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Honduras: IMF Austerity, Macroeconomic Policy, and Foreign Investment

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Executive Summary

In December 2014, the Honduran government signed an agreement with the International Monetary Fund (IMF) giving the country access to a total of $189 million in financing over three years. As a condition of the deal, Honduran authorities agreed to implement fiscal consolidation amounting to 6.5 percent of GDP over four years, in addition to so-called "structural reforms" including privatizations, pension reforms and public sector layoffs. The stated goal of this program is to lower government debt by shrinking the public sector budget deficit, but the IMF is supporting this austerity program in a context of very high poverty and acute income inequality.

In this paper, we examine the IMF agreement with Honduras and find that:

- The fiscal austerity included in the plan comes during a period of persistently high poverty, increasing inequality and a labor market that remains far from recovered from its pre-recession (2008) condition. The broadest measure of unemployment and underemployment increased from 35.5 percent of the labor force in 2008 to 56.4 percent in 2013. It is highly probable that pursuing austerity measures in this context will make the situation worse.

- The agreement signed between the IMF and Honduras ostensibly aims to lower government debt, but the timing and composition of the fiscal consolidation mean that the costs will likely fall disproportionately on the country's poor majority. Spending cuts target public sector workers, capital spending and local governments, with little regard to protecting those who are most vulnerable.

- A significant portion of the spending cuts target the government wage bill, expected to decrease by 1.7 percent of GDP by 2017. If fully implemented, the IMF plan will radically reshape the public sector in Honduras through austerity measures and a sweeping reform program that effectively privatizes important parts of the economy.

- Fiscal consolidation under the IMF agreement is frontloaded, with more than three-quarters of the four-year consolidation goal achieved by 2015. By way of an explanation, the agreement refers to the possibility of "strong resistance" to these austerity measures and explicitly mentions making these policy changes well ahead of the 2017 general election.

- The IMF plan guiding the Honduran government's macroeconomic policy for the next three years contains within it only one provision designed to protect the impoverished majority in

Honduras, and that is a floor on social spending of 1.6 percent of GDP.[1] This requirement is insufficient in both size and scope, as it does not include much of the public spending on health and education.

- The IMF plan for dealing with large and persistent current account deficits relies heavily on Honduras continuing to receive large net inflows of foreign direct investment. This macroeconomic policy decision is a factor driving the country's race-to-the-bottom plan for attracting foreign investment, which is characterized by an extreme liberalization program epitomized by the ZEDEs, or "charter cities," program.

1 IMF (2014).

Introduction

For Honduras, the global Great Recession coincided with a domestic political crisis. In June of 2009, a military *coup d'état* deposed the country's democratically elected president. In a previous paper,[2] CEPR examined how in the three years following the coup, economic growth slowed, poverty and extreme poverty increased, and there was rising unemployment and income inequality. In this paper, we focus on the International Monetary Fund's (IMF) program in Honduras that, if fully implemented, will radically reshape the public sector in Honduras through austerity measures and a sweeping reform program that effectively privatizes important segments of the economy.

In December 2014, the Honduran government signed an agreement with the IMF giving the country access to a total of $189 million in financing, released in installments over three years, to support a program of fiscal consolidation, and reforms to several key state-run enterprises. The second review was conducted in July 2015 and according to the Fund, the program is meeting its benchmarks.[3] As a condition of the deal, Honduran authorities agreed to implement fiscal consolidation amounting to 6.5 percent of GDP over four years, in addition to a series of so-called "structural reforms" including privatizations, pension reforms and public sector layoffs.[4] The stated goal of this program is to lower government debt by shrinking the public sector budget deficit. However, the IMF is supporting this austerity program in a context of very high poverty and acute income inequality.

While in some ways the IMF correctly diagnoses problems in Honduras' economy, such as the country's high poverty rate, its current loan agreement is set to make the situation worse. The IMF program puts most of the weight on spending cuts as a way of achieving deficit reduction, as opposed to revenue increases. Importantly, the deal supports the privatization of public services as one of the most significant deficit reduction strategies. We find that the expectation of an increase in the quality of public services, accompanied by lower costs to the government, may be unrealistic considering the country's substantial problems with corruption and rule of law. Recent corruption cases such as the election financing scandal involving procurement at the National Honduran Social Security Institute, or IHSS (*Instituto Hondureño de Seguridad Social*), call into question the ability and willingness of the current Honduran government to effectively regulate. In addition, there is already evidence indicating a decline in total investment, and an increase in liabilities for the public sector in the form of public guarantees included in the contracts for public-private partnerships. Public

2 Johnston and Lefebvre (2013).
3 IMF (2014a).
4 For full details, see "Memorandum of Economic and Financial Policies for 2014–17" and "Attachment II. Technical Memorandum of Understanding" in IMF (2014a).

investment was reduced in order to create budget savings and to make room for the private sector, but private investment has not made up the difference.

Furthermore, the IMF program does not address the country's large and persistent current account deficit, which is the sum of the country's trade balance plus net transfers such as remittances. These current account deficits are not sustainable, and have in recent years only been enabled by high levels of foreign direct investment (FDI). But foreign investment flows are notoriously fickle, so this is a high risk strategy. Furthermore, in order to secure these high inflows of FDI, Honduras has been forced to adopt policies that compromise its future growth and development, as well as undermining democracy, accountability, public interest regulation, safeguards against corruption, and national sovereignty. Through its lending program and technical assistance, the IMF is promoting a risky national economic strategy that makes many sacrifices in order to secure the FDI that is necessary to balance a chronic current account deficit, rather than dealing with the problems underlying the deficit itself, which is currently determined in large degree by high imports levels relative to exports.

In this paper, we review how reduced government spending has come at the cost of economic growth, poverty reduction and public sector investment. Government resources have been invested in public-private partnerships (PPPs) that are ineffective because of significant problems in their transparency and accountability. The first section gives an overview of the major fiscal austerity policies that form part of the agreement with the IMF. Next we examine what is missing from the IMF agreement, a critical assessment of the country's balance of payments. In the last section we describe the implications of the current government's apparent commitment to shrinking the public sector by looking at the structural reforms mandated under the agreement, which dramatically alter the role of the public sector in Honduras.

Fiscal Austerity

The government of Honduras began having budget troubles in 2009 due to a recession resulting both from domestic events – most notably the military coup in June of that year – and external factors including the U.S. and world recessions. For the past three years, Honduras has maintained high levels of spending relative to revenues, with the highest budget deficit coming in 2013, an election year. The combined effects of the 2009 downturn and these large deficits, which involved costly debt (short-term, high interest), caused the public sector debt to more than double in six years, as a percent of GDP. The agreement signed between the IMF and Honduras ostensibly aims to lower the government debt, but the timing and composition of the fiscal consolidation mean that the costs will likely fall disproportionately on the country's poor majority. Spending cuts target

public sector workers, capital spending and local governments, with little regard to protecting those who are most vulnerable.

The plan, jointly approved by the government of Honduras and the IMF, calls for fiscal consolidation of 6.5 percent of GDP over four years. The austerity from this program falls heavily in 2015, with fiscal consolidation of 3.1 percent of GDP that year, adding to the consolidation of 1.9 percent the year before. A more gradual adjustment seems to have been ruled out based on political concerns, with the 2017 general elections in Honduras explicitly referenced in the IMF staff report:[5]

> There may be strong resistance to measures to reduce the wage bill, and to those to lower ENEE's [the national electric company's] deficit. Implementation of these measures could become more difficult as the 2017 elections approach. To limit these risks, the program envisages frontloading these actions, especially raising electricity tariffs and reducing ENEE's payroll.

On the revenue side, Honduras approved a major tax reform in December 2013 that eliminated some exemptions and increased taxes on gasoline, personal income, telephone services, and raised the value added tax from 12 percent to 15 percent. According to the IMF, the tax reform led to an increase in revenue equal to 1.7 percent of GDP in 2014, about two-thirds of which came from the increase in the value-added tax, and 10 percent from the gasoline tax.[6] In a January 2015 study the Central American Fiscal Studies Institute (*Instituto Centroamericano de Estudios Fiscales,* or ICEFI) published a critique of this tax reform, saying that the measure was regressive and disproportionately affected those with low income because it increased the proportion of indirect taxes.[7]

In negotiations with the Fund at the end of 2014, Honduran authorities argued that it would be politically difficult for them to pass another law to raise taxes so soon after the December 2013 tax reform. Like the argument that helped determine the pace of the fiscal consolidation, this reasoning was also accepted by the IMF:[8]

> The authorities also indicated that, with the government lacking a congressional majority and given the substantial revenue measures already approved, there is not much scope for further tax rate increases during the current administration.

5 IMF (2014a).
6 Page 8, IMF (2014a).
7 ICEFI (2015a).
8 IMF (2014a).

The approved program thus deals almost exclusively with achieving a sharp reduction in government expenditures. Based on analysis of similar policies, we can predict that this may increase income inequality in Honduras. Studies show that fiscal austerity programs tend to raise inequality, and IMF research has shown that spending-based fiscal consolidations tend to have worse effects, increasing inequality more than tax-based fiscal consolidations.[9] The main areas targeted for spending reductions include the government wage bill, capital spending, transfers to local governments, the national electric company (Empresa Nacional de Energía Eléctrica, ENEE) and the national telecommunications company, Hondutel (Empresa Hondureña de Telecomunicaciones).

Under the IMF agreement, wages for federal employees are slated to stay constant for 2014-2015, and then increase at a maximum of 5 percent annually from 2016 to 2017. This would imply a maximum salary increase of 10.3 percent over 2014-2017, below the rate of expected inflation. Prices during the same period are forecast to increase 16.1 percent. The current administration also plans to eliminate so-called redundant positions and to limit recruitment in line with new, lower budget ceilings. In sum, many of those who work for the federal government, such as teachers and healthcare workers, will face layoffs, while those who remain employed will take real wage cuts.

Despite the large impact of these measures for the public sector and for the overall consolidation plan, the IMF agreement does not include a justification for targeting the government wage bill. Savings from reducing expenditure on wages and salaries is expected to equal 1.7 percent of GDP over four years (2014-2017), but it is not clear whether the number of public sector employees or their compensation is out of line with countries at a similar level of development as Honduras. On the other hand, the level of technical capacity of public servants in Honduras is one of the lowest in the region and has shown little improvement in recent years.[10] This would suggest that investing in training for civil servants and improving operating procedures, while maintaining public sector employment as an important source of formal employment in the economy, might be a better policy.

The IMF agreement also imposes changes to the pension program for public sector employees. Details are not yet known regarding the final social security reform package, but reports indicate that employee contributions to the social security system will increase from 3.5 percent to 5 percent.[11] The reform package is also expected to increase the range of private sector care providers that can receive government subsidies, but implementing legislation has not yet been finalized.[12]

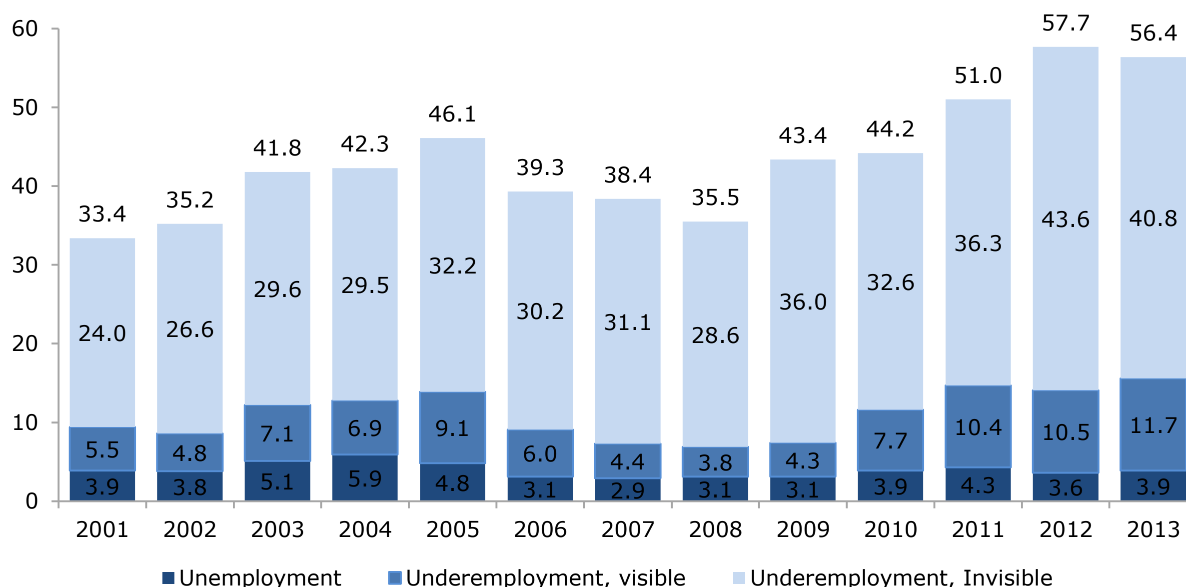
9 Woo et al. (2013), Ball et al. (2013).
10 Ibid.
11 El Heraldo (2015).
12 CESPAD (2015).

The fiscal austerity included in the plan comes during a period of persistently high poverty, and a labor market that remains far from recovered from its pre-recession (2008) condition. In **Figure 1** we see that that the broadest measure of unemployment and underemployment increased from 35.5 percent of the labor force in 2008, to 56.4 percent in 2013. This measure includes unemployment and two measures of underemployment. The first, called visible underemployment in Honduras, includes those who worked less than 36 hours in the reference week and expressed the desire to work more hours. The second, the so-called invisible underemployment category, includes those who worked 36 hours or more in the reference week but who nevertheless earned less than the minimum wage.

FIGURE 1

Honduras: Unemployment and Underemployment

Percent of the Economically Active Population



Source: OML (2015).

Labor market policies have no doubt played a large role in the recent deterioration of the labor situation. In November of 2010, the government enacted what was then deemed a "special emergency program" that allowed companies to hire workers on an hourly or part-time basis for as little as two hours on temporary contracts, the November 2010 National Program for Employment by the Hour (*Programa Nacional de Empleo por Horas, Decreto* 230-2010).[13] Previously the labor code allowed part-time/hourly employment and contractor employment (defined by completion of specific projects), but it required that these employees receive similar benefits as regular full-time

13 La Gaceta (2010a).

employees, including vacation days and an education stipend for dependents. The new law removes these requirements and others such as severance pay. In practice, some employers abuse the law and maintain the same workers on temporary contracts that begin shortly after the previous contract period expires, which interferes with workers' rights to form a union.[14] The law, which was extended several times and remains in effect today (*Ley de Empleo por Horas, Decreto* 354-2013), has met with opposition from many sectors of Honduran society including labor groups and women's organizations.[15]

In addition, there has been a change in the government's approach to the minimum wage. From 2006 to 2009, the average annual real increase in the minimum wage was 21.0 percent. Since this measure is adjusted for inflation, it reflects the actual increase in the purchasing power of a minimum wage salary. From 2010-2015, the average annual increase in the minimum wage has been only 5.1 percent. Most recently, 2015 was the first year since the adoption of a minimum wage in Honduras that the purchasing power actually decreased, with the real minimum wage in 2015 worth 2.6 percent less than in the previous year.[16]

Another part of the IMF plan lowers capital spending for the public sector to 3.7 percent of GDP in 2015, with further cuts through 2017, from an average of 5.3 percent of GDP over the last 10 years, according to IMF statistics (see **Figure 2**). Poor and middle-income countries generally spend much more on investment than do developed countries, as a percentage of their GDP. Public capital spending includes such infrastructure as roads, highways, water and sewer systems, telecommunications and even some spending on education (e.g. school buildings, equipment) and health (e.g. hospitals).

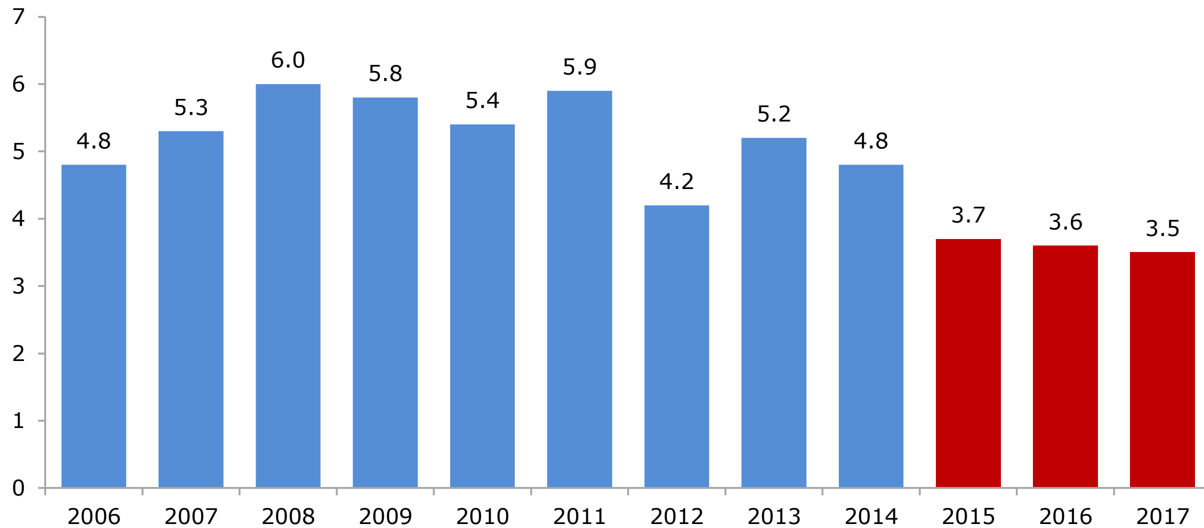
In the case of the Honduran economy, investment spending is badly needed, both to directly benefit communities through better access to improved education, sanitation and healthcare, and to help increase the pace of medium- and long-term economic growth. Total investment, which includes both public and private investment, fell drastically in 2009, declining by 44.3 percent or $1.3 billion. As a percent of GDP, it has barely recovered from this crash, remaining at 21.8 percent of GDP as compared to 36.1 percent of GDP in 2008.

14 CDM (2014).
15 Crossa (2015).
16 Secretaría de Trabajo y Seguridad Social (2015).

FIGURE 2

Honduras: Capital Expenditure

Percent of GDP

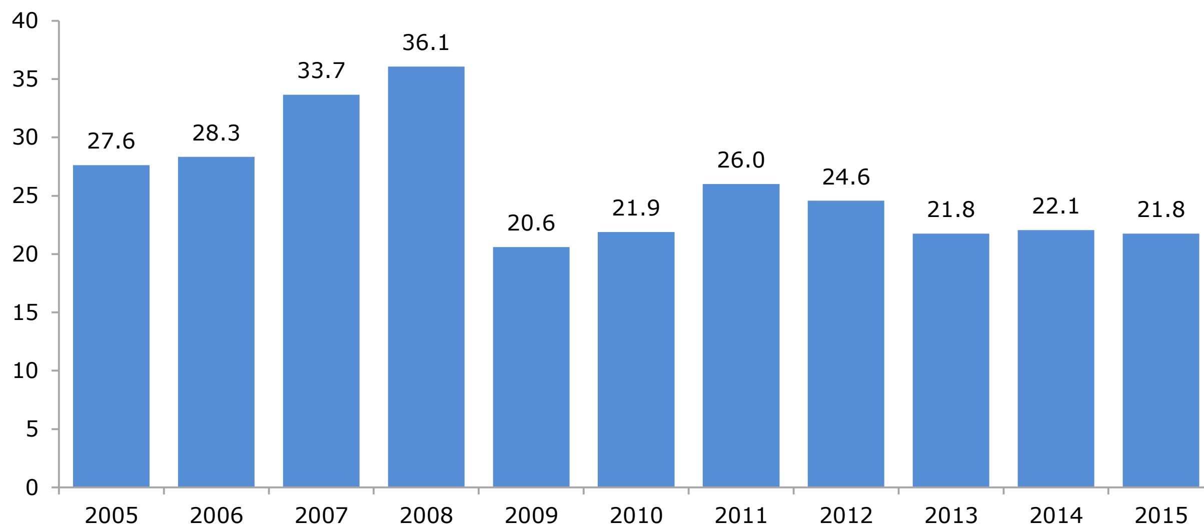


Source: IMF (2006), IMF (2007), IMF (2008), IMF (2010), IMF (2011), IMF (2013), IMF and (2014).

FIGURE 3

Honduras: Total Investment

Percent of GDP



Source: IMF (2015).

According to ICEFI, the extreme budget reductions "demonstrate that the Government [of Honduras] has somehow made the political decision to systematically reduce the size of the public

sector in the economy."[17] By sharply cutting current spending through the wage bill, which includes teachers and healthcare workers, and allowing public investment spending to remain low, the government seems to have a strategy of reducing the role of the public sector in supplying many services.

Social Context

According to the latest estimate from the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), 70.5 percent of the population of Honduras is living in multidimensional poverty.[18] This classification is based on deprivation various categories such as access to housing, water and sanitation, education and employment. No one is counted under this measure based on deprivation in just one dimension. Similar results indicating high poverty can be achieved using an income cutoff to measure poverty incidence. Due in part to the fact that Honduras has the highest income inequality in Central America, as measured by the Gini coefficient, the country has the highest rate of income poverty in Central America, even compared with Nicaragua, a country with a lower GDP per capita.[19] And, as mentioned previously, the IMF's spending-based fiscal consolidation program may worsen the country's income inequality according to studies conducted by the Fund's research department.

The IMF plan guiding the Honduran government's macroeconomic policy for the next three years contains within it only one provision designed to protect the impoverished majority in Honduras, and that is a floor on social spending of 1.6 percent of GDP.[20] This requirement is insufficient in both scope and size. First, the definition of social spending used here is extremely narrow, consisting mainly of the conditional cash transfer programs (*Bono Diez Mil* and *Vida Mejor*) along with a dozen or so smaller programs. This means that the floor on so-called social spending does not affect the bulk of public spending on health, water and sanitation, pensions, and education. On the contrary, these programs could easily be cut to meet the IMF's budget deficit targets without violating the rules meant to protect the poor in Honduras from harsh austerity policies.

Second, it is not hard to see that the floor of 1.6 percent of GDP is too low, even for the limited group of programs in the IMF definition of social spending. Honduras' low level of support for its conditional cash transfer program is a major reason why the program has had little effect on the

17 ICEFI (2015b).
18 ECLAC (2014).
19 World Bank (2014).
20 IMF (2014).

country's poverty rate,[21] with one early estimate indicating that it lowered the poverty headcount by only 0.02 percentage points in 2007.[22]

Furthermore, the IMF plan of fiscal consolidation and structural adjustment is being closely monitored, but lacks minimal degrees of transparency and accountability. Although the IMF agreement is negotiated with the executive branch of the Government of Honduras, many program benchmarks involve passing new laws or repealing old ones. The most important level of regular project monitoring involves monthly meetings between the IMF and high-level officials from the Honduran government, such as the chief of the economic cabinet, the minister and vice minister of finance, and the chief economist of the Central Bank. While records of this Program Monitoring Committee are kept, meeting minutes are not publicly available. Given the frequency of these high-level meetings, it is likely that many aspects of regular economic and social policy in Honduras are subject to consultation and approval by a team within the IMF.

Current Account Deficit

One striking aspect of the IMF agreement with Honduras is that it pays scant attention to the country's high current account deficit, financed by foreign direct investment. The current account balance equals the sum of a country's trade balance plus net income and net transfers, such as remittances.

In 2014, Honduras' current account deficit was 7.4 percent of GDP, and over the last five years has averaged 7.6 percent of GDP. This reflects the economy's high trade deficits and negative net income flows. Honduras's goods trade deficit was a huge 15.4 percent of GDP in 2014, a result that was nonetheless improved by low global oil prices. In addition, net income outflows were equal to 6.8 percent of GDP, reflecting the fact that foreigners own assets in Honduras that produce income that is taken out of the country, more than such income flows into Honduras.

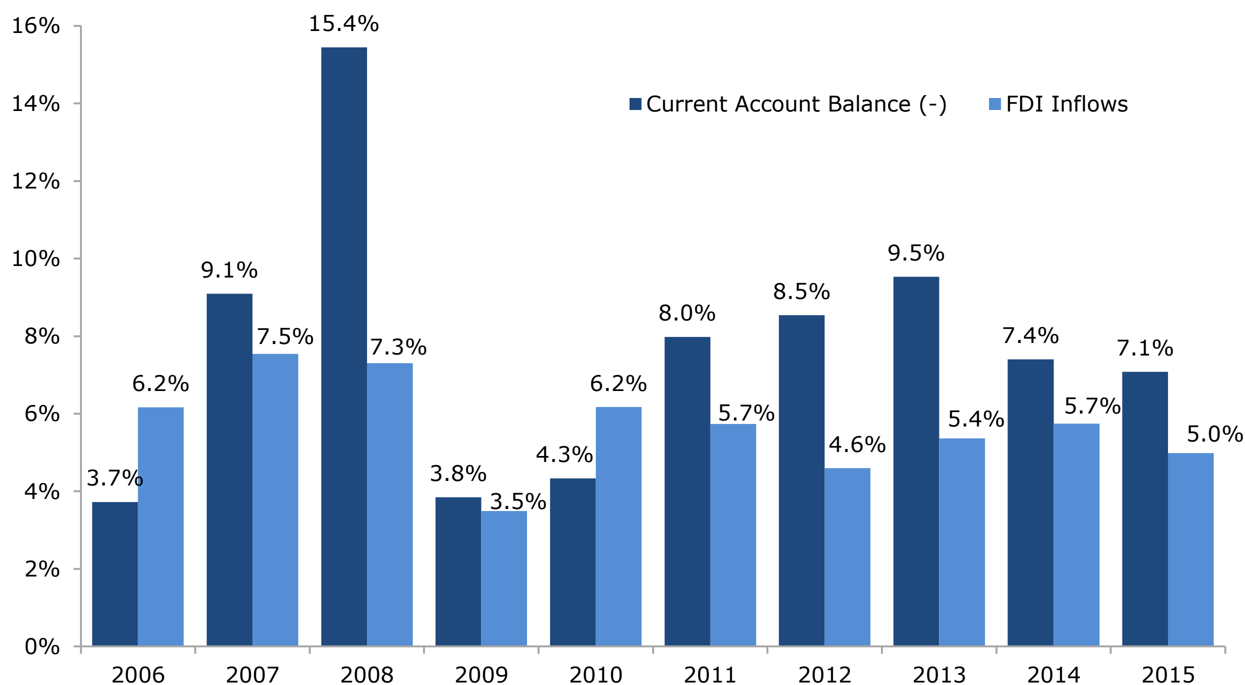
Besides these net outflows, Honduras' current account has one large inflow: remittances. Hondurans abroad sent back to their country $3.4 billion, or 17.2 percent of GDP, in 2014. This number is down from its peak (21.5 percent of GDP) before the global recession. While large remittance inflows are not uncommon for Central American countries, Honduras has one of the largest inflows of remittances, as a percent of GDP in the Americas.[23]

21 Cecchini and Madariaga (2011).
22 Osório (2008).
23 At $3 billion per year, Honduras is ranked fifth in Latin America among countries receiving remittances from the United States, after Mexico, Guatemala, El Salvador and the Dominican Republic. See World Bank (2015).

FIGURE 4

Honduras: Current Account Deficit and Foreign Direct Investment

Percent of GDP



Source: BCH (2015), IMF (2014).

Honduras' current account deficit is currently financed by large inflows of foreign direct investment. One characteristic of FDI flows in general is that they are often volatile. This has been documented recently by the IMF Research Department, for example in their 2013 publication, "Capital Flows are Fickle: Anytime, Anywhere."[24] Volatile FDI flows can be less of a problem in the case of a large economy, or if the country maintains sufficiently large international reserves, but Honduras does not benefit from either of these factors.

It is clear that since 2010, the Honduran government has pursued a concerted strategy to attract foreign investment. There is a vast literature investigating the determinants of large FDI inflows, but the popular wisdom is to pursue liberalization, privatization and deregulation in order to create a friendly environment for foreign companies, who often receive tax breaks, special privileges, and investor protections. Plans that rely on competing for FDI flows necessarily involve these sorts of policies, aimed at rising in the ranks of international credit agencies. But since Honduras has significant obstacles to overcome in order to attract foreign investment,[25] and it is suffering from

24 Bluedorn et al. (2013).

25 The murder rate for Honduras was the highest in the world in 2012 and in 2013 and remains high today. See Palencia (2014).

large and chronic current account deficits, its strategy has been more extreme than most. The privatization campaign and efforts to embrace charter cities can be seen in this light. A strategy to reduce the current account deficit over time, including an industrial and development strategy to increase exports, would seem to be more promising, and less risky and damaging in the ways described above, than the current policy of taking extreme measures in order promote what are often uncertain FDI inflows.

Privatization and Structural Reforms

The government of Honduras seems to have a strong preference for privatization, public-private partnerships, and concessions to the private sector. According to recent government publications, public-private partnerships will play a key role in lowering the public sector budget deficit. Infrastructure concessions such as highways and airports are justified by predictions of higher investment in these projects, and improvements in the quality and efficiency of public services. However, it is not clear that such predictions are justified. There are also deficiencies in the regulatory framework tasked with ensuring that those in the private sector who control previously public assets and contracts deliver on the promise of better quality services.

Generally, the success of public-private partnerships depends on having an inclusive process for strategic planning, fair rules designed to benefit the population, and enforceable controls and monitoring of individual projects.[26] The biggest impediments in the Honduran context are corruption in government and the country's weak rule of law. The 2009 coup drastically undermined the democratic process in Honduras. Since the coup, there have been numerous corruption scandals, political assassinations, and political maneuverings that have been widely considered illegal, such as the sudden removal of four Supreme Court justices in 2012.[27] Two of the country's largest newspapers labeled the move a "technical coup."[28] In addition, a partial list of political killings ahead of the last general election totals 35, a majority of those from the LIBRE party founded by supporters of the former President Mel Zelaya, who was overthrown in the 2009 military coup.[29] Perhaps the biggest scandal, and the most recent, involves fraud leading up to the 2013 election involving the IHSS (the National Honduran Social Security Institute, *Instituto Hondureño de Seguridad Social*). President Juan Orlando Hernández admitted publicly that some of the $330 million dollars known to have been pilfered from the healthcare agency were used by his electoral campaign to win the vote that brought him to power.[30]

26 UNECE (2008).
27 Williams (2012).
28 Costantini (2012).
29 Main (2013).
30 AFP (2015).

In addition to the IMF agreement, Honduran authorities are also receiving support for the implementation of economic reforms through the Alliance for Prosperity in the Northern Triangle.[31] The Alliance, funded largely by the United States, is coordinated in part through the Inter-American Development Bank, and includes Honduras, Guatemala and El Salvador as recipient countries. The Plan for the Alliance for Prosperity encompasses a wide range of policy areas such as judicial reform, trade facilitation and infrastructure priorities. In some areas, there is overlap with the IMF agreement. The document outlining the Alliance indicates support for the "creation of special economic zones," which is likely a reference to the charter cities project in Honduras (described below), and it also argues that public-private partnerships will be necessary for financing the priority investments outlined in the Plan, including infrastructure and logistics.

Public Private Partnerships

The period of decreasing investment spending and democratic breakdown described in the last sections coincided with the emergence in 2010 of COALIANZA, or the Commission to Promote Public-Private Partnerships (*Comisión para la Promoción de la Alianza Público-Privada*), a government agency tasked with "facilitating and supervising the process of contracting that allows public-private partnerships to participate in the execution, development and management of public works and services."[32] Juan Orlando Hernández, then president of the national congress, signed the legislation which created COALIANZA, and as president he has promoted the agency.

Over the past five years, COALIANZA has approved over 20 projects. These include single infrastructure projects like road concessions (e.g., the Gracias Lempira road, or *carretera de Gracias Lempira*) and airports (e.g., the Río Amarillo airport, or *aeródromo de Río Amarillo*), in addition to trusts that are financed by private banks to take on traditional government tasks (e.g., emission of passports through *El Sistema de Emision y Control de Pasaportes*) and major infrastructure (e.g., a major port in Central America, the *Terminal de Contenadores y Carga General de Puerto Cortés*).

The IMF forecasts that the government of Honduras will receive $832 million in loans from the private sector to finance public-private partnerships over the next five years (until 2019). This represents about 0.7 percent of GDP over the period, or 3.0 percent of expected central government spending.[33] What virtually all of these projects have in common is that corporations in the private sector are given monopoly rights, such as those associated with operating a uniquely located road or port, or they are granted contract-based rights to flows of public money. In

31 IDB (2014).
32 La Gaceta (2010b).
33 IMF (2014a).

exchange, the private company is asked to take on the costs and risks associated with providing public services.

As a prior condition that had to be met before the latest IMF agreement was signed, Honduran authorities passed a new law to try to limit the government's liabilities with respect to COALIANZA projects.[34] For the four years prior to the passage of this law, the government had been allowed to issue public guarantees for debt taken on by private companies. Some of the deals already in effect contain government guarantees for company earnings, according to one member of the National Assembly,[35] so rather than being a tool for achieving cost savings, COALIANZA could end up being a significant and risky burden on the public sector finances.

The experiences of other Latin American countries with similar public-private partnerships highlight the potential risks. Research based on a dataset of more than 1,000 concessions in Latin America and the Caribbean found that in the transportation sector alone, 55 percent of contracts were renegotiated. On average, this occurred three years after the deals were initially signed, and the majority were renegotiated at the request of the private sector partner, with 69 percent of changes involving delays in investment obligations, 62 percent involving increases in tariffs, and 31 percent involving a reduction in the fee paid by the private sector partner to the government.[36]

COALIANZA projects have several striking features that reflect problems in the Honduran government's strategy around public-private partnerships and concessions. We found no evidence of a publicly available multiyear plan for investments via public-private partnerships. Although aimed at increasing productive investment, the projects initiated thus far seem to be an ad hoc mixture of infrastructure projects, government services and partial privatizations of utilities. There are no publicly available documents providing a rationale for the current mix of approved projects, nor is there any study connecting the country's most pressing needs to COALIANZA funding priorities. For example, one large project is a 20-year highway concession that is expected to increase exports and tourism.[37] Without an independent assessment, it remains unclear how installing toll booths and improving this specific road will help to expand exports. Furthermore, even if government spending on this project does lead to road improvement and those improvements help exporters in the *maquila* and agriculture sectors (e.g., coffee, palm oil), it is unclear what effect this will have on poverty in Honduras.

34 Ibid. Pg 55-56.
35 Radio Progreso (2014).
36 Guasch (2004).
37 COALIANZA (2013).

Development experts and human rights defenders domestically and internationally have criticized COALIANZA, especially over its role in promoting so-called "charter cities," or as they are known in Honduras, Zones for Employment and Economic Development (*Zonas de empleo y desarrollo económico*, ZEDEs). Based on the work of Paul Romer, a U.S. economist who is a leading proponent of "charter cities," the idea is that "Inefficient rules are the major obstacle to peace, growth and development," [38] so poor countries should build cities where a charter that is written non-democratically replaces most of the country's laws and even parts of its constitution. This effectively exempts foreign companies that operate within the ZEDE from the nation's labor laws and tax system.

Starting in 2010, the Honduran Congress passed legislation amending several articles of the Honduran Constitution in order to allow for charter cities, followed by a series of laws creating the new legal framework they required.[39] In May 2012, the Supreme Court of Honduras ruled charter cities to be unconstitutional in a four-to-one decision, but only months later Congress removed the four justices that opposed the project, once again clearing the way. The ZEDEs project has been protested by community groups, human rights organizations, environmental groups, and representatives of the Catholic Church.[40] Even Romer, the economist who initially provided the intellectual justification for the project, has disavowed Honduras' approach. The Transparency Commission to which he had been named was denied access to contracts for ZEDEs signed between COALIANZA and the private sector and the latest plan for ZEDEs lacks many of the safeguards Romer considered critical.[41,42]

Privatization and the Domestic Financial Sector

Public-private partnerships can play a significant role in increasing the financialization of a country's economy.[43] Public sector contracts can be a way for corporations and banks in the private sector to secure steady returns where the associated costs are minimized by using already-built infrastructure. From the perspective of the private sector in any country, "infrastructure is stable, contracted cash flow for the long term,"[44] so the challenge is to design and enforce systems that ensure projects serve the collective purpose. As one report from the International Labor Organization noted, "The

38 Romer (2009).
39 Kroth (2014).
40 La Prensa (2014).
41 Brondo (2013).
42 NLG (2014).
43 Robert (2015).
44 Jean Perarnaud of Partners Group, a private equity investment management firm, makes this point more generally about public-private partnerships: "You could have a pipeline that you don't want to touch because there are no contractual rights on it and it is completely market-exposed to price. These are the sorts of things we don't consider infrastructure. *For us, infrastructure is stable, contracted cash flow for the long term*." Emphasis added. Quoted in Kranc 2012. Joel Kranc, "Separating the wheat from the chaff," Infrastructure Investor: Emerging Markets Handbook, June 2014, p.5, https://www.infrastructureinvestor.com/Emerging_Markets_Handbook/

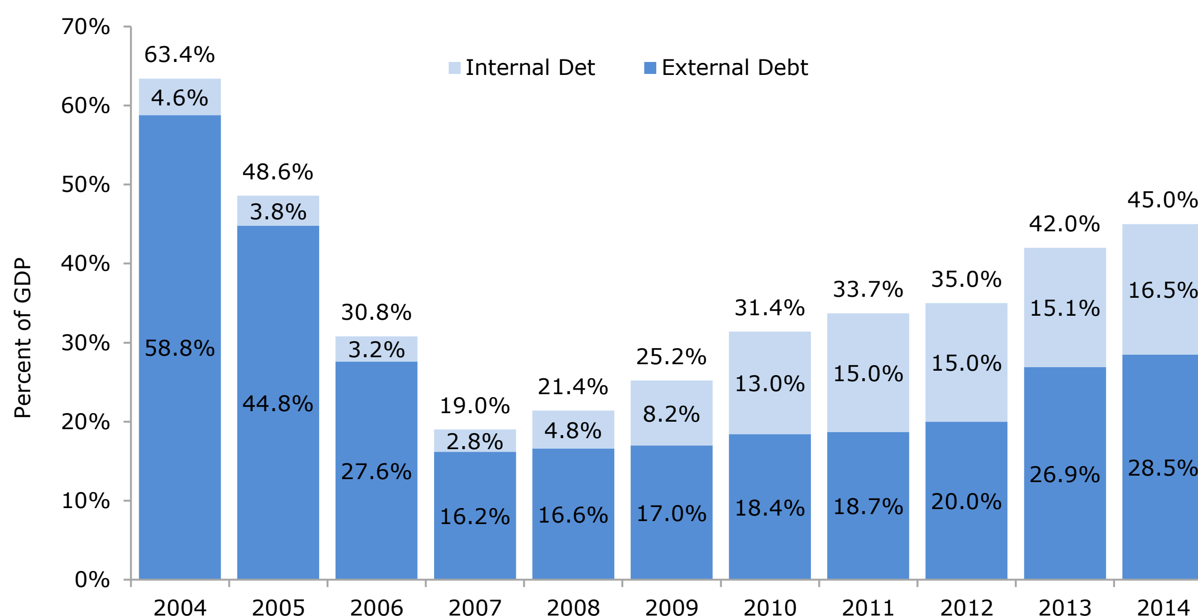
crucial issue is how to go about developing a close partnership that will ensure policy relevance while avoiding policy capture by the private agents."[45]

In Honduras, each of COALIANZA's projects operates through a trust administered by one or several of the country's private-sector banks. The process has been highly concentrated, with just three banks controlling funds for 19 out of 21 projects.[46] Through trusts, the banks receive rights over the project in exchange for their role in raising funds and coordinating project financing. This process gives banks a great deal of control over the projects since they are tasked with contracting engineering studies, evaluating financing proposals, and monitoring projects.

FIGURE 5

Honduras: Public Sector Debt, Internal and External

Percent of GDP



Source: Fofisa (2015).

The domestic financial sector has grown in importance and power in the past 10 years. As shown in **Figure 5**, Honduras benefited from significant debt cancellation in the early part of the 2000s. Since 2007, even as Honduras' external debt increased from 16.2 percent of GDP to 28.5 percent, the country's internal debt grew faster, going from just 2.8 percent of GDP to 16.5 percent. This internal debt is held mainly by domestic commercial banks, the same ones that stand to gain from the government's pursuit of public-private partnerships, which help transform state infrastructure into private financial assets. Honduras' concentrated financial industry may therefore have increasing

45 Salazar-Xirinachs, Nübler, and Kozul-Wright (2014).
46 COALIANZA (2015b).

leverage over the central government as it cedes responsibility for providing such public services as maintaining roads, supplying water, and issuing government documents like passports.

Conclusion

The agreement between the IMF and the Honduran government supports a program of economic reforms, fiscal austerity and privatizations that, if fully implemented, will dramatically alter the role of the public sector in Honduras. The agreement calls for fiscal consolidation of 6.5 percent of GDP over four years, mostly achieved through spending cuts that could affect social programs such as health and education. Some of the new policies have already begun to be implemented, such as those aimed at reducing the government wage bill by eliminating many public sector jobs and reducing the compensation of those jobs that remain. In addition, the government has aggressively pursued public-private partnerships and partial privatizations in a failed attempt to increase total investment. The result thus far is that that private investment has not increased to replace, much less exceed, the reduced level of public investment since 2009.

Importantly, the IMF agreement does not adequately address Honduras' large current account deficits. The Honduran economy's current account imbalances are mitigated by high levels of foreign direct investment, but because FDI flows are fickle they increase the vulnerability of the country to external financial shocks. In addition, reliance on FDI fuels a race-to-the-bottom development strategy whereby policies to entice foreign investment, those which favor international investors over the domestic economy and its workers and citizens, are enacted in order to compete with other poor countries.

Of course, Honduras is not the only country where the IMF has backed an austerity or privatization program. CEPR examined 67 Article IV agreements for European countries from 2008-2011 and found that the IMF consistently recommended shrinking the size of the government, regardless of whether this was appropriate, or necessary, or whether it would exacerbate an economic downturn. Fiscal consolidation was recommended for all 27 EU countries, with expenditure cuts generally preferred to tax increases. In a separate report on the IMF program in Greece since 2011, CEPR found that the Fund program required a very large privatization program, with revenues from privatization alone projected to reach 15 percent of GDP over two years. Earlier this year CEPR researchers found that Jamaica, in the third year of an IMF-backed economic program, was running the most austere government budget in the world. This policy dramatically slowed GDP growth, while failing to lower the public debt. While there are many policy differences in IMF agreements, especially between developing countries and the high-income countries of Europe that have recently

become the majority of the Fund's loan portfolio, the agreement with Honduras nonetheless fits a pattern of flawed economic policies promoted by the IMF.

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