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THE ECONOMIC FUTURE OF HONDURAS:
WHAT IT CAN DO TO MAKE IT BRIGHTER
AND HOW THE U.S. MIGHT HELP

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1

THE ECONOMIC FUTURE OF HONDURAS:
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Honduras has the lowest per capita income of all of the countries of Central and South America. Among the countries of the western hemisphere only Haiti has a lower gross national product per person. Although all of the countries of Central America (except Costa Rica) are in about the same class as Honduras, Honduras' low rank has prevailed for some time, its growth rate in per capita income (as estimated by the World Bank) during the 20 years 1960-79 being about 1.6 percent per year - the lowest of the Central America countries.

Low income usually is the outcome of lack of resources - skills and physical capital - and/or inefficient use of the resources available. Honduras' endowment of natural resources is the envy of many countries, but its people are relatively uneducated and untrained. Long term improvement in Honduras' economic condition requires a substantially higher rate of investment in its people.

The prospects for improvement in income in Honduras in the immediate future are bleak. Honduras has borrowed heavily to prevent a decline in consumption occasioned by a decrease in its real income during the past 5 years. It can no longer postpone facing up to the consequences of the past fall in income and may have to pay heavily for trying to delay some of the decline in consumption usually occasioned by an income decline. The heavy cost is partly the result of the political uncertainty in Central America that has dried up private sources of foreign capital leaving only the loans of other government and the international lending agencies.

The intermediate future, however, could be more promising. A higher income level can be obtained by using the available resources more efficiently. This does not mean that a deliberate attempt should be made to plan and direct the economy. The laws and regulations influencing the decisions made by individuals can be altered so that Hondurans and foreigners acting in their own interest can make the economy more productive. The particular, some of the steps that have been taken to alleviate the increased cost of foreign exchange have been counterproductive. These steps include the introduction of foreign exchange controls and the increase in import duties. Both discourage exports, although the import duties free more of the available foreign exchange for debt repayment.

Long-run improvement depends not only on using resources more efficiently but also on increasing the stock of capital - primarily human capital - through increased investment in education and training, sanitation, health and perhaps housing.

The U.S. contribution can take many forms. Cash, technical assistance and loans at subsidized rates are all essentially equivalent. Cash given to Honduras can be used to buy assistance, but the assistance would not have to be paid for with Honduran cash if it is provided by the U.S. If low interest rate loans are provided to Honduras, it pays less but U.S. taxpayers pay for

the subsidy. Paying in cash to lower Honduran borrowing costs would have the same effect and the same cost to the U.S.

The U.S. can fix the current value of the amount of aid it gives Honduras and let Honduras choose the form in which it propose to receive it.

As a favor to Honduras, the U.S. may impose some constraints on its aid. It may be easier for Honduras to make some needed reforms that it cannot now make, for politicians can say "we have to do this in order to get the U.S. assistance we need".

I. The Economy of Honduras in the Near Future

From the first part of 1980 to date the real income of Honduras, as measured by its real gross domestic or national product, has been more or less stationary, if not declining slightly. Since population grew at about 4 percent per year, the result is a decline in per capita income of about 4 percent per year. This compares with a growth of about 1.6 percent per year in the two decades 1960-79. By the end of 1983 instead of an average Honduran's income being 6.6 percent higher than it was at the beginning of 1980, it will be 15 percent lower. Instead of having a growth of income over the 4 years of 16 percent of the 1979 income, there has been a decline amounting to nearly 40 percent of the 1979 income.

Among the reasons for the decline have been the large increase in the price of petroleum that occurred in 1979, the decrease in the prices of some Honduran exports due to changes in world supply and demand, including the decline in economic activity in the U.S. and Western Europe, and some unproductive investments encouraged by the government of Honduras.

The government cushioned the effects that the income decline otherwise would have had on consumption by increasing its budget deficits and financing these deficits mostly by borrowing abroad. Also there were excess of imports over exports of more than \$500 million (more than 5 percent of Honduras gross national product) in the years 1979-1982. This increased foreign debt, both private and public, and requires that there be export surpluses at some future time or that foreign investment be large. The larger foreign investment might consist of transfers of assets from Honduras to foreigners, if Honduras honors its debts.

The immediate problem of Honduras is simply how to reduce the two gaps - the excess of government expenditure over tax revenue and the excess of imports over exports - in the least painful manner. Presumably taxes can be increased and government expenditures decreased to cut the budget deficit. The government cannot borrow significant amounts within the country to postpone the budgetary adjustment. If a fairy godmother does not give it the difference between expenditures and taxes, the government must borrow abroad or resort to printing money. Its foreign debt probably cannot be increased overall, so borrowing to finance the budget deficit probably would have to be accompanied by a reduction in other foreign debt. More of Honduras would be "sold" to foreigners. The deficit in the balance of payments will be reduced

if the rest of the world will not finance it. The only sources of foreign exchange would be the proceeds of current exports. Improvement in the levels of economic activity in the countries that import Honduran products will improve the export picture but not enough to alter the general character of the problem.

A. Will U.S. Crisis Aid Help Honduras?

About \$500 million of the addition to the foreign debt in 1980-83 was to cover the budget deficit. This represents more than 20 percent of the estimated net income of the country for 1983. Most of the proceeds of these loans were not invested in producing assets and have no yield. To repay such debt will require taxing more and/or spending less in the future. It must make future income of Hondurans smaller than would be the case if the debt had not been incurred. Whether the debt will be "repaid" is doubtful.

If the debt is not to be "repaid in full", i.e. if it is rescheduled, renegotiated and repudiated so that its present value is less than what the lenders expected it to be, and U.S. aid is used to help pay the debt, such aid will mostly be transferred to the holders of foreign debt. If the transfers improve the credit rating of Honduras, the aid benefits are split between Honduras and the creditors. If Honduras' treatment of its foreign debt is unaffected by U.S. aid, it will all go to Honduras.

B. What Honduras can do for itself in the immediate future

As has been noted the immediate problems of Honduras are its budget deficit and its disposable foreign exchange. Unless some of its assets are sold to foreigners, the value of Honduran imports must be equal to the value of its exports minus the repatriated earnings of foreign investors and interest and net repayment of foreign loans. The amount of new loans that can be obtained is small. Consequently, Honduras is trying to schedule foreign debt interest and repayment so as to make its export surplus as small as possible.

1. A Free Market for foreign Exchange

Honduras can make better use of whatever foreign exchange is available to it if it abandons exchange controls. An exchange rate of one dollar for two lempiras is a higher price for the lempira than could be sustained by the Central Bank. When it was apparent that it would exhaust its stock of lempiras by maintaining the price, it instituted a system of exchange controls to ration the available stock of dollars.

This measure devalued the Lempira. The price of a dollar that cannot be obtained is infinite. Most of the dollars that are available at the official rate of exchange are obtained only by the expenditure of time by both civil servants and the buyers of the dollars in creating forms to file, filling out forms, standing in line to obtain import licenses, complying with deposit requirements and in general producing and cutting red tape associated with the system of allocating the exchange. The time and other resources

spent by both civil servants and those trying to obtain the exchange constitute a loss to Honduras. Producing and cutting red tape are unproductive activities than can least be afforded by a poor country. Furthermore, the arbitrary rationing scheme that has been devised is almost certain to allocate some dollars to unproductive uses and to fail to make some available to some productive uses.

Another form of devaluation - the one usually associated with the word "devalue" - is to raise the price to all buyers of dollars so that the demand would equal the available stock. Any buyer could obtain as many dollars as he wishes at this price and the resources now devoted to producing and cutting red tape would be saved. If some imports are considered worthy of a subsidy dispensed by permitting them to be paid for with cheaper dollars, the exchange available after such imports have been paid for could be sold at a market clearing price.

A free market for foreign exchange has benefits that will last beyond the immediate crisis. Some of these will be noted in the next section.

2. Reducing the Budget Deficit

The amount of money spent by government during any period of time must be equal to the government's tax receipts plus its net borrowing (from at home and abroad) plus the money it borrows from the Central Bank. Borrowing from the Central Bank is equivalent to printing new bills. The maximum amount of government revenue that can be raised in this manner is not large - probably no more than 5 percent of national income - and the inflation rate that would result from securing this maximum amount of revenue also is not large in comparison with some of those now prevailing in Argentina, Brazil, Israel and Mexico, for example.

The revenue-maximizing rate of money issue would impose some costs upon the economy since it encourages the use of things other than money to perform functions that can be performed more efficiently by money. However, costs are also imposed in collecting taxes and in the changes in things that people do when faced with income or commodity taxes, so that "inflationary finance" need not be the worst instrument. The difficulty is that a country seldom is able to maintain a steady rate of inflation that individuals can count on for making contracts in money terms. Variable rates of inflation impose substantial losses upon an economy because they disrupt financial markets. Honduras should not be encouraged to choose the inflationary route.

Few countries can borrow internally to finance budget deficits. The recent sales of Honduran government bonds to government pension funds was a forced sale, and no other similar opportunity is available. Since the government cannot borrow abroad to finance current government expenditures, it must raise taxes, cut expenditures or both.

Various memoranda dealing with the deficit have alluded to improved tax administration as the way to raise additional taxes. Some more

revenue might be raised by more rigorous enforcement of the tax laws. However, this recipe for increasing tax revenue has been proposed to many countries at many times and has seldom had any noticeable effects. Furthermore the Honduran economy is such that new taxes and increased rates on existing taxes are unlikely to raise much additional revenue. The share of income that can be extracted by taxing without imposing substantial harm on the economy is considerably lower than in a more developed economy

The general sales tax whose rate has recently been raised from 3 to 5 percent, might be further increased. However, the tax is one in which retailers act as tax collectors for the government, and higher rates encourage making deals to evade the tax. The rate that would raise the maximum revenue is probably less than 10 percent.

Like every government budget, the Honduran one undoubtedly contains items where costs greatly exceed benefits. Cutting all items by the same proportion is not optimal and could lead to departments eliminating their most productive service, instead of their least productive one, in order to try to restore their spending authorizations.

Obvious candidates for cut back are the autonomous government agencies. Many of them show current operating losses with little prospect of positive cash flows in the future. They could be disposed of for whatever they will bring at auction thereby eliminating the drain on the budget. They may be sold positive prices in spite of current losses if the buyers believe that they can operate the enterprises more efficiently than the government. Whether their prices are positive or negative is of little concern if an agency generates losses to the government. Relieving the government of paying the losses incurred by these agencies would have cut the cash outflow by about 200 million lempiras in 1983.

Another obvious candidate for a reduction in its budget is the National University of Honduras. It receives 6 percent of the government budget - about 1.2 percent of gross national product. Virtually no tuition charge is imposed, but the University students must have completed secondary school which often is a private school with substantial tuition. Most students at the University cannot be considered as coming from poor families. The grant to the University amounts to around \$ 500 per year per student and compares with about \$90 per year per student in primary schools.

The \$500 per year per student going to the University represents a transfer to students that is difficult to justify. They are the beneficiaries of the education they receive. Their earnings will be large if their training is good. If it is poor the faculty of the University benefits from the government's support.

The cost of university instruction should be paid for by the students and the government grant to the University eventually should be shifted to support of elementary and secondary education. At the present time, the Ministry of Education is not equipped to spend efficiently any additional funds, so the government's budget can be cut instead.

II. The Intermediate Term (2-5 years)

A. What Honduras Can Do

1. A Free Market for Foreign Exchange

In pointing out what Honduras could do to improve its immediate situation it was noted that a free market for foreign exchange allocates available foreign exchange more efficiently than can a system of exchange controls. A free market will also encourage an efficient allocation of resources between production for the export and home markets, although import and export subsidies and taxes also affect the allocation so that a free exchange market alone does not assure that exports and imports are optimal.

For almost all of its history, except for the past 3 years, Honduras' exchange market has been such that anyone could buy as many dollars or lempiras as he wished at the prevailing rate. During the past half century the lempira traded for \$0.50 U.S., and the prices of imported and exported goods in Honduras moved with the prices for these goods in the U.S., except for changes in Honduran tariffs and export taxes and transportation costs from Honduras to world markets. The stock of lempiras in circulation was determined by the demand for lempiras and could not be affected by the Central Bank. If the Central Bank tried to put more lempiras into circulation than people wanted to hold, the excess was traded for dollars. To be able to satisfy all customers for dollars at the price of one dollar for two lempiras, the Central Bank had to make sure that there were not so many lempiras issued that it ran out of dollars.

Given conditions that have prevailed in the recent past, too many lempiras has been issued to maintain the truly fixed rate of exchange of the past 50 years. The government's budget deficit could not be financed from foreign loans, so it obtained credit from the Central Bank which provided the additional lempiras. The government may issue as many lempiras as it wishes but must accept the consequences in term of the effect on the value of the lempira.

With a controlled rate, the fall in the value of the lempira (rise in the value of the dollar) is not reflected to producers so that they would be encouraged to export more to correct the "shortage". They still receive only the number of lempiras per dollar provided by the official rate. Consumers must consume less of imported products, since less are available. But the effect of the controlled rate and rationing are haphazard. The effect is equivalent to an import subsidy for those who can obtain the imports and an export tax for all exporters.

2. An Export Subsidy as an Antidote to Exchange Control

If overvaluation of the lempira has the same effect on exports as does an export tax, and if it is not possible to maintain a free market for foreign exchange, an obvious way for obtaining some improvement might seem to be to subsidize exports. The subsidy can make the return (in terms of

lempiras) from exporting the same as it would be under free exchange. Since the overvaluation affects all exports in the same manner, the subsidy should be the same to all exporters - if the subsidy is a correction for the effects of exchange policy. Import duties also decrease the real value of exporting, so that some further justification for subsidizing exports may be provided by the Honduran tariffs.

The funds from the subsidy, however, must come from taxpayers. If they are obtained by further import duties, they offset the effect of the subsidy. The difficulties in raising further tax revenue and cutting government expenditures are apparent. A concerted effort to free the exchange rate, rather than further intervention of the government in the economy, seems a clearly preferred solution.

3. Change the Structure of Import Duties

The present structure of import taxes in Honduras reflects the influence of the Central American Common Market. All members of the Common Market imposed essentially the same tariffs on imports from outside of the Common Market, and no tariffs were imposed on almost all of the trade among the countries. The outcome was particularly unfavorable to Honduras in that Honduras paid higher prices for most of the industrial products produced by other Central American countries and received the same prices for its exports, most of which could be exported to countries outside the Common Market. The industry that developed in Honduras for export to other countries of Central America was based on Honduras' advantage in comparison with these other Common Market countries rather than in comparison with the rest of the world. Most of the development could not compete in the world market and should not be considered as permanent. Honduras withdrew from the Common Market in 1970 but negotiated trade treaties with most of the countries in Central America after this withdrawal and kept much of the tariff structure created for its participation in the Market.

There is a wide range of tariffs as percentages of world prices for products imported into Honduras. The average tariff probably is somewhere between 30 and 35 percent. For goods and services that are exported to the world market, the tariff has no effect upon the economy. Some goods are produced in Honduras and consumed at home and exported to the Common Market that would not have been produced in the absence of the tariff, i.e. they would have been imported from countries outside of the Common Market. Such goods should not be produced in Honduras, if the country is to make best use of its resources. The tariff produces no revenue and distorts the productive structure.

Many goods are consumed in Honduras that are not produced here. The tariffs on such goods are a particular form of commodity taxes. The real cost of such goods is the exports required to buy them. A dollar of exports buys a dollar's worth of any import, so this cost is the same for all such imports. These taxes affect the overall productive structure, since they reduce the real value of exporting to those engaged in that activity - if they would use some of the export receipts to purchase foreign goods.

Corresponding to these import duties is an export tax which would have the same effect on exports. The import duties divert exchange to the government but decrease the total amount of exchange available for all purposes.

A tariff structure that was neutral in its impact on exports would tax imports at the same rate as domestic goods are taxed. Such a tax structure is not feasible if the government is to obtain foreign exchange to service its debt. However, some improvement can be made if (1) Common Market imports are treated as are imports from the rest of the world and (2) any commodity produced at home and imported is taxed at a lower rate than a commodity not produced at home. Government obtains all of the revenue from duties on commodities that are imported but not produced at home. The "tax" is shared between the government and home producers if some of the good is imported and some is produced in Honduras.

For goods that are imported and not produced at home, those whose quantities purchased are most sensitive to price should be taxed least - if the identity of the taxpayer is of no consequence. This provision certainly does not hold in Honduras, and taxing "luxuries" at higher rates than "necessities" probably is one of the requirements for maintaining some form of democratic government. However, high import duties encourage smuggling and corruption of customs officials, so that luxury tax rates exceeding 100 percent probably are not saving the maximum amount of exchange.

In spite of the government's "need" for exchange, the overall tariff rates probably should be reduced. The additional exchanged "saved" (i.e. made available for purposes other than imports of goods and services) from an average tariff rate greater than 15 to 20 percent probably is less than the decrease in total exports resulting from the higher rates.

4. Freeing Financial Markets

Honduras has a long history of regulation of financial institutions. In an unregulated environment, a bank could borrow or accept deposits from any source - foreign or domestic - and make loans to any borrowers at home and abroad. There would be no constraints on what could be paid for deposits and what it could charge for loans. The restrictions in Honduras have varied and have imposed different costs on the economy over time. At the present time, Honduran private banks cannot borrow from foreign sources except to finance certain commodity loans, they cannot charge more than 19 percent per year on loans for any purpose and can charge no more than 16 percent per year on loans for some purposes. The latter class of loan is not a very important class. The interest rate maxima apply as well to most lenders other than banks, although the degree to which they are enforced on these other lending institutions is variable.

Government lending also is important in Honduras, accounting for a substantial fraction of the loans to some sectors. Government lending policy has been very erratic depending on the whims of those in power. There is little justification for government lending in an economy where financial institutions are uncontrolled and the legal structure establishes and enforces

"reasonable" rights of both borrowers and lenders. However, it is unlikely that the government will refrain from lending, and the freeing of private financial markets will help the economy even though government lending agencies exist. Also given the current foreign exchange crisis, it is unlikely that private financial transactions with foreigners will be unregulated. The principal modification that can and should be made is the elimination of interest ceilings on loans.

If the ceilings were rigorously enforced, higher risk loans would not be made. Almost everywhere lenders can be found who are willing to make higher risk loans at higher rates of interest. The higher default rates and other costs associated with such loans are compensated for by higher rates of interest. In Honduras and other parts of the world where the effects of interest rate ceilings have been investigated, it has been found that the borrowers who are not able to obtain credit because they are considered to be high risks are not only the "poor" but include also those who have not borrowed previously and the innovators without adequate collateral and with proposals that will not always succeed but often will yield big payoffs when they do.

Almost everywhere borrowers and lenders try to "work around the ceilings". Usually they succeed in doing so, but at some cost. Lenders deliberately violate the law knowing that they may be fined or imprisoned and include the expected costs of being prosecuted in the rates they charge. If the law applies only to specific kinds of loans, new kinds of loans and lending institutions spring up as substitutes for the controlled ones.

This is fortunate for the economy. That there are money lenders registered with the Central Bank making loans at rates above the legal ceiling and seldom being prosecuted is a blessing to Honduras. However, since working around the ceilings incurs additional costs it makes the spread between what the lender receives and what the buyer pays higher. It is as if there were a tax per lempira of loans. Depositors in financial institutions and those placing money with the money lenders would receive less and borrowers would pay more than if there were no such tax.

Until May 1981 there were legal ceilings on rates banks could pay to depositors. However, these were abandoned for the same reasons that they have been almost abandoned in the U.S. New forms of financial institutions not covered by the ceilings were developed and bank deposits fell. In Honduras, when lempiras were freely convertible into dollars, the ceilings on deposits contributed to investment by Hondurans outside of the country.

Although there are no longer legal ceilings on what banks can pay to depositors, the ceilings on lending rates impose effective ceilings on what banks can pay. They cannot pay more than the rate at which they lend minus the costs of administering loans and deposits.

The harm that such ceilings inflict on Honduras is difficult to estimate. However, it varies directly with the degree to which it is believed

the ceiling will be enforced. Whatever the amount of damage, it can be reduced at no cost by removing the ceilings.

LONG-RUN ECONOMIC EFFECTS OF INCREASED DEVELOPMENT

II. A.I.D. to Honduras

A. What Might Be expected from Preferential Tariff and Tax Treatment By the U.S

Long-run improvement in Honduras' economic condition requires not only that the resources of the country be used efficiently, but also that the capital of the country - particularly its human capital - be increased. Once political stability in Central America is restored, foreign investment in Honduras is expected to resume, since there are opportunities that promise high rates of return. The risk of expropriation, high taxes and controls over the repatriation of earnings is low.

It is highly likely that the U.S. will provide tariff preferences on most products exported by Central American countries and also will reduce the effective rates of taxation on the earnings of U.S. companies investing in these countries. The type of development that would take place in response to these preferences cannot be predicted accurately. Most of Honduras' exports to the U.S. at present enter with little or no import duties. Expansion in these items will be the result of factors little related to the Caribbean development effort.

Among these factors are those which reduce costs of production - improved technology, better management, a better labor force and reductions in the costs of doing business that are imposed by government. These include the costs of cutting red tape, complying with regulations, etc.

Extending to U.S. investors in Honduras essentially the same tax treatment they receive in Puerto Rico and most U.S. possessions can result in development of types of industry in Honduras that have not been considered profitable. Industry whose capital: labor ratio is large and whose capital is easy to move - pharmaceuticals and electronics, for example - moved to Puerto Rico as a result of the tax law changes. Similar moves to Honduras might occur.

The expansion of foreign investment in itself is not likely to have a spectacular effect on Honduras income. Except for the taxes Honduras imposes on it, the capital income from foreign investment goes to the foreign investor. The tax rates cannot be very large or there will be no tax advantage to investing in Honduras rather than the U.S.. In fact, Honduras probably will have to grant special tax treatment to new U.S. industry to take full advantage of the change in the U.S. law.

It is the increase in labor income due to the increased foreign investment that represents the principal benefit to Honduras. For each one percent increase in the amount of total physical capital in Honduras, labor income increases by about one-half of one percent. Foreign investment is about 10 percent of total physical capital, so duplicating present foreign investment would increase Honduran income by only about 5 percent.

Of course the new investment won't be like that already here. Along with it will come foreign management and worker training so that the increased income to Honduras from doubling foreign investment might be 10 percent rather than 5 percent. Some additional domestic investment might be generated by the foreign investment, but some foreign investment is a substitute for domestic investment so the net change is not easy to estimate.

In any event, the increased Honduran income from increased foreign investment will transform the economy from a poor one to a not-so-poor one rather than from poor to middle income. Other steps that will increase the productivity of labor are needed if bigger gains in income are to be achieved. These steps involve investing in the workers themselves and in the environment in which they live and work - in education, sanitation, health and perhaps housing. Substantially increased investment in these items is a process that will take decades.

B. Improving Schooling

Education takes forms others than schooling, on-the-job training being an important one. However, on-the-job training is very costly for many types of jobs if workers cannot read and write and make simple arithmetic calculations. A high level of literacy does not assure high income (note the case of Argentina), and there are high income countries that have low levels of literacy (Saudi Arabia and Yemen are examples). However, differences in the populations of various countries with respect to their schooling seem to account for much of the differences in their incomes.

1. The Honduran Educational System is Inefficient

Much that ought to be known about education in Honduras, if good guesses about what changing it would accomplish are to be made, is not known. However, there are many indications that the system both lacks resources and uses what it has inefficiently.

(1) The direction of education is completely centralized in the Ministry of Education which specifies the curricula, salary scales for teachers, characteristics that teachers must possess to be legitimate members of the teaching corps, etc. It also hires the teachers and assigns them to the schools. It builds and maintains the schools and carries on a myriad of functions that in many other countries are performed at the local level. The result is chaos in almost every phase of school operations. In particular, rural areas suffer from absence of books, able teachers and physical facilities. Although attendance in school for 6 years is supposedly compulsory, there are not enough schools, teachers and other inputs for

schooling to make it feasible for much of the population to achieve the compulsory standard. It is believed that no more than half of the current school age population will receive 4 or more years of schooling.

(2) The total budget of the Ministry of Education is equal to about 3 percent of gross domestic product. In addition, 6 percent of the national budget or about 1.2 percent of gross national product goes to the National University of Honduras. About \$90 per primary student per year is the estimated average expenditure. For comparison, the average current operating cost per public school student in the U.S. is around \$1,500 per year.

In contrast to public schools the National University is overfunded. An major shift in university financing to collect more from the students and less from the taxpayers would seem an important way to do better with what educational funds are available. However, the entire educational system needs to be restructured if it is to make good use of the money available. It would be a waste to put more money into the system as it now exists.

2. Increasing the Capacity and Use of the School System Takes Time

It is highly unlikely that if more money were provided to increase sharply the number of student years of education, qualified teachers would be available to permit an immediate increase. To train teachers takes time even if teacher training facilities are available. If they are not, then still more time is required to "teach the teachers who will teach the teachers".

Furthermore a big drive to expand quickly the system will not insure that the bigger system will be fully utilized. Going to school for a few more years may add to earnings per year at some times after the schooling is completed. But earnings while the student is attending school are smaller. A balancing of the increase from higher rates of pay and the decrease from fewer years in which to be paid affects the choice of how much schooling is obtained.

In the U.S. loss of earnings from attending school rather than working is important for university students but not usually for primary or secondary school students. In Honduras a child of primary school age can help with crops and livestock, shine shoes, run errands and perform other tasks for which he will receive enough income to help significantly his family. Also he can care for smaller children in the home thereby permitting both parents to work away from home.

Although improving the quality of public education will increase expected earnings from schooling, it will not reduce the cost to a family of sending one of its earners to school. Even though there are the buildings, teachers, books, etc. available so that 6 years of education could be provided to every one of school age, there will not be a large increase in school attendance unless family income is raised so that the family can live satisfactorily without the income generated by school age children.

Aiding Honduras to improve its educational system is not a problem that requires immediate financial assistance. Not much should be granted until the percent structure is altered. Once the system is repaired or replaced, the capacity build up need not be rapid.

C. Health and Sanitation

By almost any of the indexes used to measure health, Honduras has a relatively low score. Poor health is an important factor in accounting for low income. A population that has a high incidence of illness cannot work as effectively as a healthy population. Children miss school, and resources have to be devoted to treating the illnesses.

There are many reasons for poor health - genetic factors, nutrition, personal habits and the environment. Nutrition and the environment are particularly important contributors to ill health in Honduras as evidenced by the incidence of diseases related to malnutrition, contaminated water and indiscriminate disposal of human waste.

These conditions often prevail because of low income and the other things associated with it. Safe water and adequate sewage disposal facilities cost money. Relatively uneducated people may not know how to obtain an adequate diet at low cost. There are a myriad of things that might be done in a poor country that would improve health. Because the selection from which to choose is so large and cost-benefit estimates are crude, the choice of ways that the U.S. might select to help improve health in Honduras is bound to be somewhat arbitrary.

Many of the things associated with diet and personal cleanliness are best provided by personal guidance from school and health personnel. This kind of activity must rely heavily on government agencies. If a big expansion in such activities would have a high pay-off, one would expect them to be undertaken on a large scale by the government or by private charitable agencies.

Other things that can be done - particularly those connected with the provision of water and the disposal of sewage - require capital investment. Rural and small town water and sewage investments usually consist of digging wells and constructing latrines. Expansion in U.S. assistance in this area does not seem to be needed since it already is being provided by the U.S. and other governments and by international charitable organizations and lending institutions.

Capital investments totaling 150 to 200 million dollars are said to be needed to improve the water and sewage systems of the two largest cities. Like the cost of electric power and telephone systems which can be recovered by charges to the users of these services, the costs of water and sewer services could be recovered by such charges. Again, if the services are worth more than they cost, one would expect them to be expanded. A U.S. city faced with a shortage of water and sewer facilities would borrow the money and expand the system and repay the loans from the receipts from the sale of water and from sewerage charges.

Apparently this doesn't happen in Honduras because water and sewer services are provided by a national governmental agency (Servicio Autónomo Nacional de Acueductos y Alcantarillados). Its schedule of charges is determined by political as well as economic considerations and its source of capital is what the national government can borrow and is willing to allocate to it. An improvement in health that may be worth much more than it costs may not be undertaken by a city or town without financial assistance because of the political structure of the country.

If Tegucigalpa and San Pedro Sula were able to issue bonds, the bonds would have to carry a high rate of interest. However, the option to finance a capital project in this manner is not available under present arrangements.

As is the case in schooling, improving health and sanitation without outside aid is made more difficult by the structure of the government. This structure also makes aid more difficult to use effectively. However, sanitation involves much more physical capital than does education. An international agency usually can see to it that loans and grants are used as they were intended to be used in spite of the bureaucratic structure. Consequently improvement in sanitation may be easier to aid effectively than education.

D. Decentralization of Government and Encouraging Private Alternatives

Improving education and health in Honduras will be a slow process under favorable circumstances. It will be slower when decisions about education and health are almost all made by the national government. People in local areas who want to improve a school, a road or a water system do not have the authority to levy sufficient taxes to pay for such projects.

Some services now furnished by the government could be provided by private agencies. There are private schools in Honduras, and water and electrical power systems in many parts of the world are privately owned. Private provision is an easy way of mobilizing voluntary contributions where each user of service can pay for what he uses. It is not such an easy way if it has been agreed that the richer part of the population should pay for some of the service obtained by the poor.

Governmental decision making in Honduras is not as highly centralized as it was only a few years ago, but the degree of decentralization is far less than seems optimal. It would be a mistake to think that the Hondurans have never thought about the problem. There probably are some valid arguments against decentralization that are not obvious to one not intimately familiar with the country. Although it may not be feasible in rural areas to collect taxes to finance schooling there, the local community could be given a much larger role in the selection of teachers and curriculum than now appears to be the case.

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