Honduras: Recent Economic Performance

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Contents

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Executive Summary

Honduras is the third poorest country in Latin America, ahead of only Nicaragua and Guyana. It has a long history of political and economic instability, which had finally been brought under control by the end of the 1980s. This cycle of relative stability ended with the coup d'état that overthrew President Manuel Zelaya Rosales on June 28, 2009. The current instability is worsening the country's economic downturn, and also preventing Honduras from adopting the measures needed to counter-act the effect of the global recession on the economy.

Despite several efforts to promote economic development, the most important changes in the country's insertion into the global economy came only after the creation of the Export Processing Zone system in 1987. This, along with a very cheap labor force and close political ties to the U.S., turned Honduras into an attractive site for multinational firms to locate their production facilities, especially textiles. Employment within export processing zones (EPZ), and free zones (FZ) increased more than 40 percent per year from 1990 to 1996. By 2005 the maquila sector accounted for about 65 percent of total exports.

However, despite the lowest wages in Central America, Honduras' maquila sector has had trouble in recent years competing with Asian producers, where wages are much lower. As a result, the maquila share of exports has fallen significantly in recent years, and Honduras has been unable to move up the value-added chain of economic development.

The economy nonetheless did very well during the Zelaya administration, which took office in January of 2006. GDP grew by 6.6 percent in 2006 and 6.3 percent in 2007; it slowed in 2008 due to the world recession, but still came in at 4 percent. Honduras was the fastest growing country in Central America after Costa Rica. Poverty was reduced significantly in the first two years (for which there are data), from 65.8 percent of households in 2005 to 60.2 percent in 2007. Inequality also fell: From 2005 to 2006, the percent of income captured by the lower (poorer) deciles went from 2.1 to 2.5, and the percent going to the intermediate deciles also increased from 35 to almost 39 percent. At the same time, the share captured by the richest segment fell, from nearly 47 percent in 2005 to 42.4 percent in 2006.

Inflation remained under control; it peaked at 10.8 percent in 2008, but this was due mainly to the worldwide spike in commodity import prices, and it was soon to come down. (The year-over-year inflation rate last September was only 3.1 percent). The current account deficit also hit high levels in 2007 and 2008, peaking at –11.7 percent of GDP in 2008; however, this retreated into positive territory in 2009 as import prices and demand for imports fell. The Zelaya government was able to maintain a sufficient level of reserves and a stable exchange rate. The government also used expansionary monetary policy, in the form of lowering reserve requirements, to counter-act the global credit crunch as it hit Honduras in 2008.

The government also enacted a 60 percent increase in the minimum wage, which brought an enormous adverse reaction from the employers' community. In spite of their efforts, the Supreme Court upheld the increase, partly on the grounds that even with the increase, the Honduran minimum wage did not cover the basic consumption basket in urban or rural areas. Prior research has also shown that increases in the minimum wage in Honduras have a significant part in reducing poverty and extreme poverty. The government also significantly increased access to education for

an estimated 450,000 children through the abolition of school fees, and implemented a more-than-25-percent increase in the number of children receiving free school lunches.

The economy has continued to be hit by the world recession in 2009, and is particularly vulnerable due to its high dependency on remittances, which peaked at more than 21 percent of GDP in 2006. The four months of instability since the coup d'état have combined with these external shocks to take a toll on economic performance.

From July 2 to November 3, international reserves at the central bank have fallen by $444.6 million, or 18.4%. The current level of $1.98 billion represents a level of about 3.2 months of imports, which is at the margin of sufficiency. At present, Honduras would have access to another $163.9 million of reserves from the IMF, under a special allocation of Special Drawing Rights (SDRs) created this year and extended to all member countries. However, because the de facto government is not recognized internationally, access to these reserves has been denied by the Fund.

The tourism sector, which grew at a rapid 9 percent last year, is expected to decline this year because of both the U.S. and world recession, and also because of the crisis.

Some of the impacts of the current crisis are difficult to quantify but they are undoubtedly significant. Jesus Canahuati, vice president of the nation's chapter of the Business Council of Latin America, estimates that the curfew imposed by the de facto regime cost the economy $50 million per day.

From January to August, the IMAE (Indice Mensual de Actividad Economica) has shown a 3.4 percent decline, compared to growth of 2.4% in the same period from 2008.

As recently as June, Consensus Economic had forecast 0.7 percent growth for 2009; by late September this was lowered to negative 2.6 percent; some of this undoubtedly reflects the impact of the crisis.

Introduction

From the early 1900s until the early 1980s, Honduras had a long history of political and economic instability. Exports centered mostly around bananas from the first decade of the 20th Century until the 1950s, when attempts were made to promote diversification. Coffee and other agricultural products became important as a result of these efforts and, by 1960, bananas' share in total exports was down to 45 percent.[1] Shortly thereafter, and as a result of the newly created Central American Common Market (CACM), some industrial products were exported to other Central American countries. This manufacturing activity, however, declined drastically after the war with El Salvador in 1969 and the Honduran decision to leave the CACM.

The first election after nearly a decade of military rule was held in November 1981; the winner, Roberto Suazo Córdoba, assumed the presidency in January 1982. Legal and legitimate electoral processes were held thereafter every four years, without interruption. This cycle of political stability ended last June 28, when President Manuel Zelaya was removed from office by force.

Despite several efforts to promote economic development, the most important changes in the country's insertion into the global economy came after the creation of the Export Processing Zone system in 1987. This, along with a very cheap labor force and close political ties to the U.S., turned Honduras into an attractive site for multinational firms to locate their production facilities, especially textiles.[2] Employment within export processing zones (EPZ), and free zones (FZ) increased more than 40 percent per year from 1990 to 1996.[3, 4]

The transformation of the production structure, along with a closer integration with the international economy, however, has not brought much change to Honduran society, and the country remains among the poorest in Latin America.

The purpose of this paper is to provide a brief overview of the main characteristics of the Honduran economy in the last few years. The information available at the time of this writing allows for a look at the first two years of the Zelaya administration (when information allows, a third year is included) and for comparisons with the preceding years.

1 Merrill 1995.

2 Export processing industries in Honduras (in what is commonly referred to the maquila sector) may operate under two alternative laws: the Free Zone Law (FZ) and the Export Processing Zone Law (EPZ). The FZs, on the one hand, allow entire areas (like municipalities) to be turned into Free Zones which can only be managed by the government. The EPZs, on the other hand, are developed as industrial parks by private administrators. Both of these systems use several incentives, including exemption from income and customs taxes, total freedom to dispose of foreign exchange reserves, as well as simplified legal and administrative paperwork. More details on FZs and EPZs in Honduras may be found in Jenkins, Esquivel and Larraín 1998, 21-22.

3 See Jenkins, Esquivel and Larraín 1998, 27-28.

4 The growth of the EPZ system during the 1990s was a generalized phenomenon in Central America; according to an ILO report, Central America had some 922,000 workers in the EPZ systems in 2006 (Singa Boyenge 2007, 12-13).

General Information: Some Macroeconomic Indicators

As noted above, Honduras is, by all standards, a poor country. However, the production structure is no longer centered on a few agricultural crops or mineral extraction, exports have grown, and foreign multinationals are now located in various areas within the national territory. Export processing activities provide numerous employment opportunities and, along with foreign remittances from Hondurans living abroad, generate considerable amounts of much-needed foreign exchange. And yet, in 2007, Honduras occupied position number 112 of 182 countries in the Human Development rankings published by the United Nations Development Program.[5]

According to the World Bank, Honduras, with a per capita income of US$3,870, is the third poorest country in Latin America (only ahead of Guyana and Nicaragua, with US$2,510 and US$2,620, respectively).[6] Structural adjustment programs signed with the World Bank in the early 1980s and 1990s included strict conditions that proved difficult to attain.[7] As in other countries, the whole process was tied to macroeconomic stabilization involving reductions in the fiscal deficit and tight monetary policy, both of which generated unemployment and uncertainty in the business sector.[8]

5 By comparison, Guatemala, Nicaragua, and El Salvador, were in positions 122, 124, and 106, respectively. See United Nations Development Program 2009, Statistical Annex, Table H.

6 Refers to Gross National Income, PPP, current international prices. See World Bank 2009.

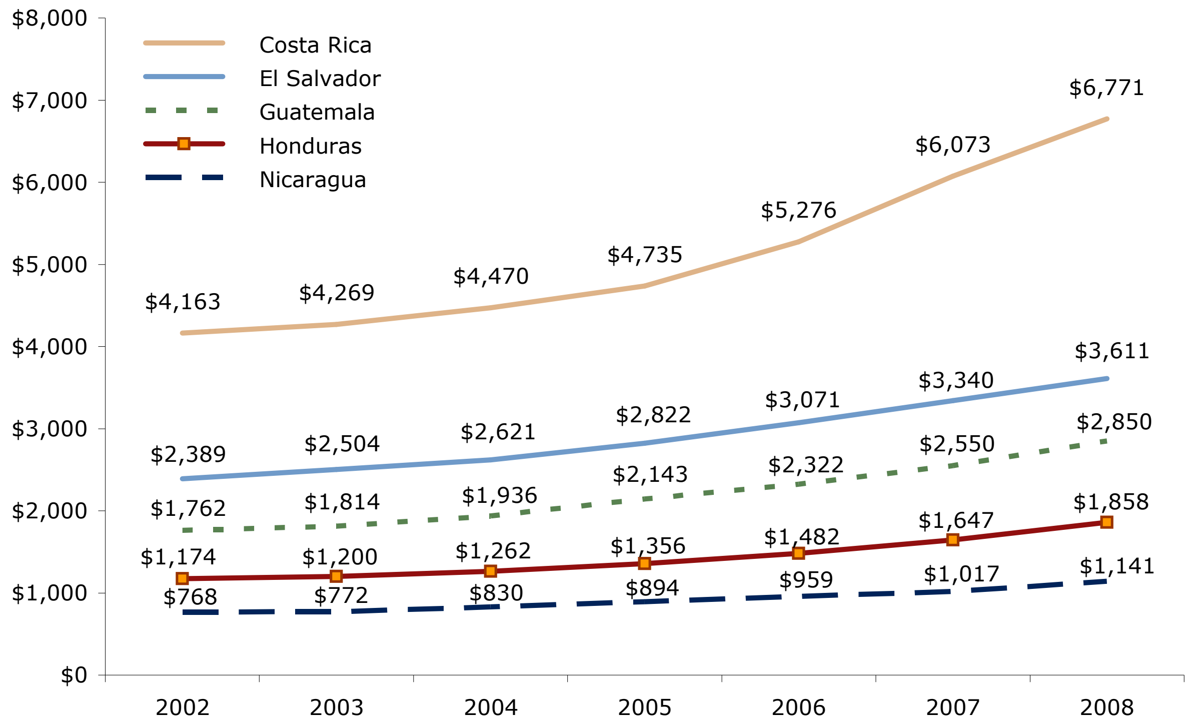
7 The first structural adjustment program (SAP) was signed by then-President Jose Azcona in 1988. The program was also supported by the International Monetary Fund and the USAID, but it did not start until Rafael Callejas became President in 1990. Other programs were signed and implemented with several international financial institutions thereafter, but usually with conditionalities that became difficult to attain. The SAPs signed by Honduras usually required privatization, devaluation, export promotion and increases in the price of public services. See Bull 2005.

8 Schulz and Sundloff-Schulz 1994.

Production and Growth

Honduras is the second smallest of the five economies in Central America. As shown in **Figure 1**, in terms of per capita income, Honduras is ahead of Nicaragua, but behind the other three countries in the area. It is worth noticing, however, that during the three years in the Zelaya period, per capita GDP increased consistently, and by a wider margin than during the previous administration.

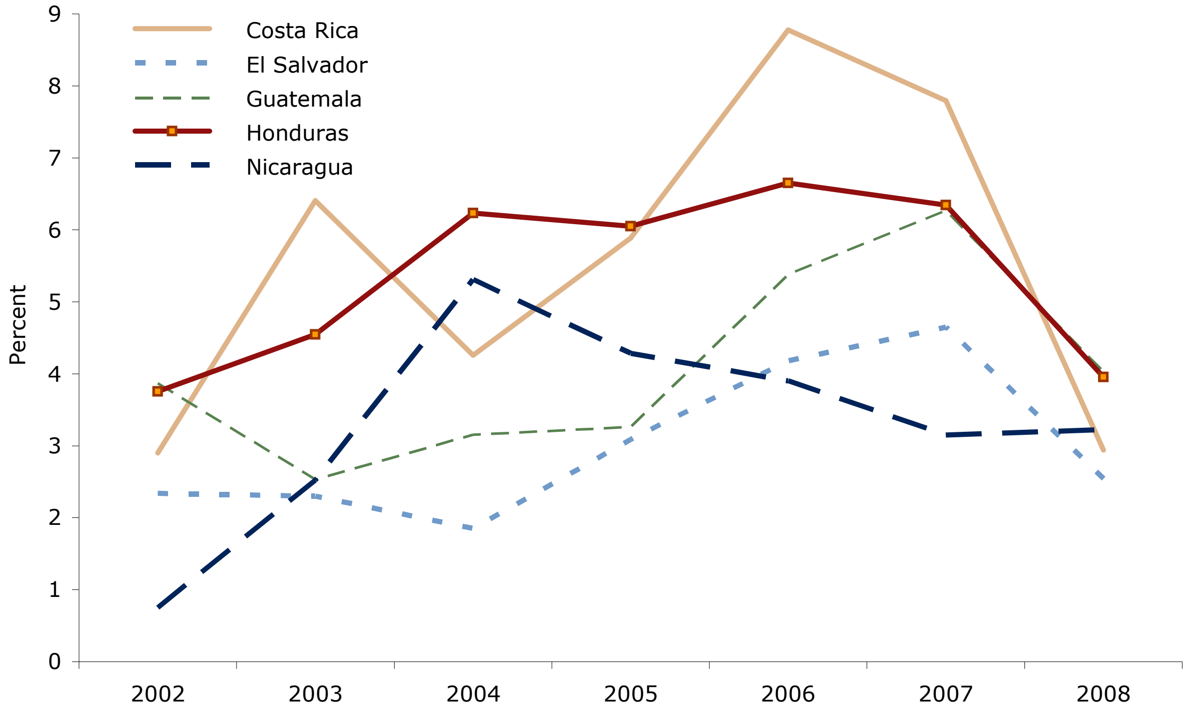
FIGURE 1
CENTRAL AMERICA: PER CAPITA GDP (CURRENT US$)



Source: Consejo Monetario Centroamericano 2009a, 2009b.

In **Figure 2** we see real GDP growing more than 6 percent per year from 2004 to 2007. During 2006 and 2007, the rates of GDP growth were higher than they had been during the previous four years, with Honduras ahead of all the countries in the region but Costa Rica. In 2008 the expansion slowed down as a result of the world recession, but output still grew 4 percent in real terms, the highest rate in the region.

FIGURE 2
Central America: Real GDP Growth Rates

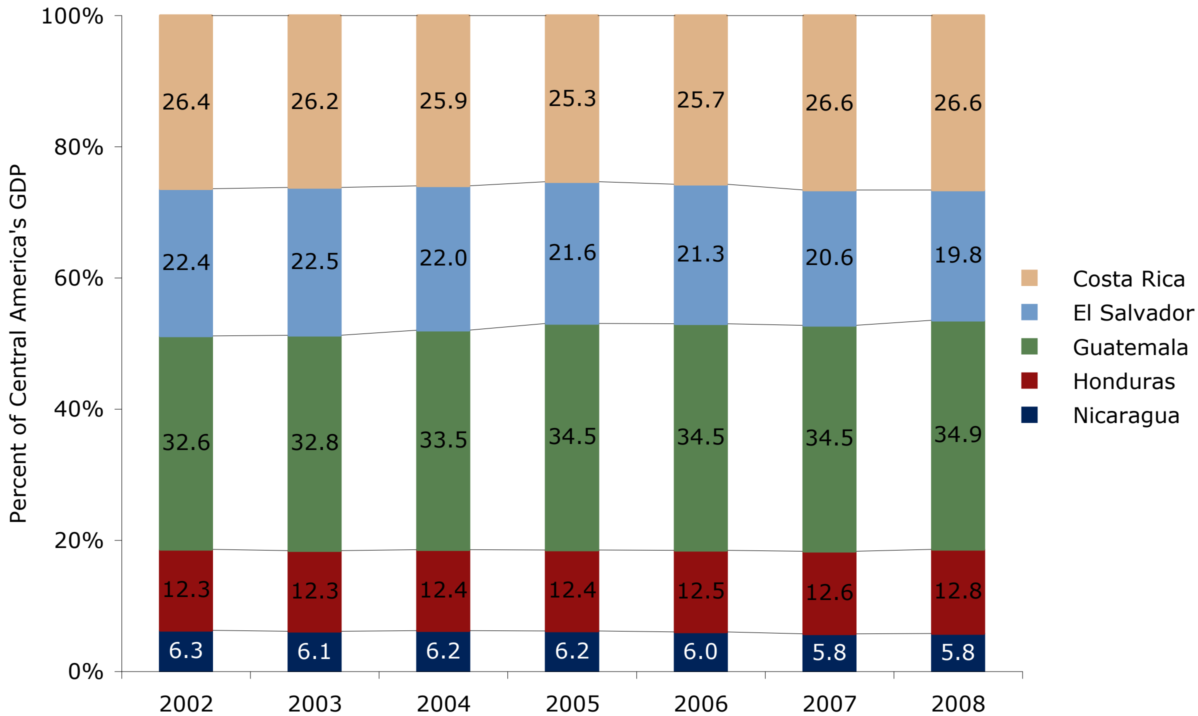


Costa Rica	2.9	6.4	4.3	5.9	8.8	7.8	2.8
El Salvador	2.3	2.3	1.9	3.1	4.2	4.7	2.5
Guatemala	3.9	2.5	3.2	3.3	5.4	6.3	4.0
Honduras	3.8	4.5	6.2	6.1	6.6	6.3	4.0
Nicaragua	0.8	2.5	5.3	4.3	3.9	3.2	3.2

Source: Consejo Monetario Centroamericano 2009b.

Figure 3 shows the Honduran participation in the region's GDP, which remains small, but shows a slight increase from 2006 to 2008. These gains in the Honduran share result mainly from output growth that is faster than that of El Salvador and Nicaragua.

FIGURE 3
Central America: Share of Each Country in Region's GDP (Percent)

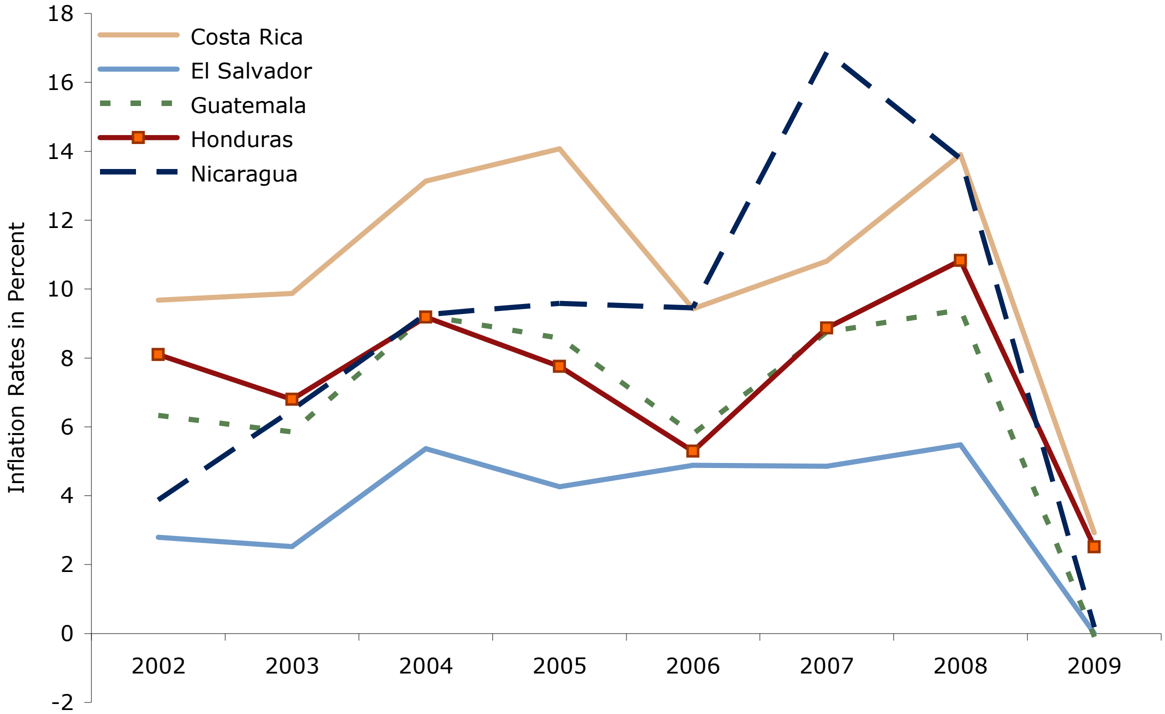


Source: Consejo Monetario Cetroamericano 2009b.

Price Stability

After a period of relative stability from 2002 to 2006, inflation started to pick up again in 2007 and reached 10.8 percent in 2008. (See **Figure 4**). As in other small and open economies, commodity and oil prices were among the most important determinants of inflationary pressures in 2008. A comparison with Central American neighbors shows that in 2006, Honduras had the second lowest inflation rate, only behind El Salvador (which operates within a dollarized economy); a similar situation occurred in 2007. In 2008 prices did pick up but, as already explained, this was mostly caused by international commodity prices.[9] As expected, prices have grown at a much slower pace during 2009; the year-over-year inflation rate last September was only 3.1 percent.[10]

FIGURE 4
Central America: Inflation Rates



Costa Rica	9.7	9.9	13.1	14.1	9.4	10.8	13.9	2.9
El Salvador	2.8	2.5	5.4	4.3	4.9	4.9	5.5	0.0
Guatemala	6.3	5.9	9.2	8.6	5.8	8.8	9.4	-0.1
Honduras	8.1	6.8	9.2	7.8	5.3	8.9	10.8	2.5
Nicaragua	3.9	6.5	9.3	9.6	9.5	16.9	13.8	0.2

Source: Consejo Monetario Centroamericano 2009b.
Note: Data from 2009 refer to the inflation rate between December 2008 and September 2009.

9 Consejo Monetario Centroamericano 2009b.
10 Banco Central de Honduras 2009a.

Monetary and Fiscal Policy

Various features of Honduran macroeconomic policy are summarized in **Table 1**. The Zelaya administration reduced the fiscal deficit, as a percent of GDP, from 3.35 in 2005 to 2.34 in 2008. In 2006 and 2007, the deficit was held at 1.12 and 2.9 percent of GDP, respectively. It is also worth noticing the important decrease in public debt, as a percent of GDP, which went from almost 45 percent in 2005 to 17.4 percent in both 2007 and 2008.

On the monetary policy side, Table 1 shows how a significant reduction of the lending rate[11] (from 18.5 percent in December 2005 to 16.5 percent in 2007) encouraged vigorous growth of credit to the private sector, in real terms, during 2006 and 2007. The resulting economic growth also contributed to a significant reduction in the open unemployment rate in the urban sector, which went from 6.5 percent in 2005 to 4.9 and 4.0 percent in 2006 and 2007, respectively.

Two elements, however, combined to prevent the continuation of this trend. First, inflation pressures from the international economy fueled higher price growth, which the central bank attempted to control by raising the policy interest rate (from 6 percent at the end of 2006 to 7.75 in December 2008); these policy moves put pressure on the lending rate, which went from 16.5 percent in 2007 to 20.0 percent in 2008.

A second element preventing the continuation of Honduran growth was the international financial crisis and world recession, which led to a scarcity of international funding that, in turn, also contributed to the rise in lending rates. According to ECLAC, Honduran financial institutions remained solid, and with limited exposure to contagion from the international financial crisis. However, foreign banks operating in the country were advised by their parent companies to maintain higher levels of liquidity, thus reducing availability of credit.[12]

The international situation only allowed for a limited increase in credit during 2008 (0.55 percent in real terms, as seen in Table 1). The government's response to the credit crunch in that year was to reduce the legal reserve requirement from 12 percent to 10 percent, thus freeing nearly US$95 million for use by the banking system in credit operations.[13] The reserve requirement was later pushed down to zero for loan requests where at least 60 percent of the lending resources would go to production activities.[14] The government also submitted funding requests to various external sources, including the government of Venezuela (US$30 million to be assigned to the Banco Nacional de Desarrollo Agropecuario - BANADESA), and US$100 million through the Bolivarian Alternative for Latin America and the Caribbean (ALBA).[15] The Honduran private sector reacted favorably to these moves, which were aimed at mitigating the impact of the global recession on the local economy.[16]

11 Data on the "lending rate" refer to a weighted average of the annual rates charged on loans provided by commercial banks.
12 By mid 2008, foreign banks in Honduras held 20 percent of total assets in the Honduran banking system. See ECLAC 2008, 113.
13 ECLAC 2008, 113.
14 See Consejo Monetario Centroamericano 2008, 44.
15 ECLAC 2008, 114.
16 La Prensa 2008.

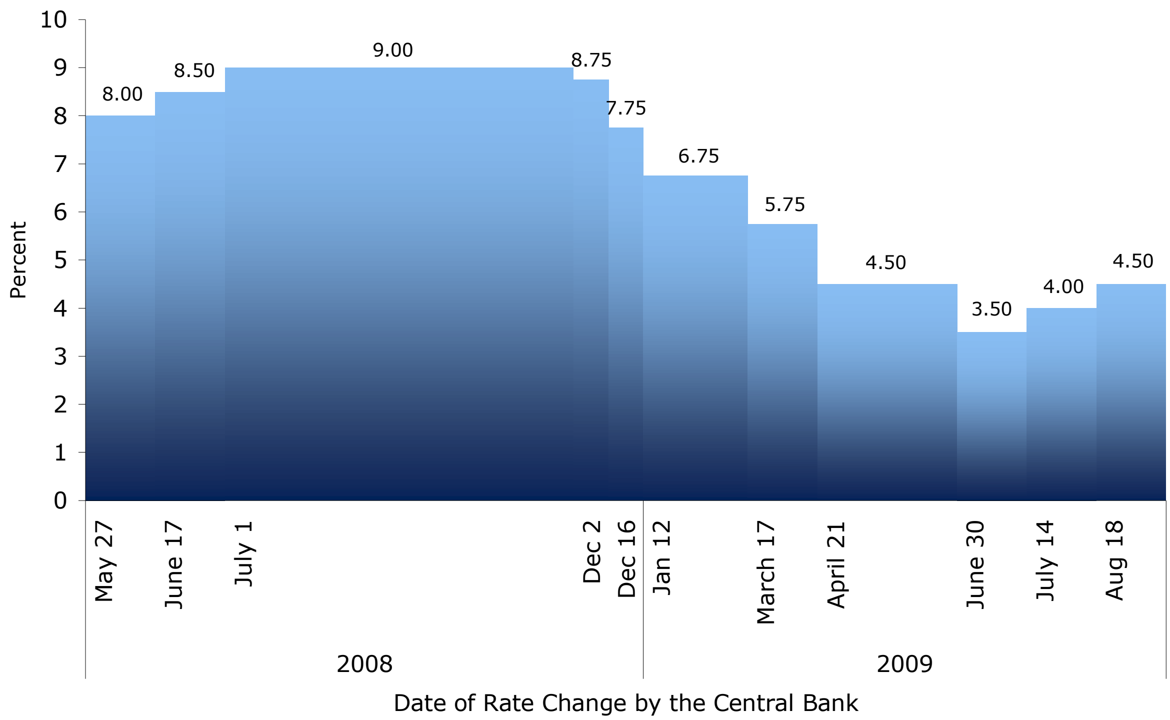
TABLE 1
Honduras: Selected Macroeconomic Indicators (Percent, unless otherwise indicated)

	Dec 2003	Dec 2004	Dec 2005	Dec 2006	Dec 2007	Dec 2008
Real growth of credit	4.06	-0.04	9.82	21.58	31.78	0.55
Nominal lending rate	20.24	19.45	18.36	16.6	16.46	20.04
Policy interest rate	NA	NA	7.00	6.00	7.50	7.75
Unemployment rate (open, urban sector)[1]	7.60	8.00	6.50	4.90	4.00	NA
Government budget balance (percent of GDP)[2]	-5.67	-3.40	-3.35	-1.12	-2.90	-2.34
Public debt (percent of GDP)[1]	NA	59.60	44.70	28.90	17.40	17.40
Nominal exchange rate	17.93	18.81	19.03	19.03	19.03	19.03
Net international reserves (millions US$)[2]	1,282.48	1,800.70	2,162.81	2,613.68	2,514.31	2,460.00
Terms of trade[1]	88.00	87.20	87.20	83.20	81.60	79.40

Source: Banco Central de Honduras
Note: [1] Information from ECLAC (2009). [2] Information from Consejo Monetario Centroamericano.

During 2009, the measures described above to face the global slowdown were complemented by reductions in the policy interest rate, which went from 7.75 in December 2008, to 3.5 percent in June 2009 (see **Figure 5**). When the rate went up on July 14, Zelaya and his cabinet were no longer in power and decisions were being made by members of the de-facto government.

FIGURE 5
Honduras: Policy Interest Rate (Percent)



Source: Banco Central de Honduras

Going back to Table 1 it may be seen that net international monetary reserves remained at reasonable levels, as will be explained in more detail in the next section. The sharp deterioration of the terms of trade did not hurt the level of reserves, partly as a result of strong remittances from abroad and strong merchandise exports. The general situation in the Honduran foreign sector allowed the nominal exchange rate to remain at 19.03 lempiras per dollar.

The Foreign Sector

Total exports rose 8.7 percent in 2008, compared to lower percentages in 2007 and 2006 (6.21 and 4.12, respectively). As described in **Table 2**, the expansion is explained mostly by the performance of merchandise exports, which rose more than 20 percent in 2008, an important recovery from weaker results in 2007 and 2006. This growth is partly explained by coffee, bananas, and palm oil, which contribute a combined 20 percent of the merchandise category (see **Table 3**).

TABLE 2
Honduras: Total Export Growth Rates (Percent)

Product/sector	2004	2005(p)	2006(p)	2007(p)	2008(p)
Merchandise Exports	**21.60**	**16.75**	**10.23**	**8.73**	**20.38**
Coffee	44.34	32.16	16.24	21.29	20.66
Banana	56.64	24.69	-7.30	19.94	32.58
Palm oil	6.91	-5.12	32.89	47.68	66.05
Cultured shrimp	9.28	-3.33	25.62	-2.96	-32.01
Cigars	20.01	5.51	-0.38	9.74	9.26
Plastic and plastic manufactures	137.24	18.32	33.43	-14.47	29.58
Tilapia	42.30	74.89	17.34	14.45	18.28
Textiles	143.28	226.92	-25.83	36.70	-8.54
Soap and detergent	56.25	-20.30	7.97	-9.27	25.78
Other products	3.97	10.28	10.85	-0.97	21.72
Goods for transformation (GFT)	**20.85**	**9.06**	**0.56**	**4.61**	**0.95**
Total Merchandise + GFT	**21.11**	**11.76**	**4.12**	**6.21**	**8.69**

Source: Banco Central de Honduras
Note: (p) indicates preliminary data.

The solid results in merchandise trade in 2008 were accompanied by a meager less-than-one-percent growth in the so-called "goods for transformation" category (GFT), commonly referred to as "the maquila sector."[17] Table 3 shows that the performance of this sector has been rather irregular during the last years, which is unfortunate, since it represented almost 56 percent of total exports in 2008.

17 These GFT are produced within Free Zones or Export Processing Zones, which were described in a previous footnote.

TABLE 3
Honduras: Composition of Exports of Merchandise and Goods for Transformation (Percent)

Product	2003	2004	2005(p)	2006(p)	2007(p)	2008(p)
Coffee	5.22	6.22	7.36	8.21	9.38	10.41
Banana	3.62	4.69	5.23	4.66	5.26	6.41
Palm oil	1.51	1.33	1.13	1.44	2.01	3.06
Cultured shrimp	3.20	2.89	2.50	3.02	2.76	1.72
Cigars and Cigarettes	1.61	1.60	1.51	1.45	1.49	1.50
Plastic and plastic manufactures	0.57	1.11	1.18	1.51	1.22	1.45
Tilapia	0.45	0.53	0.83	0.94	1.01	1.10
Textiles	0.19	0.39	1.14	0.81	1.05	0.88
Soap and detergent	0.93	1.20	0.85	0.89	0.76	0.88
Other products	17.71	15.21	15.00	15.97	14.89	16.68
Goods for transformation (GFT)[1]	64.97	64.83	63.26	61.10	60.18	55.90
TOTAL	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source: Banco Central de Honduras 2009c.
Notes: (p) indicates preliminary data. [1] Refers to *bienes para la transformación*, commonly known as *maquila*.

The relative weight of GFT has declined steadily since 2003, as shown in Table 4. Interestingly, low Honduran wages (which remained for many years among the lowest in Central America), and participation in the CAFTA-DR[18] agreement have not prevented this decline. This should come as no surprise since almost 87 percent of exports in the GFT sector are generated by textiles and textile materials (see **Table 4**), activities in which various Asian nations have a competitive advantage due to their lower wages. Unfortunately, the lack of location-specific assets, such as a skilled labor force and various forms of physical and social infrastructure makes it difficult for Honduras to move up the value added chain, towards segments that are not as heavily dependent on low wages and/or lack of labor rights. The increase in exports associated with machinery and equipment, however, denotes an attempt at moving towards other areas in foreign trade.

Paradoxically, the dynamic export activities within the Honduran economy have recently been those that are based on commodities or primary products, which are precisely the ones that behave in the least dynamic fashion within the global economy. It is thus clear that important changes have to be promoted if this country is to move to a higher level of development. We will elaborate a bit more on this argument in the next sections.

TABLE 4
Goods for Transformation[1]: Composition of Exports (Percent)

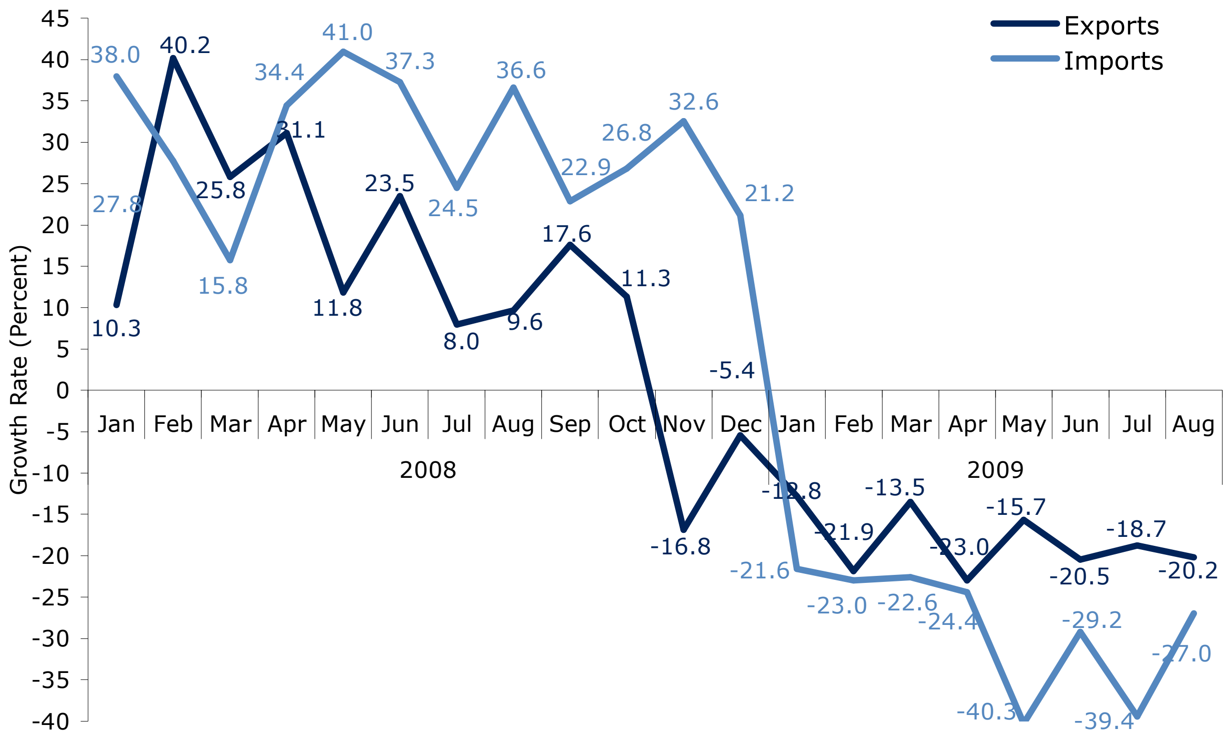
Sector	2003	2004	2005 (p)	2006 (p)	2007 (p)	2008 (p)
Textiles and textile materials	91.3	90.2	85.8	85.0	85.0	86.6
Machinery and equipment	6.6	7.1	10.1	13.7	13.4	11.7
Other products and/or materials	2.0	2.8	4.1	1.3	1.6	1.6
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Banco Central de Honduras 2009c.
Notes: [1] Goods that are produced within Free Zones or Export Processing Zones, traditionally referred to as *maquila*. (p) indicates preliminary data.

18 CAFTA-DR is the Central America-Dominican Republic Free Trade Agreement with the U.S.

Figure 6 shows more clearly the impact of the global recession on merchandise exports. It is clear that sales to other countries started to fall in November 2008, and have continued to decline throughout the portion of 2009 for which data is available. Unfortunately the falloff in export demand has combined with an uncertain political situation which has clearly delayed the application of counter-cyclical policy measures.

FIGURE 6
Honduras: Recent Evolution of Merchandise Trade[1]



Notes: [1] Monthly, year-over-year rates of growth; does not include the goods for transformation sector.
Source: Banco Central de Honduras 2009e.

Merchandise imports also fell in 2009; in fact, as shown in **Table 5**, every single import category saw a significant decrease with respect to 2008. The reduction in the price of oil and of raw materials on the one hand, and intermediate inputs on the other hand, contributed to the large decline in these categories. In contrast, during 2008, the opposite situation in terms of international prices led to substantial increases in the oil and raw material bills.

TABLE 5
Honduras: Structure and Evolution of Imports [1] (January through May of Each Year)

Type of import	Share in total imports (percent)		Rate of growth (percent)	
	2008	2009	2008	2009
Consumption goods	26.89	34.44	22.17	-4.79
Fuel, lubricants and electricity	22.05	14.63	63.75	-50.68
Fuel	*21.42*	*13.93*	*65.07*	*-51.67*
Lubricants	*0.58*	*0.70*	*18.60*	*-10.12*
Electricity	*0.05*	*0.00*	- -	- -
Raw materials and intermediate products	26.94	28.24	65.07	-51.67
Construction materials	3.51	3.61	19.79	-23.60
Capital goods	18.34	16.70	29.09	-32.30
Others	2.26	2.38	5.16	-21.80
TOTAL	**100.00**	**100.00**	**31.20**	**-25.66**

Source: Banco Central de Honduras.
Notes: All data preliminary. [1] Excludes the “goods for transformation” sector.

On December 22, 2007, Honduras became a member of Petrocaribe, a pact for energy cooperation involving 18 countries in the Caribbean and Latin America, including among others, Venezuela, Cuba, Nicaragua, and Guatemala. Obviously the center piece of this pact is Venezuela, which provides substantial volumes of oil with favorable credit conditions to the member countries.[19] In the case of Honduras, it was initially disclosed that the country would purchase between $750 and $800 million worth of Venezuelan oil (approximately 40 percent of the Honduran oil bill in 2008).[20] Membership in Petrocaribe allows the country to only pay 40 percent of the total bill in cash; the remaining 60 percent is paid in kind (i.e. with exports of goods and services), over a 25 year period, with two grace years and a 1 percent annual interest rate.

Even though oil prices declined considerably after the second half of 2008, over the whole year, higher consumption volumes made up for the lower prices; as a result, imports of fuel and lubricants increased more than 63 percent during that year.

As expected from the behavior of imports and exports, the current account balance went, as a percent of GDP, from -3.73 in 2006, to -9.94 in 2007 and to -13.80 in 2008, as seen in **Table 6**. The lack of strength in the export processing zones did not help the Honduran economy during 2006 and 2007, when high commodity prices raised the import bill. And during 2008 the slowdown in the global economy must have prevented further investment and production in the maquila sectors.

Remittances from other countries have become a very large portion of GDP, peaking at 21.3 percent of GDP in 2006. In recent years they have played an increasing role in providing foreign

19 For more information on Petrocaribe, see http://www.petrocaribe.org/.
20 See *La Nación* 2008a.

exchange. They are expected to decline during 2009, but hopefully not to the extent of causing a major imbalance within the balance of payments.[21] According to a 2007 household survey, remittances from abroad represent, on average, 9.5 percent of household income.[22]

The reduction in the balance of the capital and financial account, and in foreign direct investment, provide a clear picture of the international economic situation: stricter financing conditions on foreign funds, and lower levels of investment by the multinationals as a result of more pessimistic perceptions on the recovery of the world economy. International monetary reserves, which were enough to cover 5.6 months of imports in 2006, fell to 3.6 months of imports in 2008.

TABLE 6
Honduras: Selected Components of the Balance of Payments (Percent of GDP)

	2002	2003	2004	2005	2006 (p)	2007 (p)	2008 (p)
Current account	-3.58	-6.72	-7.65	-2.98	-3.73	-9.94	-13.80
Family remittances	9.74	10.23	12.83	18.20	21.30	20.60	19.60
Capital and financial account	3.24	4.29	11.26	6.96	9.35	9.00	11.80
Foreign direct investment	3.42	4.74	6.23	6.14	6.17	6.61	6.10
Net International Reserves (in months of imports)[1]	5.84	4.84	5.56	5.40	5.60	5.00	3.60

Source: Banco Central de Honduras 2009c.
Notes: (p) indicates preliminary data. [1] Consejo Monetario Centroamericano 2009a.

21 The situation, however, might change. A recent study by the Inter-American Development Bank estimates that remittances to Latin America from the U.S. may fall by 11 percent in 2009 as a result of the recession. See Inter-American Development Bank 2009.
22 The other major sources of income are wages (45 percent) and proceeds from self-employment (35.7 percent). See Instituto Nacional de Estadística de Honduras 2007.

Poverty, Social and Political Conflict, and the Need for Reforms

As explained in the first section of this report, Honduras is one of the poorest countries in Latin America; it is also a country of sharp contrasts between the urban and rural populations, and between the rich and the poor. Within urban zones, 97.7 percent of the housing units have access to electricity, but this rate drops drastically (to 49.8 percent) in the rural sector.[23] The head of the urban household completes, on average, 6.4 years of schooling while their counterparts in the rural regions only complete 4.6 years of schooling; perceived income in the urban areas is twice as big as that in the rural areas.[24]

In 2001, as shown in **Table 7**, more than 64 percent of Honduran households lived below the poverty line. This proportion declined slightly over the next two years, only to move up again in 2005 to 66 percent. During the two first years of the Zelaya administration this percentage fell significantly to 62.1 and 60.2, respectively, in 2006 and 2007.

TABLE 7
Central America: Percent of Households Below the Poverty Line[1]

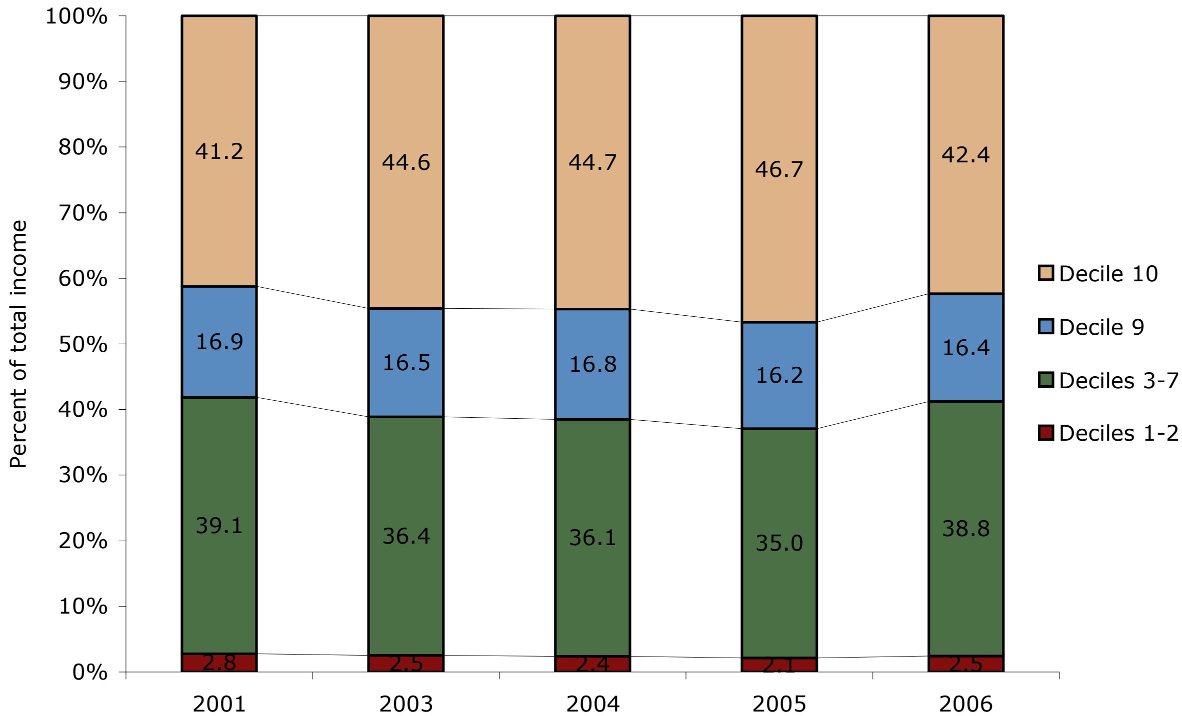
	2000	2001	2002	2003	2004	2005	2006	2007	2008
Costa Rica	20.60	20.30	20.60	18.50	21.70	21.20	20.24	16.73	17.70
El Salvador	38.79	38.81	36.77	36.10	34.59	35.10	30.73	34.59	NA
Guatemala[2]	56.19	NA	NA	NA	NA	NA	51.00	NA	NA
Honduras	NA	64.40	63.90	63.50	64.30	65.80	62.10	60.20	NA
Nicaragua[2]	NA	45.80	NA	NA	NA	46.2	NA	NA	NA

Source: Socio Economic Database for Latin America and the Caribbean (SEDLAC)
Notes: [1] Refers to moderate poverty. [2] Refers to individuals, instead of households.

Inequality is shown in **Figure 7** as the share of each decile of the population in total income; it decreased in 2006. From 2005 to 2006, the percent of income captured by the lower (poorer) deciles went from 2.1 to 2.5 percent, and the percent going to the intermediate deciles also increased from 35 to almost 39 percent. At the same time, the share captured by the richest segment fell, from nearly 47 percent in 2005 to 42.4 percent in 2006.[25]

23 Instituto Nacional de Estadística de Honduras 2007.
24 Ibid.
25 The most widely used indicator of inequality, the Gini coefficient, was only available up to 2005 when it reached 0.55. By comparison, the coefficients, also in 2005, for Nicaragua, El Salvador, and Costa Rica were 0.52, 0.49, and 0.47, respectively.

FIGURE 7
Honduras: Income Inequality



S
ource: Socio-Economic Database for Latin America and the Caribbean (SEDLAC).

Minimum Wage Reform

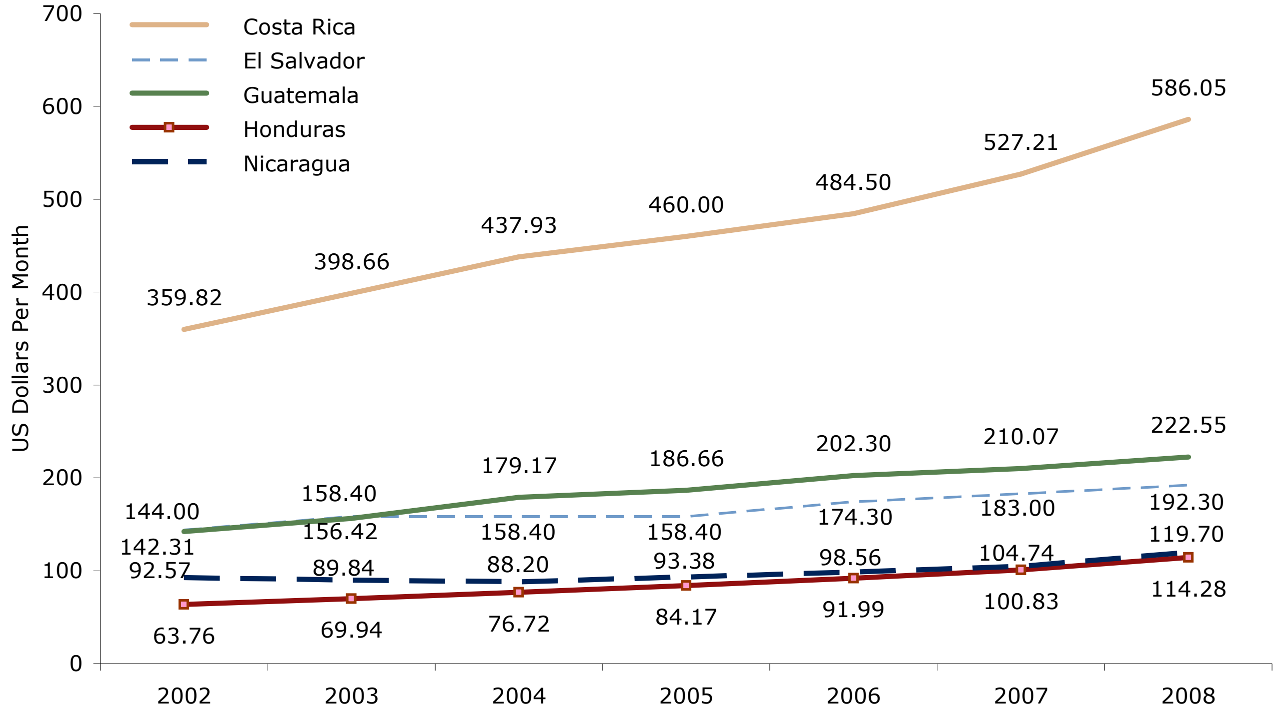
The above information on poverty and inequality is hardly surprising, and we have already discussed the low ranking Honduras has in terms of the human development index. **Figure 8** shows that, up until 2008, this country had, along with Nicaragua, the lowest minimum wage rates in the region. Not only are these numbers very low, but also the gap with respect to the country's Central American neighbors is striking.

On December 23, 2008, and after one month of fruitless negotiations between workers and employers, the Zelaya administration decided to increase the monthly minimum wage in the urban area from 3,400 Lempiras (US$178.66) to 5,500 Lempiras (US$289.02), about a 60 percent increase.[26] In the rural areas, the minimum wage was increased to 4,055 Lempiras (US$213.08). The government decree (reference number 374-STSS-08), set to take effect on January 1st, 2009, was given a warm reception by labor, but generated bitter reactions from employers.

Before the government's decree, the workers' goal was to bring the minimum wage to the level of the basic consumption bundle: 6,200 Lempiras (US$325.80). With the changes approved in December, the minimum wage in the urban sector would cover 88.71 percent of the basic bundle, while the coverage in the rural sector would only reach 65.40 percent.

26 Heraldo 2008 and Hondurasnews 2009. The conversion from Lempiras to U.S. dollars was made with a rate of 19.03 Lempiras for one dollar. This rate is published at the Banco Central de Honduras' web page, http://www.bch.hn/tipo_de_cambiom.php

FIGURE 8
Central America: Minimum Wage Rates Per Month (US$)



Source: Consejo Monetario Centroamericano 2009b.

During the wage negotiations, employers argued that, due to the world recession, the minimum wage should not be modified.[27] After the December 23rd decree, the business sector filed numerous appeals to the Supreme Court, on the grounds that the wage increase violated their constitutional rights. Almost one month after the government's announcement, the Asociación Nacional de Industriales (ANDI) suggested to their affiliates that they should avoid paying the new salaries before the appeal was resolved.[28] By February 2009 the Constitutional Court had received more than 500 appeals from various groups within the business sector.[29]

The employers' position not only included appeals to the Supreme Court; shortly after the release of the government decree, ANDI's President recommended that firms fire one out of every three employees.[30] He later explained that if the Court ruled against ANDI, the next day there were going to be firings; but if it ruled in ANDI's favor, then workers, businesses, and government would negotiate a new minimum wage.[31]

The legal office of the Honduran government (Ministerio Público) recommended in April that the Supreme Court reject the appeals submitted by employers on the grounds that the wage increase did not imply a violation of constitutional rights.[32] The Ministerio Público's recommendation was not

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27 Ibid.
28 *La Prensa* 2009a.
29 *El Heraldo* 2009a.
30 *La Prensa* 2009b.
31 *El Heraldo* 2009b.
32 *El Heraldo* 2009c.

binding; however, towards the end of April the Supreme Court ruled that the increase in the minimum wage "is consistent with constitutional rights and therefore stands."[33] The Supreme Court indicated that the law allows the government to determine the minimum wage, and that the government must guarantee fair remuneration. The Court further argued that the government's decision on the minimum wage had been based on a socioeconomic study of the labor market which considered elements like the basic consumption bundle and cost of living estimates by the Instituto Hondureño de Estadística. With regard to the businesses' claims that the wage increase would lead to firing of workers, the Court argued that the high cost of the basic consumption bundle was an element of social justice which should lead to reasonable capital and labor relations.[34]

It is clear that the decision to raise salaries generated very adverse reactions from the business sector, and that after the decision of the Supreme Court some workers did lose their jobs.[35] But the situation already described in terms of poverty, inequality, and human development warranted strong actions regarding minimum wages.

One may argue that a 60 percent increase was excessive, but the truth is that, even after the raise, wages do not cover the basic consumption bundle. And there are also the final arguments from the Supreme Court, which very clearly support the decision to raise salaries on the grounds that it is related to the cost of the basic consumption bundle and to other elements in the Honduran cost of living.

In an interesting article, Gindling and Terrel (2006) show that in Honduras: "wage increases do reduce extreme poverty: a 10% increase in the minimum wage will reduce the probability that an average individual in the labor force is in extreme poverty by 1.8%." For large private firms: "a 10% increase in the minimum wage reduces extreme poverty and poverty by 2.0% and 1.9%, respectively." Unfortunately, the authors also report that: "legal minimum wages apply to all employees in the private sector, although … they are complied with only in large private firms and not in small private firms."

To maintain the minimum wage at its then-current level, which was the position of the business community, would have allowed it to only cover 54 percent of the basic consumption bundle. This would have been one more step in pushing the country down to more poverty and inequality.

Other Reforms

The social reforms promoted during the Zelaya administration go well beyond the increase in the minimum wage. In particular, his administration removed one of the most critical barriers to education: the national policy of mandatory school fees. Abolishing these fees opened the doors of the elementary school system to more than 450,000 Honduran children.[36]

33 *El Heraldo* 2009d. Free translation by the author.
34 Ibid.
35 The bitterness on the side of business leaders became even clearer when, in January 2009, the head of ANDI issued the recommendation that those who had dollar accounts within the country take those dollars out and send them to another place. The recommendation came as a result of regulations related to the financial sector, but it is an interesting coincidence that it was issued in January 2009, just in the middle of the debates on the minimum wage increase (*La Prensa* 2009c).
36 See OEI 2009.

Various food programs were also expanded, increasing the number of children receiving one free school meal to 1.068 million.[37] As a comparison, 800,000 children benefited from the program in 2005.

The Current Situation

As noted above, the economy slowed in 2009 with the world recession; however it was further hit by the instability and other adverse impacts of the crisis that followed the coup of June 28. Although it is sometimes difficult to separate these two effects, they are both significant.

From July 2 to November 3, international reserves at the central bank have fallen by $444.6 million, or 18.4%. The current level of $1.98 billion represents a level of about 3.2 months of imports, which is at the margin of sufficiency.[38] At present, Honduras would have access to another $163.9 million of reserves from the IMF, under a special allocation of SDRs created this year and extended to all member countries. However, because the de facto government is not recognized internationally, access to these reserves has been denied by the Fund.

The tourism sector, which grew at a rapid 14.3 percent last year, is expected to decline this year because of both the U.S. and world recession, and also because of the crisis.[39] The U.S. State Department has issued a "travel alert" recommending that U.S. citizens "defer all non-essential travel to Honduras" because of the "unstable political and security situation."[40]

Some of the impacts of the current crisis are difficult to quantify but they are undoubtedly significant. Jesus Canahuati, vice president of the nation's chapter of the Business Council of Latin America, estimates that the curfew imposed by the de facto regime cost the economy $50 million per day.[41]

From January to August, the IMAE (Indice Mensual de Actividad Economica) has shown a 3.4 percent decline, compared to growth of 2.4% in the same period from 2008. The biggest drops are in Construction (-33.6%) and Industrial Manufacturing (-8.1%).[42]

As recently as June, Consensus Economic had forecasted 0.7 percent growth for 2009; by late September this was lowered to negative 2.6 percent; some of this undoubtedly reflects the impact of the crisis.[43]

Before the coup there was already a sharp fall-off in foreign direct investment (FDI), which dropped by 42.3 percent for the first half of 2009, as compared with 2008. The uncertainty created by the present crisis is expected to worsen this trend.[44]

37 World Food Programme 2009.
38 Banco Central de Honduras 2009b.
39 Instituto Hondureño de Turismo 2009.
40 U.S. State Department 2009.
41 Schmidt and Martinez 2009.
42 Banco Central de Honduras 2009d.
43 Plummer 2009.
44 Banco Central de Honduras 2009f.

The coup government has also called for a 5.9 percent reduction in the budget for 2010, which would likely impede the recovery.[45]

Conclusion

During the Zelaya administration, the Honduran economy performed well: inflation was kept under control (except for 2008, when unusually high commodity prices pushed up inflation rates in several countries), the economy grew more than during the previous administration, and the levels of international monetary reserves allowed the country to maintain a stable foreign exchange rate.

The country remains poor, but social and economic policy contributed to reduce inequality and poverty. Important reforms in education, like the ones mentioned above, will bring more opportunities to the poorest segments of the population. In the long-run, a more-educated labor force will allow for a more diversified economy and the possibility to move up the value added chain.

An increase in the minimum wage in December 2008 caused much controversy and generated bitter reactions from the business sector. With the lowest wages in the Central American region, however, a step in that direction was necessary in order to fight poverty. Employers were originally planning for the minimum wage to remain unchanged and claimed later that the approved increase was too high. After the rise, however, the minimum wage was still not enough to cover the value of the basic consumption bundle.

Currently, the combination of political instability and the world recession is taking its toll on economic performance and this will hurt the most vulnerable sectors of the population, unless measures are taken to protect them from the deteriorating economy.

45 La Prensa 2009d.

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