent during the 1989-91 period). Assuming that the consumption basket of low income wage-earners is weighted towards tradeables, this means that the real wage earnings of that group should fall in the short run following a real devaluation (consistent with the poverty trends cited above).

Eventually the reallocation of resources stimulated by structural adjustment policies should lead to higher levels of employment and labor productivity. This, in turn, will enable real wages to rise over time, without causing a deterioration in the economy's international competitive position. In addition, since the shift in resource allocation favors a relatively labor-intensive sector (that is agriculture), this means that labor's share of national income should increase over time.

III. FY 1992 ESF PROGRAM

The FY 1992 ESF Structural Adjustment Program (SAP) represents a major change in the focus of ESF support to Honduras. Unlike past programs, the SAP supports a multi-year agenda of GOH economic reforms. It emphasizes policy improvements in three key sectors: agriculture, finance, and trade and investment. This PAAD sets the objectives for these sectors, a strategy for achieving them, and a negotiating agenda for 1992.

A stabilization component is also included in the ESF program. This is due to: (1) the importance of a sound stabilization program to structural reform efforts and (2) frequent slippages by the GOH in abiding by its past stabilization commitments. However, the Mission expects the IMF to play the lead donor role in this area.

A. Justification for FY 1992 ESF Support

The Mission believes that the GOH needs continued ESF support in FY 1992. This support is justified by four factors: the strength of the GOH economic reform program, the deteriorated condition of the Honduran economy, the need to bolster fragile domestic support for the program, and the existence of a large financing gap.

FY 1992 is an especially important year for continued ESF support. We want the GOH to maintain its economic reform program. Despite remarkable GOH progress in stabilizing its economy and achieving deep structural reforms, domestic support of these reforms is fragile. This is to be expected, because a positive response to reforms normally takes time. After two years of the reform program, the economy is only beginning to show a favorable response. Continued A.I.D. support is needed to help the GOH maintain the resolve to implement economic reforms (see the Issue in section I.C. of this PAAD). While other donors have come forward with considerable support of the GOH Economic Program, the flows are still not positive. USAID projects a large financing gap in 1992 (see Annex 2). Without A.I.D. support, we believe that the programs of other donors are inadequate to maintain the GOH resolve to continue its comprehensive reform program.

B. Objectives of the GOH Economic Program

This section presents the objectives and strategy of the three year FY 1992-1994 Structural Adjustment Program (SAP). It also presents the elements of the 1992 GOH Economic Program to be supported with ESF resources. The objectives and strategy of the three year SAP are summarized in Annex 3. A matrix summarizing the 1992 GOH Economic Program to be supported with ESF resources is presented in Annex 1.

The overall objective of the FY 1992-1994 SAP is for Honduras to achieve sustainable economic growth. To achieve this objective, the GOH must make deep structural reforms, stick to its stabilization program and mobilize additional support.

1. Economic Growth

As explained in the simulation model in Annex 2, the Mission believes the Honduran economy can achieve an average growth rate of 3.5 percent over the three year period from 1992 to 1994. This is a fundamental objective of the SAP. Our growth objective for 1992 calls for a GDP increase of 3.0 percent. In large part, this growth will hinge on improved performance by the agricultural sector. As in 1990 and 1991, the industrial sector is expected to be adversely affected (in the short-run) by the transformation to a more market-oriented economy.

2. Structural Adjustment

The SAP sets structural adjustment objectives for the three sectors encompassed by this program: agriculture, finance, and trade and investment. In addition, the SAP supports the GOH stabilization program. The achievement of these sectoral objectives is fundamental to attaining the economic growth objective.

The overall agricultural sector objective is for its growth to average at least 3.5 percent from 1992 to 1994 (compared to an average annual agricultural growth rate of 1.7 percent during the 1980s). Without a sharp increase in the agricultural growth rate, it would be virtually impossible to achieve the overall GDP growth targeted by the SAP.

The Mission has also set two agricultural policy objectives. Their achievement would greatly facilitate attainment of the sectoral growth target. The two policy objectives are: (1) clarify land tenure rights and liberalize the functioning of land markets, and (2) liberalize agricultural product markets and eliminate agricultural trade controls.

The second sectoral component of the SAP focuses on the financial sector. The principal financial sector objective calls for a large increase in domestic saving. As explained in the Mission's simulation model (see Annex 2), a substantial improvement in the performance of the Honduran economy is closely linked to a large increase in domestic savings. The overall objective of the financial sector component of the SAP is to increase the share of domestic savings in GDP (this share is estimated at 7.4 percent in 1991) to 10.3 percent in 1992, 11.5 percent in 1993 and 12.6 percent in 1994.

In order to increase domestic savings, the SAP sets five policy objectives: (1) strengthen the soundness of the Honduran financial system, (2) eliminate forced domestic banking system financing of the public sector, (3) allow private sector credit to be allocated by market criteria, (4) enable the financial system to generate medium and long term savings and to channel these savings to economically and financially viable activities, and (5) develop competitive, private sector-based rural financial markets.

The third sectoral component of the SAP focuses on trade and investment. This component has three objectives: (1) progress toward a transparent system of trade taxes with low rates and low dispersion, (2) enhance access of Honduran products to international markets, and (3) improve the investment climate.

3. Stabilization

In order to fully benefit from structural reforms, the GOH must follow sound stabilization policies. This means reducing the public sector fiscal deficit, keeping domestic financing of the deficit low and building up international reserves. These are objectives of the SAP.

4. Donor Support

As in past years, the Mission recognizes the need for broad donor support of the GOH economic reform program. Without ample donor financing, the GOH cannot maintain the pace of its reforms and, at the same time, achieve economic growth. An objective of the SAP is to obtain sufficient donor support to achieve the GDP growth objectives.

C. SAP Strategy and Policies Supported by the FY 1992 ESF Program

The strategy of the SAP and the measures included in the FY 1992 ESF Program recognize that we are but one of several donors supporting the 1992 GOH Economic Program. In our discussions with other donors, we have carefully limited our support to parts of the GOH reform effort where we believe we can be most effective.

As explained in our CDSS, the SAP focuses on three sectors: agriculture, finance, and trade and investment. While the SAP also includes a stabilization component, we want the IMF to play the lead role in this area.

There are other areas not directly addressed in the SAP which, nevertheless, need policy reforms. These include (but are not limited to) energy sector reforms, transport sector reforms, environmental protection, international property rights and improved public sector efficiency. These areas form parts of the policy dialogue being carried out by other donors, by other parts of the USAID Program and by other parts of the U.S. Mission.

The FY 1992 ESF Program focuses heavily on approval of the implementing regulations and carrying out of two major laws: the agricultural modernization law and the Investment Law. We expect these laws to form a cornerstone for economic growth in the 1990s.

During the last two years of the Callejas administration, the Mission will help the GOH consolidate its achievements. In January 1992, the Callejas administration entered the second half of its term -- a time when Honduran governments traditionally avoid controversial decisions and turn their attention to politics. The passage of the agricultural and investment laws and approval of their implementing regulations are the most important -- and the most difficult -- actions the Mission expects the GOH to undertake in 1992. We are encouraging the GOH to complete these actions as early as possible this year. This must be done prior to the heightening of the political debate. The FY 1992 ESF Program will also support important, but less controversial, structural adjustment measures. These will encourage major financial sector reforms, continued improvements in trade policy and the privatization of state-owned enterprises.

1. Agriculture

In order to achieve the targeted agricultural growth rate for the SAP period, the Mission's 1992-1994 strategy will have two elements:

(1) Implementation of the comprehensive agricultural modernization law which was passed on March 4, 1992. This law provides the property rights needed for a significant and sustainable increase in agricultural production, exports, incomes and employment. This is the most crucial element in the joint strategy of the World Bank, the IDB and the Mission to improve agricultural performance. We expect timely approval of the law's implementing regulations and the initiation of actions to carry out the law. These actions comprise the reforms sought by the agricultural sector component of the FY 1992 ESF Program.

Seven of these actions call for liberalizing land markets. All are addressed in the agricultural modernization law. The seven land tenure items are:

- reduce the causes for expropriation to two: exceeding the legal landholding size limits and having land idle for more than 18 months (24 months in exceptional circumstances);
- protect all forest land against expropriation;
- legalize rental of titled land;
- eliminate lower size limit on titling;
- authorize conversion of restricted titles to fee simple titles;
- reduce time restrictions on titling eligibility; and
- protect "pro indiviso" land against expropriation.

(2) The agricultural component of the SAP also focuses on the establishment and maintenance of an agricultural pricing and trade regime which reflects competitive market forces. This will build on progress the GOH has already made in this area.

The 1992 program calls for the elimination of all import and export controls on all agricultural inputs and products with the exception of health and sanitary controls. The latter are not meant to constitute economic impediments to free trade. The GOH agreed to eliminate the last price control on agricultural products (on low grade coffee). Furthermore, it committed itself to no price interventions or subsidies -- explicit or implicit -- by the State in agricultural markets.

The Mission's agricultural strategy uses both the SAP and PL-480 Self-help measures to encourage the GOH to make important sectoral reforms. These programs were designed to be complementary.

2. Trade and Investment

The trade and investment component of the SAP calls for improving the trade regime, the investment climate and enhancing access of Honduran products to international markets. The strategy breaks down into two thrusts:

(1) The first thrust calls for improving the trade regime. By the end of the SAP in December 1994, the Mission expects the GOH to have: (A) a maximum import tariff (including surcharges, if any) of no more than 20 percent, (2) a spread between the maximum and minimum tariff of no more than 15 percent, (3) no surcharges on imports, and (4) no export duties, except on bananas. Our strategy also calls for GATT membership by the end of 1994. If appropriate, we will encourage Honduran participation in regional trade agreements.

As part of the 1992 program, we support a GOH decision to lower the maximum import duty (excluding surcharges) from 35 percent to 20 percent and to raise the minimum duty from 4 to 5 percent. This was done on January 1, 1992, making Honduras the first Central American country with a maximum import duty of 20 percent.

(2) The second focus of the trade and investment component calls for improving the investment climate. Without a new and vastly improved investment code, it would be exceedingly difficult for the GOH to obtain the foreign and domestic investment it needs to achieve the modest growth targets set out in the Mission's simulation of the Honduran economy.

The most important action in this area is approval of the implementing regulations of the Investment Law which Congress is expected to pass in April 1992. We expect approval of the implementing regulations, which are being jointly prepared with the draft law, early in 1992. The new investment code should cover all economic activity in Honduras. These regulations should encompass transparent rules, treating all private enterprises equally. The provisions of the law and the implementing regulations should:

- guarantee access to foreign exchange for business operations;
- reduce existing administrative procedures regulating investments without creating new ones;
- eliminate restrictions on the remittance of dividends, royalties, and profits generated by investments;
- reduce and clearly define restrictions on the percentage of foreign business ownership;

- provide for equal treatment of foreign and domestic investment in areas open to foreign investment;
- repeal legislation and regulations in conflict with the new investment code;

The 1992 program also calls for continuing the GOH privatization process. The GOH agreed to privatize five state-owned enterprises in 1992 -- over and above the two it privatized in January 1992 to satisfy FY 1991 ESF conditionality.

3. Finance

In 1991, the GOH carried out a detailed evaluation of the Honduran financial system (the evaluation was financed by USAID). It sets a basis for a program to improve the performance of the financial system. Implementation of this program is necessary to increase domestic savings enough to attain the overall growth targets set out in the simulation of the Honduran economy into the 1990s.

The financial sector program will follow five thrusts:

(1) Preparation, approval and implementation of legislation and the regulations needed to strengthen the supervision of the banking system.

As part of its 1992 Economic Program, the GOH has agreed to draft and present to Congress legislation to strengthen the supervision of the banking system.

(2) Introduction of the use of open market operations by the Central Bank of Honduras (BCH) as an instrument of monetary policy.

The GOH has agreed to initiate open market operations as part of the reforms to be supported by FY 1992 ESF resources. The IDB also may negotiate conditionality in this area as part of its multi-sectoral credit loan.

(3) Elimination of the reserve requirement as an instrument to force subsidized banking system financing of the public sector. The fiscal impact to the central government of removing this subsidy will be partially offset by using ESF-generated local currency to retire GOH internal debt.

This strategic thrust seeks to generate more savings and improve the efficiency of the Honduran banking system. The former will be accomplished by discouraging BCH rediscount operations, which depress interest rates paid on domestic savings and, as a consequence, reduce the supply of savings. This strategy will improve the efficiency of the Honduran banking system by allowing credit to be allocated on the basis of market principles, rather than through BCH-administered directed credits.

The GOH agreed to lower the legal reserve requirement from 35 to 30 percent in 1992. This will be done gradually on a timetable to be negotiated jointly with the IMF, the IDB and USAID.

In order to avoid an inordinate amount of credit expansion as a result of a lower reserve requirement, the BCH will restrict the amount of rediscounted funds made available to financial intermediaries. To help the BCH accomplish this, we will support a BCH commitment to raise the cost of all rediscounted funds to at least the maximum cost of savings generation to financial intermediaries.

The 1991 program also supports a GOH commitment to unify the administration of all rediscount operations in the BCH. This will give the monetary authorities more effective control over the monetary policy. The World Bank also supports this measure.

(4) The Mission's strategy in the SAP also calls for creating conditions necessary to promote long-term savings and lending.

In order to free up international capital flows, the Mission is supporting a GOH program to legalize foreign exchange trading by foreign exchange houses. The GOH Congress approved legislation to legalize foreign exchange houses on February 13, 1992.

(5) The SAP strategy encourages financial deepening and agricultural growth through the accelerated development and strengthening of rural financial markets. This strategy will be carefully coordinated with the agricultural sector program.

In 1992, the Mission will support programs by the World Bank and IDB in this area.

4. Stabilization

The Mission wants the IMF to keep its lead role in negotiating and following up on the GOH stabilization program. We will assess the viability of IMF projections, discuss the projections with the IMF, monitor GOH progress in this area, and encourage the GOH to comply with targets in IMF-supported programs. GOH compliance with IMF-supported stabilization measures form part of SAP conditionality.

The Mission does not, however, expect to negotiate a stabilization program with the GOH. Only if the GOH falls out of compliance with its IMF program and the two sides cannot reach agreement on a Fund-supported program, the Mission might consider a more active role in this area.

D. Tranching of ESF Disbursements

The Mission proposes to disburse the ESF grant in two equal tranches. Targeted disbursement dates are July and the last fiscal quarter in 1992.

E. Use, Monitoring and Audit of Dollar Resources

1. Use of Dollar Resources

The Central Bank of Honduras (BCH) will establish Separate Accounts at commercial banks in the United States chosen by the BCH as its correspondent bank(s). Dollar funds provided for balance of payment support will be deposited into the Separate Account(s) in the designated correspondent banks(s). The Separate Account(s) will be interest bearing and 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 disbursements.

The use of the Separate Account(s) complies with U.S. law. It will provide accountability for these funds, and precludes the commingling of balance of payments support funds with the Central Bank's other foreign exchange resources. Funds deposited in the Separate Account(s) and interest generated by such funds may be used to finance CIF value of private sector imports, except for materials and equipment which could cause significant tropical deforestation, from the U.S. falling in the following classifications:

- agricultural inputs (with the exception of pesticides)
- capital goods
- intermediate goods
- spare parts
- petroleum products

2. Monitoring and Audits

a. Monitoring

The Mission's Office of Economic and Program Analysis is responsible for the overall monitoring of ESF Dollar Cash Transfer Programs. The Office of the Controller, Financial Analysis and Review Section (CONT/FARS), monitors the utilization of ESF dollars transferred to the Government of Honduras (GOH). It ensures that the funds are deposited and can be tracked from the Separate Account(s) to their final use and that program funds are properly managed and accounted for in accordance with the ESF Agreements.

CONT/FARS verifies that ESF disbursements are deposited in uncommingled interest-bearing account(s) and that the BCH has in place adequate operating procedures for the

Separate Account(s). The BCH provides the Mission with periodic reports showing the uses of both the dollar deposits and interest generations, and monthly bank reconciliations supported by copies of bank statements for each Separate Account. The BCH also is required to establish and maintain files for each transaction funded from the Separate Account(s). Each file contains documents which support the transaction's eligibility, establish that payment has been made and demonstrate that commodities have been cleared through Honduras's customs and have entered the economy.

The BCH is authorized to make disbursements from the Separate Account(s) to finance eligible transactions through direct payments (letters of credit or collections/suppliers's credit) and reimbursements to the BCH or to local commercial banks. Our close monitoring of the Separate Account(s) helps the BCH to manage the accounts correctly and ensures that ESF dollars are used for agreed upon purposes.

Our May 1991 General Assessment disclosed that the BCH has in place adequate internal control systems to account for and manage the ESF dollar cash transfers deposited in the Separate Account(s). Given the Mission's interest and dedication in assuring that the GOH is maintaining an adequate accountability environment, the Mission is plans to update its General Assessment in FY 1992.

b. Audits

In line with Agency guidance and USAID's objective of strengthening GOH accountability, the Controller General of Honduras (CGH) will annually perform audits of the Separate Account(s) established under ESF Dollar Cash Transfer Programs in accordance with GAO standards. The Mission believes that the CGH has the capability to perform financial audits in accordance with the GAO standards. In the past, the CGH has not been able to perform audits of USAID projects due to untrained personnel and inadequate resources. However, USAID Project No. 522-0338, Assistance to the Controller General of Honduras, has helped to improve the CGH's policies, systems, procedures and personnel. As a result, the CGH has already performed audits of GOH organizations managing USAID projects. These audits have demonstrated a much improved audit capability of the CGH. The RIG/A/T is currently reviewing the CGH's audits and evaluating their adequacy. We expect this review to confirm our assessment of the CGH's capability.

In order to verify the CGH audits as well as provide the CGH with additional guidance, the Mission will also contract through the Non-Federal Audit Program, qualified independent audit firms to perform annual audits of the ESF dollar Separate Account(s). We will follow-up on the results of these audits in order to assure that all recommendations are closed by the BCH in a timely manner. The Mission's FY 1992 Non-Federal Audit Program includes an audit of the ESF dollar Cash Transfers made to the GOH. Host country-owned local currency funds generated by the program will be used for funding these audits.

F. Programming and Accountability of Local Currency Resources

1. Programming

Based on the results of our May 1991 General Assessment of the GOH's capabilities to manage A.I.D.-funded local currency programs, the Mission has determined that use of the four programming options of Specific Sector, General Sector, and General Budget Support, and A.I.D. Trust Funds is justified. The General Assessment found that GOH budgeting and financial management systems were adequate to assure that both U.S. dollars and local currencies associated with U.S. assistance are used for intended purposes and that therefore there is a high degree of confidence in GOH's accountability environment. The Mission is assisting the GOH to improve its evaluation program to make sure funds have the intended impact.

The Mission plans to program funds in the following order of priority (programming options are in parentheses):

1. GOH counterpart to A.I.D./GOH bilateral projects (Specific Sector Support)

2. Eighteen month reserve for A.I.D. Trust Fund needs (A.I.D. Trust Fund)

3. Budget support to reduce the GOH's internal debt (General Budget Support)

4. Counterpart to other donor, GOH and PVO projects (Specific Sector Support)

5. Budget support to help meet requirements of particular sectors or ministries of the GOH (General Sector Support)

After providing for our highest priority needs, the Mission plans to exercise the programming option of General Budget Support to specifically respond to a GOH request to assist in reducing its domestic debt, thereby easing the budgetary burden to the GOH of reducing the reserve requirement (see Section III.C.3. of this PAAD). Lastly, we anticipate that General Sector Support and programmed local currencies may be necessary to fund GOH activities implemented by PVOs.

2. ESF Local Currency Program Monitoring

The Office of Development Finance manages the Mission's local currency program and CONT/FARS assists it in the financial monitoring of local currencies. CONT/FARS has both the experience and adequate staff to do so. Therefore, the Mission has determined that it will not require supplemental technical assistance.

3. Accountability

Our May 1991 General Assessment concluded that the GOH has adequate accounting and internal control systems to ensure that the funds deposited in the Special Account can be tracked to their final use, as described below.

a. Special Account Management

The Ministry of Finance and Public Credit (MFPC) is the GOH agency responsible for the management of the Special Account. Upon receipt of ESF dollars, the BCH transfers to the MFPC an amount of local currency equivalent to the dollar disbursement. To assure that local currency generations are not commingled with other GOH resources, the funds are deposited into a Special Account for the Program at the BCH in the name of the MFPC. This account is non-interest bearing in accordance with Honduran law.

The May 1991 General Assessment disclosed that the MFPC uses standard accounting practices and that their accounting system is adequate to control, account for and manage the local currency funds deposited in the Special Accounts. The Mission's update of the General Assessment planned for FY 1992 will include a review of the MFPC's overall monitoring capabilities including the ability to arrange for or perform financial assessments and audits of recipient organizations when the funds are used to support local currency projects.

The MFPC reports monthly to AID on all local currency deposits and withdrawals from the ESF Special Account by budget line item. The MFPC also provides Special Account bank statements and corresponding reconciliations. The Mission reviews these reports to ensure that funds have been disbursed for agreed upon purposes, and issues monthly status reports detailing the amounts programmed, disbursed and available under each Program's Special Account. Annually, we verify a sample of the documentation supporting disbursements made under each local currency ESF Program.

The Mission will assure that the Special Account is audited periodically. These audits may be performed by an independent firm, the CGH or other acceptable audit entity. As indicated in Section III.E.2.b., the Mission believes that the CGH has the capability to perform these financial audits, and RIG/A/T is verifying this. In the event that the CGH cannot perform these audits, the Mission will require the MFPC to contract independent audit firms to perform them. If necessary, the Mission will use jointly programmed local currency generations to contract qualified independent audit firms to perform audits through the Non-Federal Audit Program.

b. Assurance that Local Currencies are Properly Used

The 1991 General Assessment found that the MFPC has the capability to assume monitoring responsibilities for local currency programmed for budget support at the

Specific Sector, General Sector, and General Budget Support levels and for extra budgetary support at the Specific Sector level.

Should the Mission and the GOH want to program funds for extra budgetary support, the MFPC will be required to perform or arrange for performance of financial assessments and audits of the recipient organizations. If necessary, the Mission will arrange for these financial assessments and/or audits by either contracting independent firms, requesting CGH or RIG/A/T audits. In addition, CONT/FARS will also perform financial reviews, as needed.

c. Performance Indicators

Most funds are to be programmed towards the GOH's contribution to its bilateral projects with A.I.D. These projects include appropriate performance indicators, as do other donor projects. For General Sector and General Budget Support, the Mission and the GOH will develop appropriate performance indicators which will be identified and discussed in local currency programming Implementation Letters or other subsequent agreements.

IV. CONDITIONS AND COVENANTS

A. Conditions Precedent to the First Disbursement

Prior to the initial disbursement of the Grant or to the issuance by A.I.D. of documentation pursuant to which such disbursement will be made, the Grantee shall provide to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agrees in writing:

1. A written opinion of counsel acceptable to A.I.D. that this Agreement has been duly authorized and/or ratified by, and on behalf of the Grantee, in accordance with the laws of the Republic of Honduras, and that it constitutes a valid and legally binding obligation of the Grantee in accordance with all its terms.

2. A statement of the names of the persons holding or acting in the office of the Grantee, together with a specimen signature of each person specified in such statement.

3. Evidence that the Grantee has established the Separate Account (s) in the United States for ESF dollar disbursements, and that, unless A.I.D. otherwise agrees in writing, it has furnished an evidence, in form and substance satisfactory to A.I.D., describing the mechanism by which funds will be disbursed from the account. The disbursement mechanism should include requirements for supporting documentation for each transaction funded from the separate account which indicates the transaction's eligibility, establishes that payment has been effected, and, as applicable, demonstrates that commodities have been cleared through customs and have entered the economy. This supporting documentation will permit monitoring of disbursements and requirements for periodic reports to A.I.D. or disbursements from the account.

4. Evidence of progress in preparing the implementing regulations for the Agricultural Modernization Law.

5. Publication of the implementing regulations for the Investment Law in <u>LA GACETA</u>.

6. Evidence of progress in implementing financial sector reforms.

7. Evidence of progress in implementing the tariff reforms in Decree 18-90 of March 1990.

8. Evidence of progress in meeting the principal objectives and targets of Honduras' stabilization program supported by the International Monetary Fund.

B. Conditions Precedent to the Second Disbursement

Prior to the second disbursement of the Grant or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made, except as A.I.D. may otherwise agree in writing, the Grantee shall provide to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing:

1. Publication of the implementing regulations for the Agricultural Modernization Law in LA GACETA.

2. Evidence of progress in carrying out the Investment Law.

3. Evidence of progress in implementing financial sector reforms.

4. Evidence of progress in implementing the tariff reforms in Decree 18-90 of March 1990.

5. Evidence of progress in implementing Honduras' privatization program.

6. Evidence of progress in meeting the principal objectives and targets of Honduras' stabilization program supported by the International Monetary Fund.

C. Covenants

The Grantee covenants that, unless A.I.D. otherwise agrees in writing, it will:

1. Upon each ESF disbursement, deposit into a Special Account in the Central Bank of Honduras established for this Program, the Lempira equivalent of each disbursement. The Lempira disbursement will be calculated by using the highest rate of exchange which, on the date of disbursement, is not unlawful in Honduras. These Lempiras will be programmed for such purposes as will be mutually agreed upon in writing by the Grantee and A.I.D. within 120 days from the dates of deposits.

2. Maintain current its interest payments and installments of principal, and 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 United States of America or any of its agencies.

ANNEX 1

ADJUSTMENT MEASURES TO BE SUPPORTED WITH ESF ASSISTANCE IN 1992

Component	First Tranche	Second Tranche
1. Agriculture	A. Preparation of transparent implementing regulations for at least half the key measures contained in the Agricultural Modernization Law B. No price interventions or subsidies by the State in agricultural markets	A. Completion and approval of the implementing regulations for the Agricultural Modernization Law B. No price interventions or subsidies by the State in agricultural markets C. Congressional approval of a uniform import tariff (prior to application of price band) on basic grains and wheat
2. Trade and Investment	A. Approval of transparent implementing regulations for the investment code which: - guarantee access to foreign exchange purchase for business operations - reduce existing administrative procedures regulating investments without creating new ones - eliminate restrictions on remittances of dividends, royalties and profits generated by investments - reduce and clearly define restrictions on foreign business ownership - provide for equal treatment of foreign and domestic investment in areas open to foreign investment - repeal legislation in conflict with the new investment code B. Implementation of a minimum import tariff of five percent and a maximum tariff of 20 percent C. No new customs exemptions	A. Satisfactory progress in implementing the investment code B. Five privatizations in addition to those implemented as part of the 1991 program C. No new customs exemptions
3. Financial Sector	A. Agreement to lower the reserve requirement to 30 percent in 1992 B. All BCH rediscount rates must be at least as high as the marginal cost of savings movilization by the banking system 1/ C. Unify administrative operations of BCH rediscount lines D. Congressional approval of legislation which allows foreign exchange trading by foreign exchange houses	A. Satisfactory progress in lowering the reserve requirement B. Presentation to Congress of legislation to improve the regulation and supervision of the banking system C. Initiate open market operations D. Approval of implementing regulations which permit foreign currency trading by foreign exchange houses E. Incorporation of pension funds in the system of supervision by the Superintendency of Banks
4. Stabilization	Satisfactory progress in implementing an IMF-supported stabilization program	Satisfactory progress in implementing an IMF-supported stabilization program

1/ This is to be accomplished by using the following formula to set a floor under rediscount rates:

$$r = \frac{I_r}{1 - e} - (K * I_b)$$

where: r = the floor rediscount rate
I_r = average of the highest interest rate paid by each bank on all deposits
e = the legal reserve requirement
K = the proportion of required reserves held by banks in bonds
I_b = interest rate paid on bonds elegible to be held as required reserves

ANNEX 2

SIMULATION OF THE HONDURAN ECONOMY THROUGH 1998

This annex reviews the Mission's latest medium-term scenario of the Honduran economy. The assumptions of the simulation model used to generate the scenario and an explanation of how the model works is described in the Mission's CDSS (reviewed in Washington in June 1991). The FY 1992 ESF Concepts Paper contains a shorter explanation of the model's characteristics. As mentioned in these documents, the model is not a forecast. It serves as a framework for analyzing the consequences of interrelationships between economic policies and exogenous factors in the context of a model based on national accounts.

The latest scenario of the Honduran economy is more optimistic than the scenario in the FY 92 ESF Concepts paper (presented in Washington in November 1991). Since the presentation of the Concepts Paper, the GOH has improved its economic performance. For the first time in more than ten years, it brought the public sector fiscal deficit under control. The exchange rate stabilized. Moreover, the GOH Congress passed two major pieces of legislation: the Agricultural Modernization Law and the Investment Law.

Policy improvements are beginning to yield small positive results. In recent months economic indicators are showing signs of recovery. GDP grew modestly in 1991 and higher GDP growth is expected in 1992.

The most important changes in the scenario presented in this annex as compared with the version in the Concepts Paper are the following:

- Projected GDP growth for 1992 is raised from 2.5 percent to 3.0 percent (see the summary table of the scenario at the end of this annex). The GOH projects this growth at 3.5 percent. While the latter growth rate is attainable, we believe 3.0 percent is more likely.

- Gross international reserves are higher in the latest simulation. There was a large build-up of reserves at the end of 1991. We expect them to continue increasing faster than originally anticipated. The latest scenario projects gross reserves to reach the equivalent of three months of imports by 1997. In the previous scenario, international reserves were projected to increase to two months of imports in 1997.

- The debt indicators are much more favorable for Honduras in the current scenario. Unlike the previous version, this simulation fully incorporates the favorable impacts of Honduras' eligibility for highly concessional financing. The World Bank declared Honduras an IDA-only country. This allows Honduras to use IDA reflows to service interest on IBRD loans (the latter have market-based interest rates). This provides substantial debt relief. It allows the burden of Honduras' external debt to decrease through time. For example, the scenario in the Concepts Paper projected the external debt to GDP ratio at 103 percent in 1998. The latest scenario reduces this to 83 percent.

- ESF levels are estimated at $50 in FY 1992 and straight-lined at $30 million from 1992 to 1995. Then, these disbursements are projected to decrease gradually to $20 million in 1996, $10 million in 1997 and zero in 1998 (Note that the table on the next page only counts ESF disbursements of balance of payments support, excluding projectized ESF and including $17 million held over of FY 1991 funds). These projections contrast to earlier estimates of $50 million per year. By 1998 we expect that the Honduran economy should be strong and able to sustain continued growth without ESF balance of payments support. Even with zero ESF in that year, the scenario projects no financing gap.

Despite more optimistic projections in the current scenario, problems still loom on the horizon. Foremost among these are large projected financing gaps in five of the next seven years. The 1992 gap of $31 is more than one percent of Honduras' projected GDP (the gap is calculated after assuming disbursement of $60 million in ESF balance of payments support -- $17 million in FY 1991 funds and $25 in FY 1992 funds). This is somewhat lower than the gap projected in the FY 1992 Concepts Paper because the latest projections assume greater IFI disbursements on softer terms.

Over time the financing gap tends to narrow more in the present scenario than in earlier ones. This is largely due to higher projected IFI disbursements at softer terms. Continued increases in IFI and other bilateral programs are key to achievement of the improved economic indicators of the present scenario.

Like previous scenarios of the Honduran economy, this version underlines the need for greater private investment (in absolute terms and as a proportion of GDP) to sustain higher GDP growth. Much greater saving by Hondurans (expressed in terms of either gross domestic saving, GDS, or gross national saving, GNS) is necessary to finance higher growth while permitting a modest reduction in the burden of the external debt.

More specifically, the scenario projects an increase in the GDS share of GDP from 7.4 percent in 1991 to 12.6 percent in 1994 and to 16.8 percent in 1998. In relation to GDS shares in GDP of other lower-middle-income countries, Honduran domestic saving is very low. According to the World Bank, the share of GDS in GDP averaged 23 percent for lower-middle-income countries in 1989 (see the World Bank's <u>World Development Report 1991</u>, Table 9, page 220).

It is important to note that the GOH is currently revising its national accounts. We expect major changes to affect past values of these accounts. If major changes are made, they will undoubtedly affect the results of future simulations of this model.

Honduras: A Scenario of the Economy, 1991-1998

	1991	1992	1993	1994	1995	1996	1997	1998
GDP growth rate	2.2%	3.0%	3.5%	4.0%	4.5%	4.7%	5.0%	5.2%
Agriculture	3.4%	3.2%	3.5%	4.0%	4.5%	4.5%	4.5%	4.5%
Industry	0.0%	1.6%	2.2%	2.8%	3.6%	4.2%	4.8%	5.4%
Other	0.7%	3.5%	4.0%	4.4%	4.8%	5.0%	5.2%	5.4%
GDP per capita growth	-0.5%	0.3%	0.8%	1.3%	1.8%	2.1%	2.3%	2.6%
Gross reserves (months of imports)	0.50	0.90	1.40	1.80	2.20	2.60	3.00	3.00
ESF disbursements * ($ millions)	$41	$60	$26	$27	$29	$19	$10	-
Financing gap ($ millions)		$31	$73	$28	-$19	$58	$65	-$26
Balance of payments								
Current account balance/GDP	-15.1%	-12.0%	-8.9%	-7.4%	-5.5%	-4.2%	-3.5%	-2.7%
Export growth rate (C&NFS)	5.2%	7.3%	5.8%	6.3%	8.3%	8.0%	6.7%	6.1%
Nontraditional growth rate	10.1%	8.5%	8.5%	8.0%	11.2%	8.6%	9.9%	11.5%
Import growth rate (C&NFS)	6.0%	4.0%	2.2%	4.1%	5.0%	5.7%	5.9%	5.2%
Gross investment/GDP	14.4%	14.9%	13.8%	14.3%	14.7%	15.4%	16.0%	16.1%
Private investment/GDP	7.9%	8.7%	9.5%	9.9%	10.3%	10.7%	11.2%	11.2%
Gross savings/GDP								
GDS/GDP	7.4%	10.3%	11.5%	12.6%	14.1%	15.5%	16.4%	16.8%
GNS/GDP	-0.7%	3.0%	4.9%	6.9%	9.2%	11.2%	12.6%	13.4%
Private consumption: per capita growth rate	-3.1%	-1.6%	0.9%	0.2%	0.4%	0.7%	1.5%	2.7%
External debt:								
Debt (including arrears/GDP)	106%	109%	110%	108%	102%	97%	91%	83%
Debt (including arrears/Exports)	256%	245%	244%	236%	217%	199%	184%	165%
Debt service/GDP	14.0%	13.8%	9.6%	9.0%	8.8%	9.6%	9.4%	9.2%
Debt service/Exports	34.0%	31.0%	21.3%	19.8%	18.7%	19.7%	18.8%	18.4%

* excludes projectized ESF

ANNEX 3

OBJECTIVES AND STRATEGY OF THE THREE YEAR STRUCTURAL ADJUSTMENT PROGRAM, 1992-1994

A. General Objectives:

1. Enable the Honduran economy to enter a path toward broad-based, sustainable economic growth; attain a GDP growth rate averaging at least 3.5 percent over the three year period from 1992 through 1994.

2. Attain a GDP growth rate of 3.0 percent in 1992.

B. Agricultural Component:

1. Objectives:

a. Increase real annual agricultural growth to an average of at least 3.5 percent during the three year period from 1992 to 1994.
b. Clarify land tenure rights and liberalize the functioning of land markets.
c. Liberalize agricultural product markets and eliminate agricultural trade controls.

2. Strategy:

a. Implementation of a comprehensive agricultural modernization law which will provide the property rights incentives necessary to stimulate a significant and sustainable increase in agricultural production, exports, incomes and employment.
b. Establishment and maintenance of an agricultural pricing and trade regime which reflects competitive market forces.

C. Financial Component:

1. Objectives:

a. Increase Gross Domestic Savings as a percentage of GDP to at least 10.3 percent in 1992; 11.5 percent in 1993 and 12.6 percent in 1994.

b. Strengthen the soundness and efficiency of the Honduran financial system.
c. Eliminate forced domestic banking system financing of the public sector.
d. Allow private sector credit to be allocated by market criteria.
e. Enable the financial system to: (1) generate medium and long term savings and (2) channel these savings to economically and financially viable activities.
f. Foster the development of competitive, private sector-based rural financial markets.

2. **Strategy:**

a. Preparation, approval and implementation of legislation and regulations needed to strengthen the supervision of the banking system.
b. Introduce the use of open market operations by the BCH as an instrument of monetary policy.
c. Gradually lower the reserve requirement; cushion the budgetary impact of this measure by using ESF-generated local currency to retire GOH internal debt.
d. Create conditions and instruments to promote long term savings and lending.
e. Design and implement a rural financial market development strategy based on savings mobilization and credit allocation by commercial banks and decentralized, community-based financial agents and institutions.

D. **Trade and Investment Component:**

1. **Objectives:**

a. Progress toward a transparent system of trade taxes with low rates and low dispersion.
b. Enhance access of Honduran products to international markets.
c. Improve the investment climate.

2. **Strategy:**

a. Improve the trade regime by lowering import tariffs, eliminating export tariffs and gaining GOH admission into the GATT.
b. Approval of a new investment code and its regulations, and privatize all CONADI, BANADESA and COHDEFOR companies.

E. Stabilization Component:

1. Objective:

Maintain sound GOH stabilization policies.

2. Strategy:

The Mission wants the IMF to keep its lead role in negotiating and following up on the GOH stabilization program. We will assess the viability of IMF projections, discuss the projections with the IMF, monitor GOH progress in this area, and encourage the GOH to comply with the targets in IMF-supported programs.

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DEVELOPMENT

LAC-IEE-92-25

ENVIRONMENTAL THRESHOLD DECISION

Project Location	:	Honduras
Project Title	:	Structural Adjustment Program (FY 92 ESF BOP Program)
Project Number	:	522-0365
Funding	:	$25 million (ESF)
Life of Project	:	1 Year (FY 92)
IEE Prepared by	:	Rafael Rosario, USAID/Honduras
Recommended Threshold Decision	:	Categorical Exclusion
Bureau Threshold Decision	:	Concur with Recommendation
Comments	:	Concurrence subject to condition stated in IEE and placed in Program Agreement between GOH and A.I.D. that there will be neither: (1) the procurement nor use of pesticides; nor (2) support for activities or for the procurement or use of equipment that could lead to commercial extraction of timber or significant tropical deforestation without first receiving the LAC Bureau Environmental Officer's approval of the appropriate Environmental Assessment(s).

John O Wilson Date APR 14 1992

John O. Wilson
Deputy Chief Environmental Officer
Bureau for Latin America
and the Caribbean

Copy to : Marshall D. Brown, Mission Director
USAID/Honduras

LAC-IEE-92-25

ENVIRONMENTAL THRESHOLD DECISION, cont'd

Copy to	:	Rafael Rosario, USAID/Honduras
Copy to	:	Richard Whelden, USAID/Honduras
Copy to	:	Wayne Williams, REA/CEN
Copy to	:	Mark Silverman, LAC/DR/CEN
Copy to	:	Maureen Dugan, LAC/CEN
Copy to	:	IEE File

INITIAL ENVIRONMENTAL EXAMINATION

PROJECT LOCATION:	HONDURAS
PROJECT TITLE:	Structural Adjustment Program (FY 92 ESF Balance of Payments Program)
PROJECT NUMBER:	522-0365
FUNDING:	$25 Million (ESF)
LIFE OF PROJECT:	One Year (FY92)
IEE PREPARED BY:	Rafael Rosario USAID/Honduras

RECOMMENDED THRESHOLD DECISION:

A. Program Description:

The program consists of a $25 million grant in support of the Government of Honduras (GOH) Economic Stabilization and Recovery Program. A.I.D. resources will be made available to the GOH in two separate disbursements keyed to the financing requirements of the GOH's program, but conditioned on progress in implementing its economic program. The dollars provided under this program will be available to finance a range of essential private sector imports from the U.S. Host country owned local currencies generated under the program will be used to support public and private development activities.

B. Recommendation:

This program qualifies for a Categorical Exclusion under 22 CFR 216.2 (d) (2) (vi), "Contributions to international, regional or national organizations by the United States which are not for the purpose of carrying out a specifically identifiable project or projects:. Section 216.2 (d) (e) of categorical exclusions are not applicable to assistance for the procurement or use of pesticides. Further, as of FY 91 Congress Act instructed that ESF appropriated funds shall not be used in a way that would result in any significant loss of tropical forest. In the absence of a final FY92 legislation, the Mission has decided to continue to embrace this provision. Therefore, the program agreement between the GOH and A.I.D. will exclude pesticides and materials and equipment that could lead to significant tropical deforestation as eligible uses of separate account funds.

Based on the above, it is recommended that no further environmental study be undertaken for this program, and that a "Categorical Exclusion" be approved.

Concurrence: Marshall D. Brown
Mission Director
USAID/Honduras

Date: 4/7/92

Clearance: CRichter, EPA (For CR)
RWhelden, DF
MWilliams, RLA Travel Status
BLEckersley, DMD

Honduras

5C(2) - ASSISTANCE CHECKLIST

Listed below are statutory criteria applicable to the assistance resources themselves, rather than to the eligibility of a country to receive assistance. This section is divided into three parts. Part A includes criteria applicable to both Development Assistance and Economic Support Fund resources. Part B includes criteria applicable only to Development Assistance resources. Part C includes criteria applicable only to Economic Support Funds.

CROSS REFERENCE: IS COUNTRY CHECKLIST UP TO DATE?

A. CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUNDS

1. **Host Country Development Efforts** (FAA Sec. 601(a)): Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

Program will assist GOH to achieve objectives of: sustainable economic growth to implement structural adjustment in the agriculture finance, and trade and investment sectors; to adhere to sound stabilization policies;and to obtain dono support to realize GDP grow targets.

2. **U.S. Private Trade and Investment** (FAA Sec. 601(b)): Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Cash transfer dollars will be used for private sector importation of raw material intermediate and capital goods, spare parts, agricultural inputs and other imports from the U.S. essential for the functioning of the Honduran economy.

3. **Congressional Notification**

a. **General requirement** (FY 1991 Appropriations Act Secs. 523 and 591; FAA Sec. 634A): If money is to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified (unless the notification requirement has been waived because of substantial risk to human health or welfare)? .... N/A

b. **Notice of new account obligation** (FY 1991 Appropriations Act Sec. 514): If funds are being obligated under an appropriation account to which they were not appropriated, has the President consulted with and provided a written justification to the House and Senate Appropriations Committees and has such obligation been subject to regular notification procedures? .... N/A

c. **Cash transfers and nonproject sector assistance** (FY 1991 Appropriations Act Sec. 575(b)(3)): If funds are to be made available in the form of cash transfer or nonproject sector assistance, has the Congressional notice included a detailed description of how the funds will be used, with a discussion of U.S. interests to be served and a description of any economic poolicy reforms to be promoted? .... YES

4. **Engineering and Financial Plans** (FAA Sec. 611(a)): Prior to an obligation in excess of $500,000, will there be: (a) engineering, financial or other plans necessary to carry out the assistance; and (b) a reasonably firm estimate of the cost to the U.S. of the assistance? .... N/A

5. **Legislative Action** (FAA Sec. 611(a)(2)): If legislative action is required within recipient country with respect to an obligation in excess of $500,000, what is the basis for a reasonable expectation that such action .... Cash transfers are conditioned on satisfactory compliance by the host government wit economic support fund conditionality. This may include legislative action.

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will be completed in time to permit orderly accomplishment of the purpose of the assistance?

6. **Water Resources** (FAA Sec. 611(b); FY 1991 Appropriations Act Sec. 501): If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, *et seq.*)? (See A.I.D. Handbook 3 for guidelines.) ....N/A

7. **Cash Transfer and Sector Assistance** (FY 1991 Appropriations Act Sec. 575(b)): Will cash transfer or nonproject sector assistance be maintained in a separate account and not commingled with other funds (unless such requirements are waived by Congressional notice for nonproject sector assistance)? .... YES

8. **Capital Assistance** (FAA Sec. 611(e)): If project is capital assistance (*e.g.*, construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively? .... N/A

9. **Multiple Country Objectives** (FAA Sec. 601(a)): Information and conclusions on whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions. ....Main objectives of the program are targeted towards: accelerating agricultural sector reform implementing trade and investment laws; expeditir financial sector reforms; achieving tariff reforms; progress in the privatization program; and continue efforts in the economic stabilization program supported by the IMF.

10. U.S. Private Trade (FAA Sec. 601(b)): Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise). .... Cash transfer dollars will be used for private sector importation of raw materials intermediate and capital goods, spare parts, agricultural inputs, and other imports from the U.S. essential for the functioning of the Honduran economy.

11. Local Currencies

a. Recipient Contributions (FAA Secs. 612(b), 636(h)): Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars. ...... N/A

b. U.S.-Owned Currency (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? .... No

c. Separate Account (FY 1991 Appropriations Act Sec. 575). If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies: .... Yes, separate accounts will be established prior to disbursement of funds, and in accordance with A.I.D. regulations.

(1) Has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that government providing the amount of local currencies to be generated and the terms and conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account? .... YES

(2) Will such local currencies, or an equivalent amount of local currencies, be used only to carry out the purposes of the DA or ESF chapters of the FAA (depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government? .... YES

(3) Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purposes? .... YES

(4) If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government? .... YES

12. Trade Restrictions

a. Surplus Commodities (FY 1991 Appropriations Act Sec. 521(a)): If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity? .... N/A

b. Textiles (Lautenberg Amendment) (FY 1991 Appropriations Act Sec. 521(c)): Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of .... NO

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textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

13. Tropical Forests (FY 1991 Appropriations Act Sec. 533(c)(3)): Will funds be used for any program, project or activity which would (a) result in any significant loss of tropical forests, or (b) involve industrial timber extraction in primary tropical forest areas? .... NO

14. PVO Assistance

a. Auditing and registration (FY 1991 Appropriations Act Sec. 537): If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.? .... N/A

b. Funding sources (FY 1991 Appropriations Act, Title II, under heading "Private and Voluntary Organizations"): If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government? .... N/A

15. Project Agreement Documentation (State Authorization Sec. 139 (as interpreted by conference report)): Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision). .... N/A

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16. **Metric System** (Omnibus Trade and Competitiveness Act of 1988 Sec. 5164, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance activity use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage? .... N/A

17. **Women in Development** (FY 1991 Appropriations Act, Title II, under heading "Women in Development"): Will assistance be designed so that the percentage of women participants will be demonstrably increased? .... N/A

18. **Regional and Multilateral Assistance** (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. .... NO

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19. Abortions (FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 525):

a. Will assistance be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization? .... NO

b. Will any funds be used to lobby for abortion? .... NO

20. Cooperatives (FAA Sec. 111): Will assistance help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life? .... N/A

21. U.S.-Owned Foreign Currencies

a. Use of currencies (FAA Secs. 612(b), 636(h); FY 1991 Appropriations Act Secs. 507, 509): Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services. .... N/A

b. Release of currencies (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? .... NO

22. Procurement

a. Small business (FAA Sec. 602(a)): Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed? .... N/A

b. U.S. procurement (FAA Sec. 604(a)): Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him? .... N/A

c. Marine insurance (FAA Sec. 604(d)): If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company? .... N/A

d. Non-U.S. agricultural procurement (FAA Sec. 604(e)): If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) .... N/A

e. Construction or engineering services (FAA Sec. 604(g)): Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.) .... N/A

f. Cargo preference shipping (FAA Sec. 603)): Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates? .... NO

g. Technical assistance (FAA Sec. 621(a)): If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the ....-.................... N/A facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?

h. U.S. air carriers .... N/A
(International Air Transportation Fair Competitive Practices Act, 1974): If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?

i. Termination for convenience .... N/A
of U.S. Government (FY 1991 Appropriations Act Sec. 504): If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

j. Consulting services .... N/A
(FY 1991 Appropriations Act Sec. 524): If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)?

k. Metric conversion .... N/A
(Omnibus Trade and Competitiveness Act of 1988, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance program use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest

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documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?

l. Competitive Selection Procedures (FAA Sec. 601(e)): Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? .... N/A

23. Construction

a. Capital project (FAA Sec. 601(d)): If capital (e.g., construction) project, will U.S. engineering and professional services be used? .... N/A

b. Construction contract (FAA Sec. 611(c)): If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? .... N/A

c. Large projects, Congressional approval (FAA Sec. 620(k)): If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the Congressional Presentation), or does assistance have the express approval of Congress? .... N/A

24. U.S. Audit Rights (FAA Sec. 301(d)): If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? .... N/A

25. Communist Assistance (FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? .... YES

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26. Narcotics

a. Cash reimbursements (FAA Sec. 483): Will arrangements preclude use of financing to make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated? .... YES

b. Assistance to narcotics traffickers (FAA Sec. 487): Will arrangements take "all reasonable steps" to preclude use of financing to or through individuals or entities which we know or have reason to believe have either: (1) been convicted of a violation of any law or regulation of the United States or a foreign country relating to narcotics (or other controlled substances); or (2) been an illicit trafficker in, or otherwise involved in the illicit trafficking of, any such controlled substance? .... YES

27. Expropriation and Land Reform (FAA Sec. 620(g)): Will assistance preclude use of financing to compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President? .... N/A

28. Police and Prisons (FAA Sec. 660): Will assistance preclude use of financing to provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? .... YES

29. CIA Activities (FAA Sec. 662): Will assistance preclude use of financing for CIA activities? .... YES

30. Motor Vehicles (FAA Sec. 636(i)): Will assistance preclude use of financing for purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? .... YES

31. Military Personnel (FY 1991 Appropriations Act Sec. 503): Will assistance preclude use of financing to pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? .... YES

32. Payment of U.N. Assessments (FY 1991 Appropriations Act Sec. 505): Will assistance preclude use of financing to pay U.N. assessments, arrearages or dues? .... YES

33. Multilateral Organization Lending (FY 1991 Appropriations Act Sec. 506): Will assistance preclude use of financing to carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)? .... YES

34. Export of Nuclear Resources (FY 1991 Appropriations Act Sec. 510): Will assistance preclude use of financing to finance the export of nuclear equipment, fuel, or technology? .... YES

35. Repression of Population (FY 1991 Appropriations Act Sec. 511): Will assistance preclude use of financing for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? .... YES

36. Publicity or Propoganda (FY 1991 Appropriations Act Sec. 516): Will assistance be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress? .... NO

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37. Marine Insurance (FY 1991 Appropriations Act Sec. 563): Will any A.I.D. contract and solicitation, and subcontract entered into under such contract, include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate? .... N/A

38. Exchange for Prohibited Act (FY 1991 Appropriations Act Sec. 569): Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person in exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employee, expressly prohibited by a provision of United States law? .... NO

B. CRITERIA APPLICABLE TO DEVELOPMENT ASSISTANCE ONLY

1. Agricultural Exports (Bumpers Amendment) (FY 1991 Appropriations Act Sec. 521(b), as interpreted by conference report for original enactment): If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities: (1) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (2) in support of research that is intended primarily to benefit U.S. producers? .... N/A

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2. **Tied Aid Credits** (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund"): Will DA funds be used for tied aid credits? .... N/A

3. **Appropriate Technology** (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

4. **Indigenous Needs and Resources** (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. .... N/A

5. **Economic Development** (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? .... N/A

6. **Special Development Emphases** (FAA Secs. 102(b), 113, 281(a)): Describe extent to which activity will: (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment 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 appropriate U.S. institutions; (b) 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 .... N/A

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and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries.

7. **Recipient Country Contribution** (FAA Secs. 110, 124(d)): Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)? .... N/A

8. **Benefit to Poor Majority** (FAA Sec. 128(b)): If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority? .... N/A

9. **Abortions** (FAA Sec. 104(f); FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 535): .... N/A

a. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?

b. Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations?

c. Are any of the funds to be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?

d. Will funds be made available only to voluntary family planning projects which offer, either directly or through referral to, or information about access to, a broad range of family planning methods and services?

e. In awarding grants for natural family planning, will any applicant be discriminated against because of such applicant's religious or conscientious commitment to offer only natural family planning?

f. Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

g. Are any of the funds to be made available to any organization if the President certifies that the use of these funds by such organization would violate any of the above provisions related to abortions and involuntary sterilization?

10. Contract Awards (FAA Sec. 601(e)): Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? .... N/A

11. Disadvantaged Enterprises (FY 1991 Appropriations Act Sec. 567): What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 40 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)? .... N/A

12. **Biological Diversity** (FAA Sec. 119(g): Will the assistance: (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas? .... N/A

13. **Tropical Forests** (FAA Sec. 118; FY 1991 Appropriations Act Sec. 533(c)-(e) & (g)): .... N/A

a. **A.I.D. Regulation 16:** Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16?

b. **Conservation:** Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (1) stress the importance of conserving and sustainably managing forest resources; (2) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (3) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (4) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (5) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (6) conserve forested watersheds and rehabilitate those which have been deforested; (7) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (8) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (9) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (10) seek to increase the awareness of U.S. Government agencies and other donors of the immediate and long-term value of tropical forests; (11) utilize the resources and abilities of all relevant U.S. government agencies; (12) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land; and (13) take full account of the environmental impacts of the proposed activities on biological diversity?

c. **Forest degradation:** Will assistance be used for: (1) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; (2) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas; (3) activities which would result in the conversion of forest lands to the rearing of livestock; (4) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undergraded

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forest lands; (5) the colonization of forest lands; or (6) the construction of dams or other water control structures which flood relatively undergraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?

d. **Sustainable forestry:** If assistance relates to tropical forests, will project assist countries in developing a systematic analysis of the appropriate use of their total tropical forest resources, with the goal of developing a national program for sustainable forestry?

e. **Environmental impact statements:** Will funds be made available in accordance with provisions of FAA Section 117(c) and applicable A.I.D. regulations requiring an environmental impact statement for activities significantly affecting the environment?

14. **Energy** (FY 1991 Appropriations Act Sec. 533(c)): If assistance relates to energy, will such assistance focus on: (a) end-use energy efficiency, least-cost energy planning, and renewable energy resources, and (b) the key countries where assistance would have the greatest impact on reducing emissions from greenhouse gases? .... N/A

15. **Sub-Saharan Africa Assistance** (FY 1991 Appropriations Act Sec. 562, adding a new FAA chapter 10 (FAA Sec. 496)): If assistance will come from the Sub-Saharan Africa DA account, is it: (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) to be used to promote sustained economic growth, encourage .... N/A

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private sector development, promote individual initiatives, and help to reduce the role of central governments in areas more appropriate for the private sector; (c) to be provided in a manner that takes into account, during the planning process, the local-level perspectives of the rural and urban poor, including women, through close consultation with African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa; (d) to be implemented in a manner that requires local people, including women, to be closely consulted and involved, if the assistance has a local focus; (e) being used primarily to promote reform of critical sectoral economic policies, or to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities; and (f) to be provided in a manner that, if policy reforms are to be effected, contains provisions to protect vulnerable groups and the environment from possible negative consequences of the reforms?

16. **Debt-for-Nature Exchange (FAA Sec. 463):** If project will finance a debt-for-nature exchange, describe how the exchange will support protection of: (a) the world's oceans and atmosphere, (b) animal and plant species, and (c) parks and reserves; or describe how the exchange will promote: (d) natural resource management, (e) local conservation programs, (f) conservation training programs, (g) public commitment to conservation, (h) land and ecosystem management, and (i) regenerative approaches in farming, forestry, fishing, and watershed management. .... N/A

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17. **Deobligation/Reobligation** (FY 1991 Appropriations Act Sec. 515): If deob/reob authority is sought to be exercised in the provision of DA assistance, are the funds being obligated for the same general purpose, and for countries within the same region as originally obligated, and have the House and Senate Appropriations Committees been properly notified? .... N/A

18. **Loans** .... N/A

a. **Repayment capacity** (FAA Sec. 122(b)): Information and conclusion on capacity of the country to repay the loan at a reasonable rate of interest.

b. **Long-range plans** (FAA Sec. 122(b)): Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increase productive capacities?

c. **Interest rate** (FAA Sec. 122(b)): If development loan is repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed ten years, and at least 3 percent per annum thereafter?

d. **Exports to United States** (FAA Sec. 620(d)): If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20 percent of the enterprise's annual production during the life of the loan, or has the requirement to enter into such an agreement been waived by the President because of a national security interest?

19. **Development Objectives** (FAA Secs. 102(a), 111, 113, 281(a)): Extent to which activity will: (1) 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 .... N/A

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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; (2) 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; (3) support the self-help efforts of developing countries; (4) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (5) utilize and encourage regional cooperation by developing countries?

20. **Agriculture, Rural Development and Nutrition, and Agricultural Research (FAA Secs. 103 and 103A):** .... N/A

a. **Rural poor and small farmers:** If assistance is being made available for agriculture, rural development or nutrition, describe extent to which activity is specifically designed to increase productivity and income of rural poor; or if assistance is being made available for agricultural research, has account been taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made.

b. **Nutrition:** Describe extent to which assistance is used in coordination with efforts carried out under FAA Section 104 (Population and Health) 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.

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c. **Food security:** Describe 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.

21. **Population and Health (FAA Secs. 104(b) and (c)):** If assistance is being made available for population or health activities, describe 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

22. **Education and Human Resources Development (FAA Sec. 105):** If assistance is being made available for education, public administration, or human resource development, describe (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

23. **Energy, Private Voluntary Organizations, and Selected Development Activities (FAA Sec. 106):** If assistance is being made available for energy, private voluntary organizations, and selected development problems, describe extent to which activity is: .... N/A

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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 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;

b. concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;

c. research into, and evaluation of, economic development processes and techniques;

d. reconstruction after natural or manmade disaster and programs of disaster preparedness;

e. for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;

f. 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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C. CRITERIA APPLICABLE TO ECONOMIC SUPPORT FUNDS ONLY

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

2. Military Purposes (FAA Sec. 531(e)): Will this assistance be used for military or paramilitary purposes? .... NO

3. Commodity Grants/Separate Accounts (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? (For FY 1991, this provision is superseded by the separate account requirements of FY 1991 Appropriations Act Sec. 575(a), see Sec. 575(a)(5).) .... N/A

4. Generation and Use of Local Currencies (FAA Sec. 531(d)): Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? .... YES
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
(For FY 1991, this provision is superseded by the separate account requirements of FY 1991 Appropriations Act Sec. 575(a), see Sec. 575(a)(5).)

5. Cash Transfer Requirements (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund," and Sec. 575(b)). If assistance is in the form of a cash transfer:

a. Separate account: Are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? .... YES

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b. Local currencies: 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, and has A.I.D. entered into an agreement with that government setting forth the amount of the local currencies to be generated, the terms and conditions under which they are to be used, and the responsibilities of A.I.D. and that government to monitor and account for deposits and disbursements? .... YES

c. U.S. Government use of local currencies: Will all such local currencies also 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? .... N/A

d. Congressional notice: Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance? .... YES

DRAFTER:GC/LP:EHonnold:5/17/91:2169J

Clearances:
LAC/CEN: WSRhodes KB for 6/11/92
LAC/DPP: RMeehan (draft)
LAC/TI: BDruhot (phone) 6/10/92
ARA/CEN: FMRondon (phone) 6/10/92
GC/LAC: ~~LWinter~~ J. DOYLE 6/12/92 JD

UA

HONDURAS
SC(1) - COUNTRY CHECKLIST - 1991

Listed below are statutory criteria applicable to the eligibility of countries to receive the following categories of assistance: (A) both Development Assistance and Economic Support Funds; (B) Development Assistance funds only; or (C) Economic Support Funds only.

A. COUNTRY ELIGIBILITY CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUND ASSISTANCE

1. Narcotics

a. Negative certification (FY 1991 Appropriations Act Sec. 559(b)): Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully? .... NO

b. Positive certification (FAA Sec. 481(h)). (This provision applies to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, narcotics education and awareness, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct source of illicit drugs significantly .... YES

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affecting the United States, through which such drugs are transported, or through which significant sums of drug-related profits are laundered with the knowledge or complicity of the government):

(1) does the country have in place a bilateral narcotics agreement with the United States, or a multilateral narcotics agreement?

(2) has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within 45 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (a) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to satisfy the goals agreed to in a bilateral narcotics agreement with the United States or in a multilateral agreement, to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, to prevent and punish drug profit laundering in the country, and to prevent and punish bribery and other forms of public corruption which facilitate production or shipment of illicit drugs or discourage prosecution of such acts, or that (b) the vital national interests of the United States require the provision of such assistance?

c. Government Policy (1986 Anti-Drug Abuse Act of 1986 Sec. 2013(b)). (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec 481(h)), has the President submitted a report to Congress listing such country as one: (a) which, as a matter of government policy, encourages or facilitates the production NO or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country?

2. Indebtedness to U.S. citizens .... (FAA Sec. 620(c): If assistance is to a government, is the government indebted to any U.S. citizen for goods or services furnished or ordered where: (a) such citizen has exhausted available legal remedies, (b) the debt is not denied or contested by such government, or (c) the indebtedness arises under an unconditional guaranty of payment given by such government or controlled entity?

NO

3. Seizure of U.S. Property (FAA .... Sec. 620(e)(1)): If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

NO

4. Communist countries (FAA Secs. ...... 620(a), 620(f), 620D; FY 1991 Appropriations Act Secs. 512, 545): Is recipient country a Communist country? If so, has the President: (a) determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international Communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism, or (b) removed a country from applicable

NO. Honduras is not a Communist country. No assistance will be provided to the countries mentioned in 4 (b.).

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restrictions on assistance to communist countries upon a determination and report to Congress that such action is important to the national interest of the United States? Will assistance be provided either directly or indirectly to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, Iran or Syria? Will assistance be provided to Afghanistan without a certification, or will assistance be provided inside Afghanistan through the Soviet-controlled government of Afghanistan?

5. **Mob Action (FAA Sec. 620(j)):** Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property? ....

Negotiations are under way to resolve the compensation issue related to the April 1988 incident, for which the U.S. has been partially compensated. Honduras has taken measures to prevent a reoccurence of such incidents.

6. **OPIC Investment Guaranty (FAA Sec. 620(l)):** Has the country failed to enter into an investment guaranty agreement with OPIC? ....

NO

7. Seizure of U.S. Fishing Vessels (FAA Sec. 620(o); Fishermen's Protective Act of 1967 (as amended) Sec. 5): (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made? ......

NO

8. Loan Default (FAA Sec. 620(q); FY 1991 Appropriations Act Sec. 518 (Brooke Amendment)): (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under the FAA? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the FY 1990 Appropriations Act appropriates funds? ....

From time to time, the GOH has been in default for more than 6 months (per 8 (a)) or more than 1 year (per 8 (b)) which has resulted in [illegible] sanctions prohibiting new funds commitment. Such period of prohibition have been of very short duration. At present time Honduras is not in default.

9. **Military Equipment (FAA Sec. 620(s)):** If contemplated assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment? .....

YES, taken into account by the Administrator at the time of approval of the FY 1991 OYB and will be considered again as final funding for the FY 1992 OYB is appropriated.

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(Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

10. **Diplomatic Relations with U.S.** (FAA Sec. 620(t)): Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? .... NO

11. **U.N. Obligations** (FAA Sec. 620(u)): What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget? (Reference may be made to the "Taking into Consideration" memo.) .... Honduras is not in arrears to the extent described in Article 19 of the U.N. Charter.

12. International Terrorism

a. Sanctuary and support (FY 1991 Appropriations Act Sec. 556; FAA Sec. 620A): Has the country been determined by the President to: (a) grant sanctuary from prosecution to any individual or group which has committed an act of international terrorism, or (b) otherwise support international terrorism, unless the President has waived this restriction on grounds of national security or for humanitarian reasons? .... NO

b. Airport Security (ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures? .... NO

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13. Discrimination (FAA Sec. 666(b)): Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA? .... NO

14. Nuclear Technology (FAA Secs. 669, 670): Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of a country to manufacture a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.) .... NO

15. Algiers Meeting (ISDCA of 1981, Sec. 720): Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. on Sept. 25 and 28, 1981, and did it fail to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the "Taking into Consideration" memo.) .... NO. This item was taken into account at the time of approval of the FY 1991 OYB and will be considered again as final funding for the FY 1992 OYB is appropriated.

16. Military Coup (FY 1991 Appropriations Act Sec. 513): Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance? .... NO

17. **Refugee Cooperation** (FY 1991 Appropriations Act Sec. 539): Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin? .... YES

18. **Exploitation of Children** (FY 1991 Appropriations Act Sec. 599D, amending FAA Sec. 116): Does the recipient government fail to take appropriate and adequate measures, within its means, to protect children from exploitation, abuse or forced conscription into military or paramilitary services? .... NO

B. COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO DEVELOPMENT ASSISTANCE ("DA")

1. Human Rights Violations (FAA Sec. 116): Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy? .... NO

2. Abortions (FY 1991 Appropriations Act Sec. 535): Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning? .... NO

C. COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO ECONOMIC SUPPORT FUNDS ("ESF")

Human Rights Violations (FAA Sec. 502B): Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest? .... NO

Clearances:

LAC/CEN:KBaier (draft)
LAC/SAM:AMcDonald (draft)
LAC/TI:BDruhot (draft)
ARA/CEN:DShuler (draft)
STATE/IO:THobgood (draft)
GC/LAC:MFittipaldi (draft)