CHAPTER 2

HONDURAS' MACROECONOMIC FRAMEWORK

This chapter outlines the macroeconomic framework of Honduras including the economic and social indicators that define its present status. To better understand the current economic and social situation of Honduras, comparisons are made with other countries in the Central American region and Latin America in general.

2.1 Economic Context

The World Bank categorizes Honduras as a lower middle income country, with a per capita income of US$1,030 (Table 2-1). The main historical characteristic of the Honduran economy has been its weak growth rate and its difficulty to translate growth into poverty reduction. Between 1920 and 1995 the average per capita Gross Domestic Product (GDP) growth was only 0.5% (EU, 2005).[1] The Honduran economy has also been characterized by chronic macroeconomic and fiscal imbalances. This situation has greatly prevented the reduction of poverty.

Compared to other Latin American countries, Honduras has traditionally had poor economic growth, but relatively high income stability. From 1960 to 2000 its average annual per capita growth rate was 0.8%, less than half the 1.7% average for Latin American and lower than the 1.2% average for all underdeveloped countries (World Bank, 2004a, 2004b, 2004c).

Slow growth and growth fluctuations have been characteristics of the last decades as shown in Figure 2-1. During the decade of the 1980's, Honduras economic growth

---

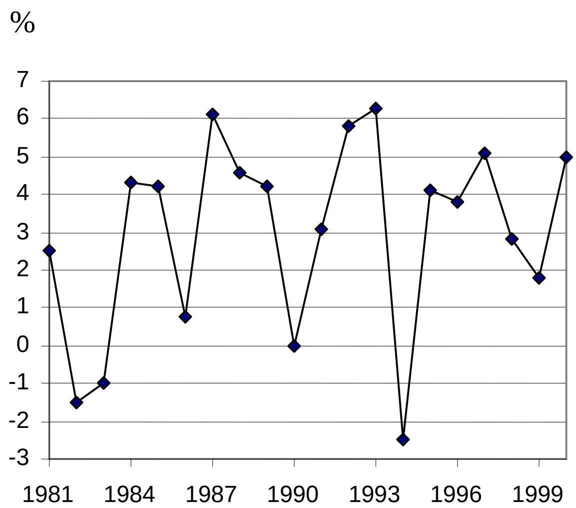
[1] A country's gross domestic product, or GDP, is one of several measures of the size of its economy. The GDP is defined as the market value of all final goods and services produced within a country in a given period of time. Until the 1980s the term GNP or gross national product was used. GDP, GNP, and Gross National Income (GNI) are almost identical terminology.

was even slower than the previous two decades and it also underwent major devaluations that significantly affected its economy. According to the Central American Monetary Council (2004), during the 1980’s the devaluation rate was 11% and the volatility rate was 2.8% compared to the two previous decades when the value rates were 0.0% respectively.

Table 2-1 Social and Economic Indicators in Honduras and Developing Countries — 2004

Item	Honduras	Latin America & Caribbean Countries	Lower Middle Income Countries
Population (millions)	7	541	2,430
GNI per capita US$	1,030	3,600	1,580
Urban population (% of total population)	46	77	49
Life expectancy at birth (years)	66	71	70
Infant mortality (per 1000 live births)	32	28	33
Child malnutrition (% of children under 5)	17	na	11
Access to improved water source (% of population)	90	89	81
Literacy (% of population age 15+)	80	89	90
Gross primary enrollment (% school-age population)	106	123	114

Source: World Bank (2005).



source: IDB (2002).

Figure 2-1 GDP Growth Rate in Honduras — 1980-2000

A weak point in the Honduran macroeconomic framework is its extremely open economy, one of the most open economies in Central America and the world (World Bank, 2004a). In 2004, its trade ratio averaged around 90%, with exports contributing 40% of GDP and imports about 50 percent. Open economies, like Honduras, are extremely susceptible to external stress forces. Honduras is therefore frequently influenced by trade fluctuations, natural disasters, and economic changes in its trade partners.

Honduran economy has been heavily dependent on agriculture. Coffee, bananas, and shrimp were Honduras main product of trade accounted for 40% of the total exports of goods and services at the beginning of the 1990's, by 2004, they represented less than 20 percent.

Manufacturing has experienced a steady increase boosted by heavy growth of the textile sector. An export oriented textile industry locally known as "*maquila*" has developed in the Northern part of the country around the city of San Pedro Sula,[2] making Honduras the second largest Latin American supplier of textile in the United States after Mexico. 6.8% of the United States textile imports in 2000 were from Honduras (European Union, 2005). The rapid development of the maquila affects the labor market and internal migration flows.

Maquila export share increased from 9% of total exports of goods and services in 1995 to 22% in 2002. The expansion of the maquila sector and the diversification of exports in general during the last decade have helped decrease the vulnerability to terms of trade fluctuations but it has also increased Honduras's susceptibility to trade shocks through greater competition from low-cost Asian clothing and textile companies.

In general, there are three main trends in Honduras 'trade pattern' (European Union, 2005):

- Exports concern a limited number of products, mainly agricultural;
- The main trade partners are the United States (35% of exports and 47% of imports) and the Central American neighbors; and

[2] This city is with a population of about half a million, it is the second largest city and is considered the economic heartland of Honduras. The *maquila* (or *maquiladora*) factories like the ones located in San Pedro Sula import materials and equipment on a duty-free and tariff-free basis for assembly or manufacturing and then re-export the assembled product usually back to the originating country.

- The trade deficit has been high (11.3 % of GDP in 2000) and seems to be growing.

From the above it is clear that there is a need to diversify production and boost non-traditional exports.

Honduras economic production scheme follows the changes in the composition of exports. For example, the reduction in the importance of agriculture, whose share of GDP went from 24% in the mid-1990s to less than 14% in 2003, while services increased from 47% to 56% of GDP by 2003 (World Bank, 2004a) (Table 2-2). The proportion of workers employed in agriculture has not changed and remains at around 39 percent.

Foreign remittances are a significant structural influence on the economy of Honduras (World Bank, 2004a).[3] These money transfers sent by thousands of Hondurans working mainly in the United States have made it possible for domestic absorption to increase since the mid-1990s without adding to the country's high debt. The substantial remittances have also kept the real exchange rate stable in the face of external shocks that weakened export performance.

Foreign remittances to Honduras have more than doubled from US$460 million in 2001 to about US$1,134 million in 2004 (Table 2-3). The importance of these substantial transfer flows to the economies of the region is evident when compared to key economic indicators such as Gross Domestic Product (GDP), Foreign Direct Investment (FDI), Official Development Assistance (ODA),[4] and tourism receipts (Migration Policy Institute, 2006). In 2004, remittances to Honduras amounted to at least 15% of GDP, suggesting a heavy dependence on remittances an engine of economic activity (Table 2-4).

---

[3] Remittances are transfers of money by foreign workers to their home countries. The World Bank estimates that migrants officially sent home more than US$223 billion to their families in developing countries in 2005. Remittances are playing an increasing larger role in the economies of many nations.

[4] ODA is a category of development aid given by the developed nations of the world to developing nations and organizations.

Table 2-2 Structure of the Industry in Honduras

% of GDP	1984	1994	2003
Agriculture	20.8	24.3	13.6
Industry	25.8	28.8	31.0
Manufacturing	15.4	17.3	20.4
Services	53.3	46.9	55.5
Average Annual Growth (%)	1984-94		1994-04
Agriculture	3.5		2.1
Industry	3.8		3.6
Manufacturing	3.6		4.4
Services	3.4		3.9

Source: World Bank (2005).

Table 2-3 Remittances to Central American Countries — 2001-2004

Unit: Millions of US$

COUNTRY	**2001**	**2002**	**2003**	**2004**
Guatemala	584	1,690	2,106	2,681
El Salvador	1,911	2,206	2,316	2,548
Honduras	460	770	862	1,134
Nicaragua	660	759	788	810
Costa Rica	80	135	306	320
Panama	--	--	220	231
Belize	--	--	73	77

Source: Migration Policy Institute (2006).

Table 2-4 Remittances to Central America Countries as a Percentage of GDP, FDI, ODA and Tourism Receipts — 2004

Unit: %

COUNTRY	**GDP**	**FDI**	**ODA**	**TOURISM**
Guatemala	10.00	2,145	3,052	348
El Salvador	16.10	655	6,620	756
Nicaragua	17.80	310	127	432
Honduras	15.10	582	385	286
Costa Rica	1.70	55	7,960	24
Panama	1.80	49	6,435	35
Belize	6.80	253	1,556	58

Source: Migration Policy Institute (2006).

With an external public debt-to-GDP ratio of around 66% by 2004, Honduras is a highly indebted country. In April of 2005, Honduras was declared eligible for the Heavily Indebted Poor Countries (HIPC) initiative (World Bank, 2004a; IMF, 2005a). The total external debt was estimated at US$4.6 billion in 2005.

To understand the current situation of Honduras it is important to look at the previous decades from which the country emerged as an economy and society in crisis. Within the context of the Central American region and in terms of the political and economic situation, the years between 1970 and 1980 were the worst of times for Central America (Acuña-Alfaro, 2000). Table 2-5 shows that the per capita GDP in the 1980s was negative and the cumulative decline for Honduras was more than 14 percent.

The decade of the 1980s was a period of overall political and economic unrest in the Central American region. During this period, Guatemala, El Salvador, and Nicaragua were involved in civil wars that affected the entire region and Honduras especially since it has borders with all three of them. The confrontations and civil wars that characterized this period of history in the region left more than 250,000 people dead and approximately three million refugees.

In terms of the economy, foreign aid from the United States played a significant role. United States increased substantially the military aid to Honduras during the early

1980s but this action brought about more debt dependency and consequently unsustainable macroeconomic balances when it decreased later in the decade as the political scenario changed in Central America. The aid dependency was again considerable after Hurricane Mitch devastated the country in 1998. [5]

Table 2-5 Real per capita GDP in Central America Countries

Unit: US$

Year	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
1980	1,759	1,325	1,085	1,015	1,097
1981	1,670	1,177	1,062	992	1,124
1982	1,505	1,079	996	936	1,078
1983	1,500	1,082	944	899	1,082
1984	1,571	1,093	922	890	1,015
1985	1,538	1,096	891	892	935
1986	1,577	1,086	867	890	886
1987	1,605	1,092	872	907	848
1988	1,614	1,088	879	923	734
1989	1,659	1,062	887	906	689
1990	1,676	1,069	888	871	629
1980-1990	**-4.7%**	**-19.3%**	**-18.2%**	**-14.2%**	**-42.7%**

Note: real per capita GDP as in 1988 US$.
Source: Acuña-Alfaro (2000).

2.2 Social Context

Honduras has a very young population with 42% under the age of 15 and a total population of almost 7 million in 2004, with a 2.4% annual growth rate. Approximately 64% of the population lives under the poverty line, and 45% are in extreme poverty (European Union, 2005).

Half of the population lives in the rural areas where poverty affects almost 75% of the people. In the urban areas, approximately 57% of the inhabitants are considered to live in poverty. In relationship to the rest of Latin America and the Caribbean, Honduras

[5] Hurricane Mitch was one of the most powerful hurricanes ever observed. Deaths due to catastrophic flooding made it the second deadliest Atlantic hurricane in history; nearly 11,000 people were killed with over 8,000 left missing. Damages amount to over US$5 billion.

ranks very poorly in terms of most social indicators but compared to other lower middle income countries its status is quite similar (World Bank, 2004a) (Table 2-1).

Honduras is undergoing a demographic transition process with a reduction in mortality rates due to improvements in health care, decreased birth rates and a slight reduction of population growth, although they still remain high compared to other Latin American countries. Urban population remains comparatively low, but is on the rise especially in the industrial capital, San Pedro Sula, as a result of the development of the maquila.

The economically active population was more than 2.3 million people by 2001 (World Health Organization, 2001) with an average annual growth of 4.4 percent. This means an annual increase of the active population of 70,000 people, far more than the absorption capacity of the economy to provide adequate education and labor opportunities (European Union, 2005).

In regards to education, despite substantial progress made over the past two decades, Honduras is still behind for quality standards, enrollment, infrastructure, and textbooks. The education system is in need of complete overhaul to adapt it to the market conditions and requirements. In 2004, 85% of the curricula concern traditional theoretical matters and only 15% are linked to the productive sector (European Union, 2005).

In 2004 the transition from primary to secondary education seems particularly difficult: from 95% primary school enrollment, only 35% continue in secondary education. Furthermore repetition levels are alarming exceeding 10% in public secondary schools. Among the reasons for poor attendance and absenteeism, may be low nutrition rates, lack of support from the family, and child labor. The latter is a common phenomenon in Honduras, and approximately more than 400,000 children and adolescents are believed to be part of the workforce (European Union, 2005).

One of the most important social characteristics in Honduras is the unfair distribution of income which is a structural obstacle to poverty reduction. The Gini coefficient for Honduras is 0.590 (World Bank, 2004c).[6] This coefficient measures the distribution of income. Since a value of zero would indicate equal distribution, the value of the coefficient for Honduras denotes high levels of inequality existing in the distribution of income in Honduras.

As illustrated in Table 2-6, the current income distribution implies that 80% of Honduran households receive only 45.7% of the nation's total income, while the wealthiest 20% of households receive 54.3% of the national income in 2002. This confirms the need to pursue an economic development strategy that explicitly favors the poorest, thereby improving income distribution.

Unequal land ownership prevents the development of the agricultural population. There is a high concentration of land in the hands of relatively few property owners. Almost 75% of the land plots represent 12% of the land used for farming purposes and they are usually located in mountain areas of low productivity. On the other hand, 2% of plots occupy some 40% of the total agricultural surface, which also happens to be flat and more fertile (European Union, 2005).

Table 2-6 Income Distribution in Honduras — 2002

Fifths of the Population from poorest to least poor)	Per Capita Income (US$/month)	% of total income
1	7.09	3.2
2	20.48	7.8
3	40.49	13.2
4	73.99	21.4
5	236.36	54.3

Source: World Bank (2004c).

The issue of public health remains of concern. Steady progress has been made in almost all sectors, except for malnutrition, where the situation has worsened. The public

[6] The Gini coefficient is a measure of inequality of a distribution. It is often used to measure income inequality. It is a number between 0 and 1, where 0 corresponds to perfect equality and 1 corresponds to perfect inequality.

health and social security systems need comprehensive reform aiming at better coverage and increased efficiency.

2.3 Poverty Reduction Strategy Paper

One of the most recent documents containing a description of the macroeconomic framework in Honduras is the Poverty Reduction Strategy Paper (PRSP).[7] The PRSP describes the country's macroeconomic, structural and social policies and programs to promote growth and reduce poverty. The PRSP process in Honduras was initiated in 2000 and covers the period 2001-2015, it was prepared by the government through a participatory process involving the civil society and development partners, including the World Bank and the International Monetary Fund (IMF, 2001).

According to the Honduras Poverty Reduction Strategy Paper in order to reduce poverty, Honduras needs accelerated, equitable and sustained economic growth. During the last ten years, real per capita GDP did not improve and this situation needs to be reversed if poverty is to be controlled.

In 2004, the first PRSP Progress Report of the Government of Honduras was prepared presenting a complete review of the government's implementation of the PRSP and updating the PRSP for the period 2004-2007 (World Bank, 2004c).

The report concludes that the country was able to meet one third of all the goals in the PRSP. Problems such as policy implementation failure or delay, combined with a slowdown in growth abroad and declining terms of trade, led to slower-than-expected growth. The report emphasizes the need to maintain a stable macroeconomic and fiscal stance. Recommendations include:

- Work towards acceleration in equitable and sustainable economic growth;
- Implementation of measures to improve competitiveness; and
- An increase in the coverage of investments in human capital to continue improving the progressivity of public spending.

[7] PRSP are documents required by the IMF and World Bank before a country can be considered for debt relief within the Heavily Indebted Poor Countries (HIPC) program.

More recently, Rodrigo del Rato, General Director of the International Monetary Fund indicated that the economy of Honduras in the last two years has had "a significant increase" but the country needs to advance in terms of "efficiency of the public spending, public investment, and social spending" (La Tribuna, 2006a). The IMF recommends that the country keep macroeconomic rigorousness in order to have positive results in terms of a strategy to reduce poverty.

2.4 Summary

Overall, the Honduran macroeconomic framework can be described as typical of other lower middle income economies but when compared to other countries in Latin America, Honduras falls short in most social and economic indicators. Another characteristic of Honduras' economy is its weak growth and difficulty to convert growth into poverty reduction. The unfair distribution of income and the problems related to the unequal distribution of land are two major problems in the Honduran economic context.

A major factor in Honduras' economy is the influx of foreign remittances sent by Hondurans working mainly in the United States. In terms of macroeconomic indicators the Poverty Reduction Strategy Paper presents the most updated information about the country's macroeconomic framework and emphasizes the need to maintain fiscal discipline and improve economic growth in order to combat poverty.