

**INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION**

HONDURAS

Initiative for Heavily Indebted Poor Countries--Preliminary Document

Prepared by the staffs of the International Monetary Fund and
The International Development Association¹
(in collaboration with the staff of the Inter-American Development Bank)

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¹ Approved by Miguel E. Bonangelino and Jesús Seade (IMF), and Masood Ahmed and Donna Dowsett-Coirolo (IDA).

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I. INTRODUCTION

1. **Since the early 1990s, Honduras has made significant progress toward reestablishing macroeconomic stability, implementing structural reforms and strengthening social policies.** These advances were temporarily halted in October 1998 as a result of Hurricane Mitch (Box 1), which devastated the economy and caused enormous social losses. Although the reconstruction of Honduras following the disaster poses a formidable challenge, the government is committed to ensuring macroeconomic stability, accelerating the process of structural adjustment, and strengthening its efforts to improve social policies and combat poverty. The government believes that alleviation of the country's heavy external debt burden is a key requirement for the successful reconstruction and transformation of Honduras.
2. **As a result of prudent macroeconomic policies and debt reschedulings from bilateral creditors (including four Paris Club reschedulings), Honduras' external debt burden has improved significantly in recent years.** From 1995 to 1998 public sector external debt fell from 100 to 74 percent of GDP and the external debt-service ratio declined from 33 percent to 20 percent. External debt management has also been strengthened, and the government has adopted a policy of contracting only concessional credits. Despite this progress, Honduras still faces a heavy debt burden, especially from a fiscal perspective with a net present value (NPV) debt-to-revenue ratio of 338 percent, and a debt-service-to-revenue ratio of about 40 percent in 1998.
3. **This paper presents a preliminary assessment of Honduras' eligibility for assistance under the Initiative for Heavily Indebted Poor Countries (HIPC),** based on the debt sustainability analysis (DSA) elaborated by the staffs of IDA and the IMF, and the Honduran authorities, with the involvement of the staff of the IDB.² It also assesses Honduras' adjustment record, policy outlook, and sensitivity of the DSA to different assumptions. The rest of the paper is organized as follows. Section II presents Honduras' ESAF eligibility and IDA-only status, and assesses Honduras' policy record since the early 1990s. Section III discusses the broad outline of the authorities' medium-term policy agenda. Section IV presents the results of the DSA, a discussion of Honduras' eligibility under the Initiative, calculations of possible assistance under different scenarios, and the authorities' views. Section V concludes with possible issues for discussion by Executive Directors.

²Initial discussions on the DSA took place in Tegucigalpa during January 18–29 and in Washington on March 10, 1999. The authorities were represented by the Minister of Finance, Ms. Nuñez de Reyes, the then President of the Central Bank, Mr. Barjún, and other senior government officials. The IMF mission comprised Messrs. DaCosta, Gómez-Oliver, Nyawata (all WHD) and Nielsen (PDR). Mr. Piñerúa, the then Fund's Resident Representative in Tegucigalpa, assisted the mission. The Bank mission comprised Mr. van Trotsenburg and Ms. Le Manchec (AFTD1), and Messrs. López and Trommer (LCC2C). Messrs. Cosio, Trapido, and Brachowicz of the IDB also participated in the final meeting in Tegucigalpa in January, and IDB comments on the draft have been incorporated. In addition, the IDB attended the multilateral development banks' meetings.

Box 1. Hurricane Mitch

Hurricane Mitch, which hit Honduras over the period October 25-31, 1998, is considered the worst natural disaster to have affected the country in recent years. The hurricane remained centered over Honduran territory for five days during which strong winds and relentless rain led to extensive damage to crops, as well as flooding and landslides on an unprecedented scale. As a result of the hurricane about 5,600 people died and 8,000 were declared missing and presumed dead. Overall, about 2.5 million people (40 percent of the population) were displaced temporarily or made homeless, and 441,150 (including about 85,000 children under the age of five) had to be placed in temporary shelters. Approximately 60 percent of the main and secondary paved roads, 20 percent of unpaved secondary and tertiary roads, and more than 100 bridges were damaged or destroyed as were water systems in all major areas. More than 17 percent of the country's 9,548 primary schools were damaged. The government estimates that the hurricane affected the housing conditions of about 660,000 people, that more than 30,000 new dwellings need to be constructed, and 50,000 need to be rehabilitated. Estimates prepared by UNDP and ECLAC suggest total direct and indirect damages of US\$5 billion, equivalent to Honduras' total GNP in 1998.

II. BACKGROUND

A. ESAF and IDA Category

4. **Honduras is currently an IDA-only country, and is eligible for assistance under the Enhanced Structural Adjustment Facility (ESAF).** With a per capita GNP³ of US\$730 in 1998, it is the third poorest country in the Latin American and Caribbean region, after Nicaragua and Haiti. Over the 20-year projection period covered in this report, economic growth is expected to remain at just under 5 percent annually, assuming prudent economic policies, continued international support, and a favorable external environment. However, even with these growth rates, per capita income (in constant 1998 prices) is expected to reach only about US\$1,300 by 2018, a level that is less than that of the fifth poorest country in the region (Ecuador) in 1998. Moreover, should economic growth average 1 percentage point less, or population growth be 1 percentage point higher than projected, per capita income by 2018 would reach only about US\$1,050. This outlook implies that Honduras will continue to need substantial international concessional assistance over the medium term, and is likely to remain an ESAF-eligible and IDA-only country in the foreseeable future.

5. **Honduras' social indicators are among the weakest in the region,** partly reflecting its low per capita income level (Table 1). Key indicators, including life expectancy, infant mortality, and the share of population with access to sanitation and safe water, are considerably worse than the regional average, although they are better than the average for HIPC countries. In terms of poverty, the 1999 World Development Indicators show that prior to the hurricane 47 percent of the population lived on less than US\$1 a day, and about 75 percent lived on less than US\$2 a day. According to the Honduran Social Investment Fund (FHIS), about 60 percent of the indigenous population has no access to safe water; about 91 percent lacks basic sanitation; and adult illiteracy rates reach 95 percent in some areas. Also, while the national child malnutrition rate is about 18 percent, it reaches 68 percent

³ GNP per capita computed using the World Bank Atlas methodology.

among some ethnic groups. Although no reliable data are yet available, it is clear that Hurricane Mitch has led to increased social pressures in the country.

Table 1. Honduras: Selected Social Sector Indicators

(In units indicated)

Honduras	Indicator	HIPC	Latin America and Caribbean
730	GNP per capita in 1998 (US\$) 1/	388	3,960
47	Infant mortality (per 1,000 live births)	97	31
66	Life expectancy (years)	52	70
65	Population with access to safe water (percent)	49	73
63	Population with access to sanitation (percent)	36	63
27	Overall illiteracy rate	47	15
28	Female illiteracy rate	57	16

Source: World Development Indicators. All variables except GNP are averages over the 1990–96 period.

1/ Preliminary.

6. **Despite these weaknesses Honduras has made considerable efforts in the social sectors.** Prior to Hurricane Mitch, public spending in the social sectors was equivalent to almost 8 percent of GDP, which was high relative to other countries with a similar level of income. Also, controlling for income levels, Honduras’ health and education indicators are above average. According to the 1998 UNDP Human Development Report, while Honduras’ income per capita ranked 126 among 174 countries, its health and education indicators ranked 91 and 118, respectively.

B. Policy Track Record

7. **Since the early 1990s Honduras has implemented a series of reforms aimed at stabilizing the economy, achieving faster economic growth, and improving social conditions.** During 1992–97 these reforms were supported by the IMF under the ESAF; by IDA through a series of adjustment and technical assistance operations beginning with a Structural Adjustment Credit (SAC) in 1991, followed by two sector adjustment credits in energy and agriculture, as well as a public sector modernization adjustment credit in 1996; and by the IDB, the main multilateral creditor of the country, through various operations in this decade.

8. **Discussions on policies that could form the basis for a new ESAF-supported program were near conclusion in October 1998 when Hurricane Mitch struck,** and attention was turned to delivering prompt emergency assistance from the Fund and IDA.

Negotiations on the ESAF program were concluded in January 1999, and the Executive Board approved the arrangement in March. The UNDP and other multilateral donors have also provided substantial financial and technical assistance, and bilateral donors have vigorously supported Honduras' stabilization and reform efforts including through debt reschedulings, and most recently through a three-year moratorium on debt-service payments due to Paris Club creditors. At a Consultative Group meeting organized by the IDB in Stockholm during May 1999, donors committed resources totaling US\$2.7 billion for Honduras' relief and reconstruction efforts.

Macroeconomic policies

9. **Economic performance under the ESAF-supported program during 1992–95 was mixed**, and there were initial delays in implementing the macroeconomic and other measures incorporated in the program. However, by end-1995 two annual arrangements were completed and all disbursements under those arrangements were made. The program resulted in a narrowing of the fiscal deficit from 4.8 percent of GDP in 1991 to 2.7 percent in 1995, and real GDP growth averaged 3 percent a year during 1991–95. Significant progress was made in the structural reforms contemplated under the program, including a reform of the tax system, a reduction in public employment, the granting of limited autonomy to the central bank, and the liberalization of interest rates, the exchange rate, and the trade system. Also, private sector participation in electricity generation was permitted, and there was some strengthening of the framework for bank supervision.

10. Agreement on a third annual arrangement was not concluded in 1996 because of uncertainties related to the electoral cycle, and in 1997 the authorities introduced an economic program, monitored by the Fund staff. **Economic performance improved under the staff-monitored program.** GDP growth accelerated to about 5 percent, inflation slowed to 13 percent, the external current account balance narrowed, and net international reserves rose to the equivalent of 2.4 months of imports at end-1997, compared with 1.4 months at end-1996. Also, the deficit of the nonfinancial public sector narrowed to less than 2 percent of GDP, while public sector savings remained at about 5½ percent of GDP. Moreover, after stagnating in 1995–96, average real wages increased by about 10 percent in 1997.

11. The new administration of President Flores took office in January 1998, and shortly thereafter took steps to strengthen the public finances and the financial system. Fiscal measures were introduced in April 1998 aimed at promoting higher private investment and bringing Honduras' tax system in line with that of the rest of Central America. The key measures were (i) a reduction in corporate and personal income tax rates; (ii) the gradual elimination of the net assets tax; (iii) provision for phasing out of export taxes on bananas; and (iv) an increase in the sales tax rate from 7 to 12 percent. Up to the period prior to the hurricane (through September 1998) the economy continued to strengthen. Real GDP growth accelerated to an estimated 5½ percent, and the 12-month rate of inflation remained at about 13 percent, reflecting the improved fiscal position, the relative strength of the Lempira, and lower import prices.

12. **The main objectives of the government's ESAF-supported program are to achieve a rapid economic recovery and address the social needs** that became more pressing as a result of the hurricane. The targets under the program are a recovery in real GDP to 5-6 percent, a reduction in inflation to 13-14 percent by end-1999, and the maintenance of a strong external position. Preliminary data show that the macroeconomic objectives for 1999 are within reach, and all the quantitative benchmarks criteria through end-June and end-September were met. Economic activity is recovering from the hurricane-related damage at the beginning of the year, and the 12-month inflation rate was 10.5 percent in September (compared with 13 percent programmed for the year as a whole). On the fiscal side, the central government registered a small surplus in the first half of this year owing to better than expected revenue from the sales tax, a strengthening of tax administration, and a slower rate of execution of reconstruction projects than initially envisaged. Also, domestic interest rates have fallen markedly, and gross international reserves increased from the equivalent of almost 3 months of imports of goods and services at end-1998 to almost 4 months at end-September 1999.

Structural policies

13. The government's structural policies in recent years have focussed on improving the efficiency of the public sector, and enhancing private sector incentives through deregulation, as well as trade and financial liberalization. On balance three successive administrations have made considerable progress in these areas, but some of the planned structural reforms (mainly in privatization and the social security system) have suffered delays (Table 2).

Table 2. Honduras: Selected Indicators
of Structural Adjustment in the 1990s

	1990	1998
Size of the public sector		
Public employment (percent of nonagricultural employment)	14.9	11.3 1/
Central government current expenditure/GDP (in percent)	17.2	15.2
Policy (in percent)		
Effective import tax	21.1	6.6
Effective export tax	12.5	0.3
Import tariffs range	1-90	1-55
Capital markets		
Multiple exchange rates	Yes	No
Interest rate restrictions	Yes	No
Current account restrictions	Yes	No
Capital account restrictions	Yes	No
Economic performance (in percent)		
GDP growth 2/	3.0	3.9
External current account deficit/GDP	7.1	1.3
Central government overall deficit/GDP	7.1	2.1
Central government current revenue/GDP	15.9	18.6
Inflation 3/	23.3	13.7

1/ Refers to 1996.

2/ Three-year average.

3/ CPI period average.

14. **Reform of the public sector began in earnest in 1991 with the enactment of the Public Sector Modernization Law.** Based on this legal framework and with technical assistance from IDA and the IDB, a reform program was developed to rationalize public sector employment, and privatize public enterprises, including those involved in power generation and distribution, telecommunications, and transportation. The program succeeded in reversing the trend of continuous increases in public sector employment. After expanding by about 30 percent between the mid-1980s and 1994, public sector employment has since fallen by 16 percent.

15. **Initial efforts to expand the role of the private sector, during the 1985–93 period resulted in the sale of a total of 51 state-owned enterprises.** This was followed in 1994 by the Framework Law for the Electricity Subsector which permitted private electricity generation, and by a Telecommunications Law (1995) which provided for the creation of a regulatory framework, preparing the transfer of operations to the private sector, and granting concessions. Subsequently, in September 1998 congress approved the sale of 47 percent

shares in the telecommunications company, HONDUTEL; this percentage was raised to 51 percent in May 1999.

16. **Significant progress has been achieved in establishing an open trade regime.** Licensing procedures have been abolished, import tariffs have been reduced from a range of 1–90 percent to a range of 1–55 percent, and import surcharges have been eliminated. The effective import duty has declined from 21 percent in 1990 to less than 7 percent in 1998. Most export taxes have been phased out, and in April 1998 legislation extended to all exporters the benefits available in free trade zones, including exemptions from taxes on most imports of raw materials and capital goods. Honduras maintains bilateral agreements with Colombia, the Dominican Republic, Mexico, and Venezuela.

17. **In 1990 the authorities abolished the multiple exchange rate regime, devalued the Lempira, and established a flexible, market-based exchange rate system.** Two years later, congress approved the establishment of foreign exchange houses, which were allowed to buy and sell foreign exchange (with the exception of merchandise export proceeds which were subject to surrender requirements) at freely negotiated rates. In 1994 the interbank market was replaced with an auction mechanism in the central bank based on a crawling peg system with a trading band of plus/minus 1 percent around the central rate. Starting in 1996 the central rate has been adjusted in line with differentials in forward-looking relative prices between Honduras and its main trading partners. In 1998 the trading band was widened to plus/minus 7 percent.

18. **In the financial system, restrictions on interest rates were gradually abolished over the 1990–92 period.** Subsequently, the central bank strengthened its prudential regulations and liberalized restrictions on opening hours and branch networks, which had helped limit competition among banks. In 1995, the central bank's supervision department was transferred to the newly established National Commission of Banking and Insurance. Initially, the results of this transfer fell short of expectations because of a shortage of qualified technical staff. However, since 1997 progress has been made in strengthening the regulatory framework, including issuing prudential regulations on capital adequacy, loan classification requirements, connected lending, and limits on external borrowing.

19. **The economic reforms of the 1990s eliminated the high implicit taxation of the agricultural sector.** Product and credit markets have been liberalized and subsidies eliminated. Also, price and import controls have been abolished together with the state monopoly on international trade in grains and wood, and government intervention in the production, pricing and commercialization of processed food. Nontargeted subsidies on food distribution and the subsidized lines of credit earmarked for agriculture have also been abolished. In 1992 the adoption of the Agricultural Modernization Law restored confidence in land tenure by clarifying grounds for expropriation and strengthening land titling rules. The Law also legalized land leases and joint investments by cooperatives, and afforded forest lands protection from expropriation.

20. **The pace of structural reform continued in the first half of 1999** in the context of the Fund, IDA and IDB supported programs. Key advances included (i) the establishment of a single regulatory agency for the electricity sector (a key requirement to facilitate privatization); (ii) the issue of a decree to permit the start of the bidding process for the sale of shares in the telecommunications company, as well as the construction and management of infrastructure projects by the private sector; (iii) the issue of bids for the concession of the airport system to the private sector; and (iv) the approval of legislation that helps promote increased private investment in the mining and tourism sectors. In addition, efforts on the fiscal front, such as strengthening the customs and tax administrations, have continued.

21. **Nonetheless, there were some slippages in key structural reforms.** The invitation to purchase shares in the telecommunications company was delayed beyond the scheduled date at the end of June owing partly to protracted negotiations with the telecommunications workers' union, and the separation of the finances of the pension and health funds of the social security scheme (IHSS), a structural performance criterion, was not completed in June 1999 as programmed. The invitation to purchase HONDUTEL shares was issued in mid-November 1999, and the authorities are working toward a full separation of the finances of the pension and health plans of the IHSS.

Social policies

22. **During the 1990s the government's social sector strategy has focused on expanding and improving the quality of primary services** in health, nutrition, education, water and sanitation, as well as on targeting these services more precisely to the poor. Public social expenditures have been channeled to programs designed to expand health care and education facilities and enhance the quality of these services. The share of social expenditures in noninterest public expenditure rose from about 37 percent in 1990 to 40 percent in 1997 (Table 3), reflecting mainly the activities of two special programs created in 1990 to combat poverty: the Social Investment Fund of Honduras (FHIS) which builds community infrastructure in poor areas; and the Family Assistance Program (PRAF) which uses government transfers to increase nutrition, maternal-infant health, and school attendance.⁴ However, during the 1990s debt-service obligations have always been higher than social expenditure.

⁴ The operations of FHIS and PRAF are integrated into the national budget.

Table 3. Honduras: Social Expenditure as Percent of Non interest Expenditure

Expenditure/Year	Average 1990-92	1993	1994	1995	1996	1997	1998 1/
Education	23	17	22	23	20	19	19
Health	16	11	14	16	12	12	10
FHIS	3	5	3	3	6	7	5
PRAF	1	1	1	2	2	2	2
Total	42	35	40	44	40	40	36
Debt-service in percent of social expenditure	144	129	165	187	220	191	117

Sources: Ministry of Finance; and staff estimates.

1/ Figures for 1998 are somewhat distorted because of the hurricane, and the significant amount of emergency assistance.

23. **Honduras has developed an extensive primary health care system with impressive results in the area of preventive health.** By 1992 immunization coverage for children under the age of one was over 94 percent for the main vaccines (this coverage has been maintained during this decade), and progress has been made in targeting higher per capita spending for primary health care in the poorest regions. With regard to the structure of health expenditures, wages and salaries represent about 45 percent of the ministry of health's budget, goods and services about 30 percent, and medicines the remaining 25 percent. Since 1990 the government has been implementing the Health Center Construction Program aimed at increasing primary health care infrastructure, and as a result of this program about 800 primary health care centers (staffed with either a nurse or a doctor) have been established. Table 4 shows the gains achieved over the last decade particularly in the areas of immunization, sanitation and access to safe water. Notwithstanding the progress made in the area of preventive health, there are some areas (for example, malnutrition remains high at 18 percent of all children under five) where results have been limited.

Table 4: Honduras: Selected Health Indicators

1980–89	Indicator	1990–96
49	Safe water, rural (percent of rural population with access)	53
51	Safe water, urban (percent of urban population with access)	81
50	Safe water (percent of population with access)	65
57	Immunization, DPT (percent of children under 12 months)	93
57	Immunization, measles (percent of children under 12 months)	91
22	Sanitation, urban (percent of urban population with access)	86
32	Sanitation (percent of population with access)	63
101	Mortality rate, under five (per 1,000 live births)	61
300	Mortality ratio, maternal (per 100,000 live births)	200
63	Mortality rate, infant (per 1,000 live births)	47
61	Life expectancy at birth, total (years)	66

Source: World Development Indicators Database.

24. **In 1994 the government commenced implementing the National Plan for Education Development.** The Plan aims to increase the quality of basic and vocational education, and decentralize some of the functions of the ministry of education. Since 1994 school construction has expanded; the availability of text books and teaching materials for vocational and primary schools has increased; teacher training strengthened; and the primary education curriculum extended from 6 to 9 years. Although the quality of education remains an issue (as evidenced by high repetition rates and disparities between urban and rural areas), the main educational indicators have improved in recent years (Table 5).

Table 5. Honduras: Selected Educational Indicators

1980–89	Indicator	1990–96
34	Illiteracy rate, adult female (percent of females 15+)	28
29	Illiteracy rate, adult male (percent of males 15+)	26
32	Illiteracy rate, adult total (percent of people 15+)	27
78	School enrollment, primary (percent net)	90
78	School enrollment, primary, female (percent net)	91
78	School enrollment, primary, male (percent net)	89
16	Repetition rate percent, primary	12

Source: World Development Indicators Database.

25. **FHIS has proved to be a highly effective instrument for financing small-scale civil works projects in the social sectors.** In order to support the government's strategy to decentralize investment decision-making to the level of the municipalities, FHIS' mandate was expanded in 1995 to include greater emphasis on community participation, as well as coordination with, and strengthening of, local governments. Over the past eight years, FHIS has channeled over US\$180 million for priority community investments in education, health,

water and sanitation, economic infrastructure, social assistance, and the environment, and has reached communities in all municipalities in Honduras.

26. **The FHIS functioned as the government's main instrument to assist communities affected by Hurricane Mitch.** The hurricane also changed the poverty distribution, exacerbating conditions facing those who were already poor and creating new pockets of poverty. This made the FHIS poverty map less useful for the purposes of targeting, and ad hoc criteria were therefore introduced to allocate funds to the neediest areas. Looking to the future, it will be essential to update the poverty map based on the national census scheduled for 2000. It will also be important for FHIS to restart its work to promote participatory local planning in cooperation with municipal governments throughout the country.

27. **The PRAF is the main safety net program that directly compensates the most vulnerable groups through five components:** the School Bond to assist primary school children; the Maternal Child Bond for pregnant and lactating women, and children under the age of five; the Bond for the Elderly; the School Pack program for primary school students; and the Program for the Development of Women, to assist women in micro enterprise development and training. The PRAF was initially piloted by FHIS, and has since increased steadily its operations over the past years. Notwithstanding some concerns regarding its effectiveness and coverage, PRAF appears to be reaching intended beneficiaries.

III. POLICY OUTLOOK

28. **Honduras' medium-term development strategy aims at achieving a sustained reduction in poverty** through an acceleration of economic growth and an increase in the efficiency and equity of social expenditures. To this end, the authorities are committed to consolidating macroeconomic stability by lowering inflation, raising national savings, and strengthening the external sector further. Structural reforms would be deepened by moving forward with privatization of public enterprises, strengthening the financial system, modernizing the public sector, and further integrating Honduras into the world economy. To ensure that the benefits of economic growth reach the neediest, the authorities are committed to reinforcing the areas of management and implementation capacity of the line ministries—especially in the social area, and to remove the execution bottlenecks that exist in the implementation of social projects.

29. **In early 1999 the Honduran government elaborated its economic program for 1999–2001 (which is supported by the current ESAF arrangement)** in a Policy Framework Paper (PFP). The agenda of the economic program is extensive. In addition to policies aimed at a rapid recovery in economic activity and the maintenance of economic stability, the program sets out Honduras' agenda for structural reforms and improvements in the social sectors. The social agenda was further refined in the preparation of the National Plan for Reconstruction and Transformation through the linking of key elements such as the mitigation and reduction of poverty, the sustainable management of natural resources, and the strengthening of democratic participation. In this regard, the government has involved civil society in the discussion and design of reconstruction programs. The process has not always

been smooth, but there is a concerted effort on both sides to work toward consensus building. As part of this process, IDA has discussed with representatives of civil society the country assistance strategy, and—under the leadership of the government—is beginning to participate in discussions on the poverty reduction strategy that will form part of the basis for the Poverty Reduction Strategy Paper leading up to the decision point document.

A. Macroeconomic Objectives and Policies

30. **The medium-term macroeconomic objectives of the government's program are to speed up the pace of economic growth** to about 5 percent annually from 2000 onwards, while gradually lowering inflation, and strengthening the balance of payments. The interim inflation targets are 13 percent by end-1999, 8 percent by 2001, and 6 percent by 2003. The pickup in economic activity is expected to benefit from the ongoing reconstruction work, a recovery of agricultural production, and a restoration of private sector confidence and investment as the scope for private sector activities is broadened and privatization gathers momentum. Under this scenario, investment would increase from an annual average of 24 percent of GDP in 1996–98 to 27 percent by 2002, while savings are expected to recover over the corresponding period from 20 percent of GDP to 22 percent.

31. **Fiscal policy will play a key role in helping meet the government's macroeconomic objectives.** During 1999–2001, the Internal Revenue Office will ensure: (i) the firm application of penalties available under the 1997 Tax Code; (ii) a broadening of the tax base by expanding the registry of large taxpayers, and increasing access to third party sources of information for cross-checking of tax returns; and (iii) a full reexamination of tax exemptions. On the expenditure side, the focus of the 1999–2000 budgets is to meet the needs for emergency relief and reconstruction, increase social expenditure, and maintain tight control over nonemergency outlays. To ensure control over current expenditure, the government is committed to offsetting any increase in the wage bill in excess of budgeted levels with cuts in spending in other areas, excluding those related to priority social needs.

B. Structural Policies

32. **Achieving sustained rates of economic growth will depend on policies to promote private sector investment,** raise the efficiency of the public sector, strengthen the financial sector, and improve the country's social and physical infrastructure. Investment will be promoted through private sector participation in the ownership and provision of key services. Specifically, the government intends to offer to a private partner at least 51 percent of the telecommunications company; has established a tariff structure in line with long-run marginal costs in the electricity sector as a precursor to the privatization of electricity distribution; and has removed the obstacles for concessions to the private sector for the management of public works and airport and seaport services. The authorities will also design plans aimed at enabling private sector participation in road construction and decentralizing water supply services.

33. **Investment will be promoted also through continued trade liberalization.** The tax on bananas was reduced from the current rate of US\$0.15 per box (40 pounds) to US\$0.04 in 1999. In the coffee sector, the export retention scheme has been eliminated, and the obligation for producers to supply a proportion (7 percent) of their crops at fixed, below-market prices for domestic consumption has been eliminated. These reforms will help improve returns to farmers, and reduce the volume of contraband exports to neighboring countries. Also, the government is committed to the continued lowering of import duties in line with the schedule agreed in the context of the Central American Common Market (CACM). This schedule calls for a reduction in the tariff for consumer goods from the current rate of 18 percent to 15 percent by end-2000.

34. **The central bank will continue to take the steps required to shift from auctions to a fully competitive interbank market as the means for determining the exchange rate in the near future.** In particular, work on improving the communication network with commercial banks has begun, and a timetable for reductions in foreign exchange surrender requirements will be established.

35. **The government regards the further strengthening of public administration as a key element of its reform program. In this connection, the authorities have been:** (i) implementing, with IDA support, a human resource management system (SIARH); (ii) continuing the public employment rationalization and salary decompression program; and (iii) implementing a new salary policy to ensure that skilled staff can be attracted and retained. An initial round of reclassification of positions and salaries has already been completed. In the area of public financial management, the government has started implementing the Integrated Financial Management System (SIAFI) in the areas of debt management and programming, and budget formulation and execution. Also, beginning in 2000, the government will implement the Public Investment System (SISPU) that will centralize investment information and establish mechanisms for monitoring and evaluation of investment projects.

36. **During 1999–2001, the government will take measures to strengthen the financial system** with IDA, IDB, and IMF assistance. Specifically, the government will: (i) complete on-site inspections of all commercial bank loan portfolios in the wake of Hurricane Mitch; (ii) implement prudential norms on lending to related parties, risk-weighted capital, external indebtedness and open foreign exchange positions; and (iii) complete CAMEL-based examinations of all commercial banks. In December 1999 the government will also submit to congress legislation to establish a deposit insurance scheme, and to regulate the stock exchange and insurance companies. In the wake of the failure of a small bank in mid-September in part due to liquidity problems in its brokerage house subsidiary, ensuring confidence in the banking system through the prompt implementation of these regulations will be a key priority over the medium term.

37. **Hurricane Mitch highlighted the importance of natural resource management and rural development** and the government will focus on promoting three broad principles: targeting poor areas, strengthening decentralized institutions, and undertaking sustainable

watershed management. Specifically, the government will concentrate on: (i) land titling and registration to improve land security; (ii) piloting a market-based assisted land reform to reduce the skewedness of land distribution; (iii) establishing a rural investment fund targeting poor producers; (iv) watershed management and river course stabilization; and (v) restructuring of forestry sector agencies to ensure the sustainability of the sector.

38. **The government has requested IDA assistance to support disaster preparedness and mitigation efforts** that would include capacity building, vulnerability assessments, and identification of flood-prone areas. The assistance would build on a regional effort in partnership with IDB to support the Center for Prevention Disasters in Central America.

39. **The effects of the hurricane have underscored the need to improve governance and transparency**, not only to reassure donors supporting Honduras in the reconstruction effort, but also as a part of the country's development strategy. In this regard, the government has adopted a two-pronged approach. Over the medium term, with IDB, IDA, and other donor support, it will focus on strengthening audit, control, and accountability mechanisms, especially the office of the comptroller general and the office of administrative probity. As part of this effort, the government is designing, with IDB support an Efficiency and Transparency Program focusing on procurement, project inspection by independent auditors, training of technical staff, and strengthening of existing institutions. Beginning in October 1999, with financing from U.S. AID, three international accounting firms have begun to audit a sample of projects. Over time, the government will focus on strengthening the judicial system and the development and implementation of an anticorruption plan.

C. Social Policies

40. **The government's overriding concern is to ensure the availability of adequate resources to cope with the social consequences stemming from the devastation caused by Hurricane Mitch**, especially for the poorest groups of the population. To ensure that the benefits of the reconstruction efforts reach the neediest, social policies will have to be reinforced, particularly in the areas of management and implementation capacity of the line ministries. At the same time that efforts are made to remove execution bottlenecks, it is essential to improve the institutional capacity to formulate and implement social policies. The government has begun work on re-assessing social conditions and poverty in the post-hurricane period as part of its preparatory work for the Poverty Reduction Strategy Paper (PRSP). The PRSP will be developed during 2000--through an open, government-led process with broad-based participation of civil society and donors, and support from the World Bank, Fund, and other external partners--as a comprehensive strategy for addressing poverty. Until the strategy is completed, the government's focus will be on addressing weaknesses in specific social sectors.

41. **During 1999-2002, the government will implement a three-pronged approach aimed at achieving higher efficiency in provision of education and health services**, increasing the effectiveness and equity of investments in the social sectors through the FHIS, and strengthening the social safety net based on the Family Assistance Program. In this

regard, over the period the level of per capita social expenditure will be at least maintained at the level of 1998.

42. **In the health sector, the government plans to reinforce the decentralization process** by transferring to municipal and regional levels some of the ministry of health functions. This will be complemented by efficiency measures that include rationalization of the budget and the human resources policy and management programs, and updating the human resources census. In addition, to strengthen the social security system, the financial accounts of the pension and health plans will be separated and transfers between the two funds eliminated. In terms of preventive health care measures, the government will continue to implement its successful vaccination campaigns.

43. **As for child malnutrition**, the authorities are implementing a pilot program (AIN or Atención Integral a la Niñez) that is showing impressive results by focusing on preventing moderate malnutrition rather than concentrating on treating severe malnutrition. The program functions as a community-based complement to the clinic-based health system, and emphasis is placed on triggering specific actions, including advice, home visits, reinforcements and, if needed, referrals. In communities where the program has functioned the longest there has been a dramatic reduction in malnutrition, from 39 percent to 8 percent in communities which had the highest levels of malnutrition, from 25 to 10 percent in communities with moderate levels, and from 9 percent to virtually zero in communities with low levels. There are plans to expand the program based on the results of an evaluation that is currently underway.

44. **The government also plans to improve the quality of basic education**, increase the efficiency in public education services, reduce disparities in service between rural and urban areas, and ensure adequate financing for the education programs. This will be pursued by: (i) establishing a decentralized system to allow community participation in the management and administration of the schools in rural areas, including the creation of education committees at a community level (the PROHECO program, see Box 2); (ii) modifying the management structure of the ministry of education through delegation to departmental offices, the introduction of new management tools, and improvements in norms and standards; (iii) applying technical criteria for the promotion and hiring of new teachers; and (iv) expanding objective standards for monitoring student achievement at the primary and secondary levels.

Box 2. The PROHECO Program

Although past reform efforts have involved modest steps to mobilize communities and parents in Honduras' education sector, the current administration is committed to the adoption of a community participation model in pre-primary and primary education, following on the successful experience underway in the region (El Salvador and Guatemala). Before the hurricane, the government believed that because it faced different initial conditions from those in neighboring countries, it needed to move cautiously to empower communities and parents with responsibility for their children's education. Following the hurricane, however, the government believes it now has the opportunity to move more aggressively with these reforms, and it plans to accelerate the introduction of its Community Participation in Education Program (PROHECO).

Self-management makes this program distinctive. Schools are operated by parents organized in a locally-elected community education association (ACE). ACE hires and fires teachers following ministry of education (MOE) guidelines, closely monitors their attendance and performance, enters into an annual contract with MOE, and receives funds to cover teacher salaries and operating costs. MOE provides teaching and learning materials and teacher training programs; ACEs provide classroom space, furniture, and school maintenance.

The government has set itself ambitious targets for 2002, including the creation of 1,250 PROHECO schools covering 50,000 children in poor rural communities lacking pre and primary schools.

45. **The government will continue to rely primarily on the FHIS to build basic social infrastructure aimed at increasing the impact of social services.** The hurricane has made it imperative for the FHIS to update its mechanism for targeting the most needy groups, and the organization is playing a key role coordinating the post-hurricane relief and reconstruction efforts. In addition, FHIS will ensure that, through the Town Hall Meetings for Municipal Development Program (Cabildos Abiertos), local communities draw up participatory and prioritized investment plans so as to ensure the maintenance and sustainability of such investments.

46. **The hurricane worsened an already difficult housing situation.** It widened the housing deficit and reduced the capacity to provide solutions—a situation that will likely take over six years to remedy. To make matters worse, internal migratory flows (mainly farmers leaving devastated farms to seek work in urban areas) have intensified markedly, thereby increasing the pressure on already reduced housing facilities. The government has sought IDB support for an emergency housing project that will attend to the immediate housing needs of low income people made homeless by the hurricane. At the same time it will ensure that proper standards are applied in new construction to reduce vulnerability to future natural disasters; establish a vehicle for channeling donor support for housing; and improve the formulation and implementation of housing policy.

47. **The PRAF will continue to be the most important government tool to provide transfers to vulnerable groups.** Since the PRAF currently reaches under a third of its target population, there is significant scope to expand coverage if new contributions can be mobilized from external donors. In addition to mobilizing increased resources, the government aims to strengthen targeting mechanisms to ensure that transfers reach the neediest groups.

48. **The government will continue its efforts to promote indigenous development.** In this regard, IDA is supporting capacity building and institutional strengthening in indigenous communities, focusing on project planning and execution. In addition, the authorities are implementing a pilot program to provide bilingual education, including translating teaching materials into some of the indigenous languages. The government has also sought IDA support for a more integrated approach to be supported by a possible indigenous development project.

49. The authorities recognize that the success of the social policies outlined above will require not only financial support from the international community, but also the strengthening of the managerial capacity of the agencies in charge of the delivery of social services. Similarly, community participation in planning, execution, and maintenance of local programs will be key.

50. **Under the Enhanced HIPC Initiative, resources released by debt relief will be devoted to the above-mentioned programs.** However, the devastation caused by Hurricane Mitch makes it difficult at this time to set detailed quantitative benchmarks to monitor progress in the social sectors and poverty reduction owing to incomplete social damage assessments, and, consequently, to the lack of an adequate baseline from which to propose quantitative progress and outcome indicators. In this regard, IDA will assist the government to improve data collection, dissemination and analysis through the MECOVI project (a partnership between IDB, ECLAC, and the World Bank aimed at improving survey capacities in Latin America). The improved data base will be used to prepare a poverty assessment, which will update IDA's 1995 report and support the elaboration of the PRSP. In addition a number of donors are supporting the 2000 National Census, which will provide a real source of data to establish poverty and social baselines after Mitch.

Box 3. Key Social Policies

Human Capital

Education: Promote community participation in pre- and primary education by giving parents increased responsibility over education of their children (PROHECO).

Health: Improve service delivery through decentralization.

Nutrition: Reduce child malnutrition through community involvement (program AIN).

Safety Net

Vulnerable groups: Enhance protection of vulnerable groups by improving targeting of PRAF transfers.

Rural poverty: Prepare long-term development strategy that includes land titling, market-assisted land reform, and rural credit.

Indigenous population: Support indigenous community participation in capacity building and institutional strengthening (Indigenous Development Program).

Social Investment

FHIS: Restart the Town Hall Meetings for Municipal Development (Cabildos Abiertos) to define appropriate programs at the local level.

IV. DEBT SUSTAINABILITY AND ASSESSMENT OF ELIGIBILITY

51. The DSA, which was prepared jointly by the authorities and staffs of IDA and the IMF, with the involvement of the IDB, is based on macroeconomic projections through 2018, and assesses Honduras' prospects for debt sustainability over this period. The debt estimates and present value (NPV)⁵ calculations are based on external debt data as of end-December 1998 provided by the authorities, on a loan-by-loan basis.⁶ An assessment of the authorities' debt management policies and institutional capacity to implement adopted policies is presented in Appendix I. No nonconcessional borrowing is contemplated under the current ESAF arrangement.

⁵ The NPV of debt is calculated using the average currency-specific commercial interest reference rates (CIRRs) for the six-month period ending December 31, 1998 and converted into U.S. dollars using the end-1998 exchange rate.

⁶ External debt data contracted with some bilateral creditors still need to be reconciled. This reconciliation process has been completed with multilateral creditors.

A. Baseline Scenario

52. **The baseline scenario for the balance of payments assumes continued implementation of sound economic policies in the context of current Fund, IDA and IDB supported programs**, aimed at macroeconomic stability, high and sustained rates of economic growth, and progress in tackling social issues. The main assumptions of the baseline scenario are quantified in Table 6, and summarized in Box 4, however, in view of the uncertainties surrounding economic developments and the flow of external financing in the wake of the hurricane, these assumptions are subject to revision.

Box 4: Key Macroeconomic Assumptions in the

Debt Sustainability Analysis

- Real import growth will average about 6 percent annually, slightly higher than the average 5 percent rate of growth of GDP.
- Transfers will remain constant in real terms through 2018 reflecting a continued international commitment to Honduras' development efforts and increased private remittances.
- Public sector net disbursements will be capped at 1½ percent of GDP.
- All new borrowing will be on concessional terms in conformity with the authorities' stated objectives. The assumed terms of new bilateral borrowing are 15-year maturity including a 6- year grace period with a rate of interest of 3 percent.^{1/} The terms for multilateral borrowing vary by creditor. ^{2/}
- Private sector net capital inflows will drop off gradually to 2.5 percent of GDP by 2005 and remain at that level thereafter.
- Gross reserves are maintained in the range of 3–4 months of imports. However, it is not until the latter half of the projection period that the balance of payments has strengthened to the point where sufficient reserves can be accumulated. Consequently, financing gaps are expected to remain through 2009.^{3/}

^{1/}The borrowing terms are in conformity with the provisions of Presidential Decree PCM-018-96 as discussed in Annex I.

^{2/} For instance, IDA borrowing terms are 40 years maturity including 10 years of grace period with an interest rate of 0.75 percent.

^{3/} Should the financing gap remain unfilled and the build-up of reserves be correspondingly smaller, gross reserves would decrease to less than 2 months of imports by 2009.

53. **The external current account deficit is projected to widen from an average of about 3½ percent of GDP a year in 1995-98 to about 9 percent in 1999**, reflecting increased imports related to the reconstruction needs, and the effects of the hurricane on key export crops (banana, coffee, sugar, and tobacco) (Table 7). Although exports are expected to recover by 2001, the current account deficit is projected to remain at about 6 percent of GDP owing to continued high import demand associated with the reconstruction, and the expected

recovery in private investment. Toward the end of the decade, the current account deficit is expected to narrow to 3 percent of GDP, and remain at 2½–3½ percent of GDP thereafter. The capital account is projected to register surpluses over the medium term (averaging about 4 percent of GDP a year). Whereas the public sector is expected to step up its borrowing from multilateral creditors,⁷ private sector inflows would comprise mainly foreign direct investment.

54. The financing gap for the 1999–2001 period was estimated at US\$854 million at the time the ESAF arrangement was approved on March 26, 1999. Taking into account the latest Paris Club rescheduling agreement of April, 1999, and prospective disbursements, the financing gap for 1999 is expected to be filled. A full assessment of financing gaps for 2000–2001 will be made early next year, taking into account disbursements stemming from commitments made at the Consultative Group meeting held in May 1999 in Stockholm, and debt relief.⁸

55. **At end-1998 total external public sector debt outstanding amounted to US\$3.9 billion.** The present value of this debt is estimated at US\$3.2 billion, equivalent to 147 percent of exports, 61 percent of GDP, or 338 percent of central government revenue⁹ (Table 9). Of total public sector debt outstanding at end-1998, about 58 percent was owed to multilateral creditors, and some 42 percent to bilateral creditors (Figure 1). The IDB is the largest creditor with 41 percent of multilateral debt, followed by the World Bank with 27 percent, and the Central American Bank for Economic Integration (CABEI) with 24 percent. The IMF accounts for 5 percent, and the remainder is distributed among the OPEC Fund, the International Fund for Agricultural Development, and Inter-American Savings and Loan Bank (Table 8).¹⁰

56. **Debt to Paris Club bilateral creditors constitutes 34 percent of total public debt,** debt to bilateral non-Paris Club creditors 7 percent, and debt to commercial creditors 1 percent. About 74 percent of Paris Club debt is pre-cutoff-date debt, of which 45 percent is on ODA terms. Honduras' main Paris Club creditors are Japan (40 percent of total Paris Club debt), Spain, and the United States (14 percent each). Most non-Paris Club bilateral debt is owed to Latin American countries, notably Mexico with 25 percent of total non-Paris Club debt. Other major non-Paris Club bilateral creditors include Taiwan Province of China (28 percent) and Kuwait (15 percent).

⁷ The increase in public sector disbursements in 1999 is mostly on account of disbursements from IDA's US\$200 million Hurricane Emergency Project.

⁸ A total of US\$2.76 billion was pledged to Honduras at these meetings, to be allocated over the course of 1999–2002 and used for emergency relief, reconstruction, debt relief and other unspecified funds. A total of 21 countries pledged almost US\$1.1 billion, mostly for reconstruction. Multilaterals pledged approximately US\$1.69 billion. IDA and the IDB were the largest multilateral contributors.

⁹ Before the application of full traditional mechanisms. In what follows and unless otherwise noted all references to debt stocks are in NPV terms.

¹⁰ About 70 percent of Honduras' multilateral debt is on nonconcessional terms.

57. **Honduras has benefited from four Paris Club rescheduling agreements.** The first agreement in 1990 was a nonconcessional rescheduling on Houston terms. At that rescheduling, Honduras was designated as a lower-middle income country. In 1992, the Paris Club granted Honduras its first concessional rescheduling on enhanced Toronto terms providing for a 50 percent debt reduction in NPV terms on amounts rescheduled. In February 1996 a third agreement was signed which included a one-year flow rescheduling on Naples terms with a debt reduction on eligible maturities of 50 percent.¹¹ The agreement covered arrears as of end-1995 and current maturities falling due from January 1, 1996 to January 31, 1997 on non previously rescheduled pre-cut off date debt (excluding late interest). In order to support Honduras in its reconstruction efforts in the aftermath of the hurricane, in December 1998, Paris Club creditors granted Honduras a deferral of all debt-service payments falling due over the three-year consolidation period (December 1998 to December 2001). The fourth Paris Club agreement took place in April 1999, where Honduras was granted a concessional three-year rescheduling on Naples terms with a debt reduction in NPV terms on eligible maturities of 67 percent.

58. There is an estimated US\$41 million of commercial debt outstanding of which about half is owed to the Commonwealth Development Corporation (CDC). A debt buy-back operation is expected to be completed by 2000.¹² The stock of private sector nonguaranteed debt is estimated at US\$0.3 billion as of end-1998.

59. **The public sector debt projections incorporate the results of the recent Paris Club rescheduling agreement of April 1999** and a prospective stock of debt operation under Naples terms (67 percent NPV reduction on eligible maturities) in April 2002. Comparable treatment is also assumed by other official bilateral creditors. It is estimated that this stock operation could lower the debt at end-2002 by US\$161 million in NPV terms.

¹¹With the annual per capita income level exceeding US\$500, Honduras was not eligible for a more concessional rescheduling agreement.

¹²IDA is providing technical assistance to help the government complete the operation. In July 1998 IDA approved a US\$400,000 grant from the Debt Reduction Facility for the financing of financial and legal advisors.

Box 5. The Central American Emergency Trust Fund

The Central America Emergency Trust Fund (CAETF) was established by the World Bank after Hurricane Mitch to channel donor contributions to cover affected countries' multilateral debt-service payments. To date, the CAETF has received about US\$116 million in bilateral contributions, of which about US\$72 million have been allocated to Honduras. At end-October 1999, the CAETF used all the allocation to cover a large share of Honduras' multilateral debt-service payments. The CAETF will continue to remain in existence as long as it has the resources to cover affected countries' multilateral debt-service. In this regard, several donors have expressed interest in making additional contributions to CAETF.

60. Reflecting the large government borrowing needs related to the reconstruction effort, the public sector's external debt is projected to increase by 13 percent from about US\$3.2 billion in 1998 to US\$3.6 billion in 2001. Notwithstanding the debt-service moratorium to Paris Club creditors, total public sector debt-service is estimated to average about US\$200 million annually over the 1999–2001 period, representing about 20 percent of government revenues. This would increase sharply to US\$370 million or about 30 percent of government revenues in 2002 as the debt-service moratorium expires (Table 10).

61. As a share of exports, external debt in NPV terms would fall from 147 percent in 1998 to 130 percent in 2002. The debt-service-to-export ratio is expected to remain at below 10 percent in 1999–2001, but to increase to 11 percent in 2002 as the bilateral debt-service moratorium expires, and then in 2004 will fall back to the 1999 level. While these ratios are moderate, the fiscal burden of the debt is substantial. In 1998 the NPV of debt-to-revenue ratio is estimated at 338 percent, and would decline only to 247 percent in 2002.

B. Sensitivity and Vulnerability Analysis

62. **Sensitivity analysis.** The Honduran economy remains vulnerable to a wide variety of adverse shocks, including natural disasters, terms of trade shifts (just three commodities accounted for half of all exports in 1998), and uncertainties regarding capital flows given an international environment of increasing demands and cutbacks in donors' aid budgets. To explore the sensitivity of the baseline scenario, two possible down side scenarios have been considered. One analyzes the consequences of a low-growth environment, and the other the effects of sharply lower terms of trade. The results of the sensitivity analysis are summarized in Table 11 and Figure 2.

63. **Low growth scenario.** While economic growth could exceed what has been incorporated into the staffs' medium-term baseline scenario, there are also downside risks. The baseline scenario's acceleration of economic growth is predicated on increased savings and investment; however, increased investments do not necessarily translate into higher

growth.¹³ Should the expected increased efficiency of investment not materialize, export and GDP growth over the medium term would be correspondingly lower. A rate of economic growth that is 1 percentage point lower than that assumed in the baseline scenario during 1999–2018 period would be consistent with a current account deficit that would be larger by about 1–2 percentage points of GDP, and with a financing gap that would be about 2–3 percentage points of GDP higher than that assumed in the baseline scenario. Consequently, the NPV of debt-to-revenue ratio would be 338 percent in 1999, falling to 251 percent by 2003, and 206 percent by 2018.

64. **Lower permanent terms of trade scenario.** In line with the latest World Economic Outlook assumptions and commodity price projections by the World Bank, the baseline scenario incorporates a deterioration in the terms of trade by 6 percent during the period 1999–2004, reflecting mainly stagnant export prices and moderate increases in import prices. Should the terms of trade loss over this period be twice that incorporated in the baseline scenario, the current account deficit would remain at about 6–8 percent of GDP over the medium term. Assuming that it would be possible to finance such high deficits on the standard concessional terms incorporated into the baseline scenario, the debt build-up would become very burdensome, with the NPV debt to fiscal revenue remaining above 200 until 2011.

C. Eligibility, Decision and Completion Points

65. As the enhanced framework determines eligibility and assistance at the decision point after full use of traditional debt relief mechanisms, the debt sustainability analysis assumes a Paris Club stock of debt operation under Naples terms in December 1999, with 67 percent NPV reduction, on pre-cutoff-date debt. This operation is assumed to cover all nonpreviously rescheduled principal and interest on pre-cutoff-date debt and to include a topping up of amounts previously rescheduled. Comparable treatment is also applied to non-Paris Club and commercial creditors. It is estimated that this operation could lower the stock of debt at end-1999 by US\$176 million in NPV terms. As a share of exports, the NPV of external debt decreases from 147 percent in 1998 to 137 percent in 1999, below the exports threshold under the Enhanced HIPC Initiative. The debt-service-to-export ratio is estimated at 12 percent in 1999. In contrast, the fiscal burden of the debt is very high. In 1998 the NPV of debt-to-revenue ratio is estimated at 338 percent, and decreases in 1999 to 305 percent. It steadily declines thereafter reaching 237 percent in 2002 (Table 12).

66. **Honduras would qualify under the Enhanced HIPC Initiative based on the fiscal/openness criteria.**¹⁴ Honduras meets the thresholds required for eligibility under the

¹³ Historically Honduras' investment rates have been high relative to economic growth. This suggests that the efficiency of investments has been inadequate as also discussed in "Honduras-Selected Issues" (SM/98/218, 8/31/98).

¹⁴ See EBS/99/138, dated July 23, 1999, and the Chairman's Summing Up (Buff/99/101, August 9, 1999).

fiscal/openness criterion¹⁵ since the export-to-GDP ratio and central government revenues-to-GDP ratio in 1998 were 47 percent, and 18 percent, respectively, and in 1999 these ratios are estimated to be 44 percent and 18 percent, respectively.

67. **Honduras is an ESAF-eligible and IDA-only country which has established a good track record for implementing sound macroeconomic policies and structural reforms** supported by an ESAF arrangement signed in 1992, a second ESAF arrangement in March 1999, and four IDA adjustment credits. Furthermore, to strengthen the conditions for sustainable economic growth, the authorities undertook important structural reforms, including financial system reforms, public sector modernization reforms and trade reforms. Accordingly, the staffs and managements recommend that Honduras, based on its record of policy implementation and the need for external resources as a result of the devastation caused by Hurricane Mitch, reaches a decision point in 2000. Subject to the views of the Boards, this decision point would be conditional on (i) satisfactory progress under the new three-year ESAF arrangement, namely, successful completion of the first and second reviews;¹⁶ (ii) progress on key structural reforms, particularly the privatization of the telecommunications company, HONDUTEL; and (iii) satisfactory progress toward the completion of the Poverty Reduction Strategy Paper.

68. In light of the Enhanced HIPC Initiative framework, the staffs intend to present in the final HIPC document specific recommendations with respect to the conditions needed to be fulfilled before Honduras would reach its completion point. Main future reforms which the staffs consider to be essential are summarized in Box 6. These reforms also form part of the agenda of structural policies that will be incorporated into the ESAF arrangement.

¹⁵ In conformity with the standard HIPC Initiative methodology, exports of goods and nonfactor services, and fiscal revenues are measured using three-year averages centered on the preceding year for the purpose of assessing the threshold of the fiscal/openness window.

¹⁶ The second review will assess performance under the arrangement through December 1999, and set out an economic program for 2000 agreed with the staffs of the Fund and the World Bank.

**Box 6: Key Reforms to be Monitored under
the “Floating Completion Point”**

Privatization process

- Bring to the point of sale the state telecommunications company, HONDUTEL.
- Take steps to advance the privatization of electricity distribution.

Financial sector

- Make significant progress in the legislative and regulatory framework of the financial system.

PRSP

- Completion of the poverty reduction strategy paper and one comprehensive progress report.

Governance

- Make satisfactory progress in the areas of improved governance and transparency, along the lines described in paragraph 39.

D. Potential Assistance Under the Initiative

69. Given the sensitivity and vulnerability analysis as well as the debt burden expressed in terms of NPV of debt as a share of government revenues, Honduras would qualify for assistance under the Enhanced HIPC Initiative. Taking into account the Enhanced HIPC Initiative framework, the staff will present a recommendation on the assistance in the Final HIPC document on the basis of actual end-December 1999 data.

70. Preliminary calculations suggest that with a decision point in 2000, after the application of full traditional debt relief mechanisms before the decision point, the assistance—based on the end-October 1999 exchange rate—could amount to US\$676 million. The calculations also indicate that the bilateral NPV reduction on eligible debt would need to substantially exceed 90 percent in order to deliver the required share of assistance. In view of the damage caused by Hurricane Mitch and the substantial reconstruction needs, the staffs will recommend in the final HIPC document the provision of interim assistance. By way of comparison, Table 13 presents the relief based on end-1998 exchange rates, together with a breakdown of the cost by creditor group assuming proportional burden sharing.

E. The Authorities’ Views

71. During the discussion of the DSA and policy intentions under the HIPC Initiative, the government emphasized that Honduras’ external debt and debt-service remain unsustainably high and would certainly delay rebuilding the physical and social infrastructure damaged by Hurricane Mitch.

72. The authorities also noted that, in a country where the social needs were significant even before the hurricane, and where basic social infrastructure such as access to safe water and sanitation, had not reached important segments of the population, debt relief that might be available under the HIPC Initiative would help provide financing for critical social and infrastructure programs. In particular, it would enable the government to accelerate and intensify its reconstruction efforts as well as improve primary education, preventive health care, and urban and rural infrastructure, all of which are essential for reducing poverty and improving Honduras' social indicators. In this regard, the authorities are fully committed to making substantial progress toward a PRSP by the time of the Final HIPC document.

73. The government noted that notwithstanding prudent debt management and strong adjustment efforts marked by increased stability in the macroeconomic front over the past several years, Honduras' external and fiscal vulnerabilities were likely to increase as a result of the widespread damage caused by the hurricane to the country's productive sectors, and especially to export crops. The authorities also noted the financial stress posed by the hurricane, both internally, through a reduction of tax receipts, and externally through a reduction of export receipts, at a time when expenditure demands have increased substantially.

74. Despite financial stress, the government is committed to maintaining prudent financial policies, and deepening structural reforms. Government officials underlined that the 1999 budget continued to be marked by a prudent fiscal policy stance, within the constraints imposed by reconstruction needs, and a reasonably tight monetary policy that would contribute toward controlling inflation. Concerning structural reforms, the government emphasized its commitment to the reforms discussed above. In particular, it underlined its commitment toward the privatization of the telecommunications company, the electricity distribution network, and the management of the national airport system. The authorities also expressed their commitment to strengthen the financial sector through adequate regulation and supervision.

75. The authorities have expressed their commitment to work with donors and the international community to permanently guarantee the transparency and accountability in the use of external and internal resources destined for the reconstruction. To achieve this goal the comptroller general's office will hire an international auditing firm with the support of multilateral and bilateral institutions. In addition, donors are supporting the strengthening of the comptroller general's office, the office of administrative probity, and the national procurement system.

76. The government noted that Honduras has little scope for borrowing on commercial terms and stressed the importance of maintaining access to external financing on highly concessional basis. The government also expressed concerns regarding the assumptions adopted in the document to project future external flows, in view of 1998 being a special year. The authorities placed importance on an early decision to provide Honduras with the maximum possible assistance in order to support the reconstruction efforts.

77. The government hopes that under the Initiative debt relief could be granted in an as much as frontloaded manner as possible to help ease the high fiscal burden of debt-service payments. In this connection, the government requests that the completion point under the Initiative be reached before 2002 so that debt-service payments do not become overly burdensome following the end of the period of the moratorium granted by Paris Club creditors.

78. The authorities have expressed their appreciation to all creditors for their continued support of Honduras' stabilization and structural adjustment efforts, and for the important assistance received during the emergency caused by Hurricane Mitch. In particular, the government expressed its gratitude to the donor community that, through the Central American Emergency Trust Fund, is helping it to meet debt-service obligations to multilateral institutions, and free up resources for reconstruction.

V. ISSUES FOR DISCUSSION

79. This paper presents a preliminary assessment of Honduras' eligibility for assistance under the Enhanced HIPC Initiative. The preliminary debt sustainability analysis presented in this paper indicates that Honduras would be eligible for assistance under the Enhanced HIPC Initiative. Moreover, based on substantial progress on reform and improved economic performance since 1995, Honduras has established a track record consistent with a decision point in 2000 under the HIPC Initiative. Relief under the Initiative would help reduce the debt burden to sustainable levels, and permit the allocation of additional resources toward the reconstruction and expansion of physical and social infrastructure. Executive Directors' views and guidance are sought on the following issues:

- **Eligibility.** Do Directors consider Honduras eligible for assistance under the Enhanced HIPC Initiative?
- **Decision point.** Do Directors agree with the staffs' recommendation of considering a Final HIPC document in 2000, conditional on: (i) the ESAF-supported program being on track after the second review and endorsement by the Executive Boards of the program for 2000; (ii) progress on key structural reforms, particularly the privatization program; and (iii) satisfactory progress toward the development of the Poverty Reduction Strategy Paper?
- **Interim assistance.** Do Directors agree with the staff's recommendation of providing interim assistance between the decision and the completion point?
- **Completion point.** Do Directors have preliminary views on the policies to which a floating completion point should be tied?

Table 6. Honduras: Economic Indicators

(Average annual percentage changes, unless otherwise indicated)

	Preliminary	Projections			
	1996-1998	1999-2001	2002-2004	2005-2012	2013-2118
Per capita GDP (in 1998 US\$) 1/	805	820	883	1,113	1,320
GDP (in millions of US\$) 1/	5,268	6,281	7,836	13,887	20,728
GDP (in millions of lempira) 1/	70,512	98,997	141,983	300,319	496,287
Real GDP	3.9	2.4	5.2	5.0	4.5
Population	3.2	3.3	2.7	2.0	1.6
Real per capita GDP	0.7	-0.8	2.5	2.9	2.9
Real exports of goods	10.4	2.9	7.5	6.5	5.2
Real imports of goods	17.0	8.2	5.8	5.6	5.0
Current account deficit 2/	3.3	8.0	4.3	3.2	3.1
Capital account surplus 2/	3.6	6.1	4.3	4.0	4.0
Gross reserves in months of imports 1/ of imports 1/	2.9	3.6	3.5	3.0	2.8
<u>Investments 2/</u>	<u>23.9</u>	<u>25.9</u>	<u>27.0</u>	<u>27.0</u>	<u>27.0</u>
Public sector	6.7	8.7	7.5	7.0	7.0
Private sector	17.2	17.2	19.5	20.0	20.0
<u>Savings 2/</u>	<u>20.0</u>	<u>17.1</u>	<u>22.1</u>	<u>24.0</u>	<u>24.4</u>
Public sector	6.1	3.9	6.9	7.0	7.0
Private sector	13.9	13.2	15.2	17.0	17.4
<u>Central government balance 2/</u>	<u>-3.2</u>	<u>-6.1</u>	<u>-1.9</u>	<u>-1.9</u>	<u>-1.9</u>
Revenue (excl. grants)	17.7	18.6	18.5	18.5	18.5
Expenditure	20.9	24.8	20.4	20.4	20.4
Consumer price inflation 1/	15.7	8.0	4.0	4.0	4.0
Terms of trade	0.6	-2.6	0.6	0.0	0.0

Sources: Data provided by the Honduran authorities and staff estimates.

1/ End of period.

2/ Period average; in percent of GDP.

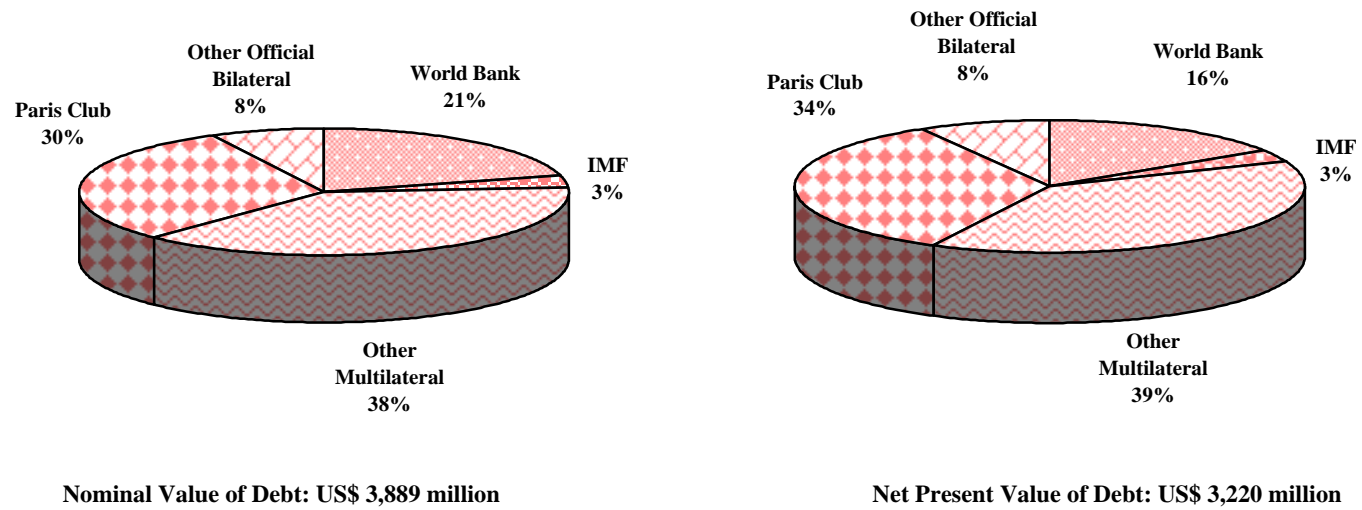
Table7. Honduras: Balance of Payments Projection

	Prel.																				
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
(In millions of U.S. dollars)																					
Current account	-67	-504	-514	-353	-323	-304	-301	-312	-324	-337	-348	-360	-369	-374	-375	-419	-467	-520	-576	-632	-698
Balance of goods and services	-333	-909	-884	-751	-716	-693	-695	-711	-725	-736	-746	-752	-754	-753	-746	-782	-820	-860	-901	-943	-987
Exports 1/	2463	2245	2526	2889	3236	3582	3897	4221	4571	4951	5363	5808	6291	6814	7380	7896	8448	9038	9670	10346	11069
Imports	-2796	-3154	-3410	-3639	-3952	-4275	-4592	-4931	-5296	-5688	-6108	-6560	-7045	-7567	-8126	-8678	-9268	-9898	-10570	-11289	-12056
Public sector interest debits	-169	-149	-138	-129	-132	-140	-137	-135	-133	-133	-134	-136	-138	-141	-145	-150	-156	-163	-170	-172	-180
Other income (net)	-40	-9	-10	-24	-38	-47	-59	-70	-83	-98	-115	-133	-152	-171	-191	-210	-231	-254	-280	-309	-340
Transfers (net)	476	563	518	551	563	576	589	603	617	631	645	660	676	691	707	723	740	757	774	792	810
Capital account	146	442	302	298	302	310	320	337	363	388	417	449	479	516	552	597	628	679	731	776	823
Public sector (net)	-30	241	85	94	102	107	115	127	137	145	156	169	178	192	205	226	231	255	278	291	305
Disbursements	183	430	265	269	295	300	310	310	330	300	320	340	380	420	460	510	540	580	620	640	670
Amortizations	-213	-189	-179	-176	-193	-193	-195	-183	-193	-155	-164	-171	-202	-228	-255	-284	-309	-325	-342	-349	-365
Private sector (net)	177	201	216	204	199	202	206	210	226	243	261	280	301	323	347	371	397	424	453	485	518
Overall balance	80	-62	-212	-55	-21	6	19	25	38	51	69	89	110	141	177	177	160	159	155	144	125
Net international reserves (- increase)	-168	-150	0	-100	-100	-100	-100	-100	-100	-100	-100	-100	-110	-141	-177	-177	-160	-159	-155	-144	-125
Exceptional financing and financing gap	89	212	212	155	121	94	81	75	62	49	31	11	0	0	0	0	0	0	0	0	0
(In percent of GDP)																					
Current account	-1.3	-9.4	-8.8	-5.6	-4.8	-4.2	-3.8	-3.7	-3.6	-3.5	-3.3	-3.2	-3.1	-2.9	-2.7	-2.8	-2.9	-3.1	-3.2	-3.3	-3.4
Balance of goods and services	-6.3	-17.0	-15.2	-12.0	-10.6	-9.5	-8.9	-8.4	-8.0	-7.6	-7.1	-6.7	-6.3	-5.8	-5.4	-5.3	-5.2	-5.1	-5.0	-4.9	-4.8
Exports 1/	46.7	42.0	43.4	46.0	47.7	49.1	49.7	50.1	50.6	51.0	51.4	51.8	52.3	52.7	53.1	53.2	53.2	53.3	53.3	53.4	53.4
Imports	-53.1	-59.0	-58.6	-57.9	-58.3	-58.6	-58.6	-58.6	-58.6	-58.6	-58.6	-58.5	-58.5	-58.5	-58.5	-58.4	-58.3	-58.3	-58.2	-58.2	-58.2
Public sector interest debits	-3.2	-2.8	-2.4	-2.1	-1.9	-1.9	-1.8	-1.6	-1.5	-1.4	-1.3	-1.2	-1.1	-1.1	-1.0	-1.0	-1.0	-1.0	-0.9	-0.9	-0.9
Other income (net)	-0.8	-0.2	-0.2	-0.4	-0.6	-0.6	-0.7	-0.8	-0.9	-1.0	-1.1	-1.2	-1.3	-1.3	-1.4	-1.4	-1.5	-1.5	-1.5	-1.6	-1.6
Transfers (net)	9.0	10.5	8.9	8.8	8.3	7.9	7.5	7.2	6.8	6.5	6.2	5.9	5.6	5.3	5.1	4.9	4.7	4.5	4.3	4.1	3.9
Capital account	2.8	8.3	5.2	4.7	4.5	4.2	4.1	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Public sector (net)	-0.6	4.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Disbursements	3.5	8.0	4.5	4.3	4.4	4.1	4.0	3.7	3.7	3.1	3.1	3.0	3.2	3.2	3.3	3.4	3.4	3.4	3.4	3.3	3.2
Amortizations	-4.1	-3.5	-3.1	-2.8	-2.8	-2.6	-2.5	-2.2	-2.1	-1.6	-1.6	-1.5	-1.7	-1.8	-1.8	-1.9	-1.9	-1.9	-1.9	-1.8	-1.8
Private sector (net)	3.4	3.8	3.7	3.2	2.9	2.8	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Overall balance	1.5	-1.2	-3.6	-0.9	-0.3	0.1	0.2	0.3	0.4	0.5	0.7	0.8	0.9	1.1	1.3	1.2	1.0	0.9	0.9	0.7	0.6
Memorandum item:																					
Gross reserves in months of imports of goods and services	2.9	3.6	3.5	3.6	3.6	3.5	3.5	3.4	3.3	3.2	3.1	3.0	2.9	2.9	3.0	3.0	3.0	3.0	3.0	2.9	2.8
amortizations falling due	20.4	27.4	26.5	26.6	25.7	24.7	25.1	24.4	25.2	24.1	23.1	21.8	20.9	20.5	20.5	20.5	20.4	20.2	20.1	19.7	19.1

Sources: Central Bank of Honduras; and staff estimates.

1/ Exports from the *maquila* industry included on a net basis.

Figure 1: Honduras: Nominal and Net Present Value of External Debt Outstanding at End-December 1998



Sources: Hondurian authorities, staff estimates and projections.

Table 8: Honduras: Nominal and Net Present Value (NPV) of Public and Publicly Guaranteed Debt Outstanding 1/
End-December 1998

	Nominal debt			NPV of debt		
	US\$ millions	Percent of total debt	Percent of multilateral debt	US\$ millions	Percent of total debt	Percent of multilateral debt 2/
Total Public and Publicly Guaranteed Debt	3,889	100		3,220	100	
Multilateral Creditors	2,415	62	100	1,853	58	100
IDB	1,040	27	43	765	24	41
World Bank	814	21	34	509	16	27
CABEI	406	10	17	446	14	24
IMF	113	3	5	101	3	5
OPEC Fund	26	1	1	23	1	1
IFAD	16	0	1	9	0	1
Bilateral Creditors	1,474	38		1,367	42	
Paris Club,	1,184	30		1,100	34	
of which, Canada	19	0		18	1	
Denmark	13	0		10	0	
France	90	2		88	3	
Germany	122	3		72	2	
Italy	151	4		118	4	
Japan	397	10		442	14	
Netherlands	24	1		24	1	
Spain	205	5		156	5	
Switzerland	20	1		18	1	
United States	144	4		154	5	
Non-Paris Club Official Bilateral	249	6		226	7	
of which: Taiwan Province of China	73	2		63	2	
Guatemala	9	0		8	0	
Kuwait Fund	37	1		33	1	
Mexico	57	1		56	2	
Costa Rica	27	1		19	1	
Venezuela	23	1		22	1	
Colombia	23	1		22	1	
Commercial	40	1		41	1	
Memorandum item:						
Private non-guaranteed debt	257			257		

Source: Honduran authorities and staff estimates.

1/ Decision point is assumed to be in 2000. However, 1998 marks the latest year for which actual data are available before the decision point.

2/ These shares are applied to the total multilateral NPV reduction required at the completion point, to determine each institution's amount of assistance under the Initiative.

Table 9: Honduras: Net Present Value of External Debt After Rescheduling, 1998-2010 1/
(In millions of U.S. dollars, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total NPV	3,220	3,327	3,569	3,605	3,735	3,820	3,928	4,036	4,147	4,249	4,350	4,445	4,561
Official bilateral and commercial	1,367	1,295	1,356	1,243	1,200	1,145	1,085	1,025	964	939	912	883	855
Paris Club	1,100	1,027	1,071	941	926	899	868	837	805	792	776	758	740
Post-Cutoff	284	296	311	326	300	274	244	214	184	172	159	145	131
of which: ODA	200	208	218	227	218	207	191	175	160	150	137	125	112
non-ODA	84	88	93	99	82	68	53	38	24	22	21	20	19
Pre-Cutoff	817	731	760	615	625	625	624	623	622	620	617	614	610
of which: ODA	365	386	398	405	411	410	410	409	409	408	408	408	407
non-ODA	452	345	363	209	215	215	215	214	213	211	209	206	202
Other Official bilateral ^{2/}	225	237	251	267	240	213	187	160	134	123	113	102	94
Post-Cutoff	224	236	250	266	238	212	186	159	132	122	112	101	92
of which: ODA	115	122	129	137	121	106	90	74	58	50	41	33	26
non-ODA	109	114	121	129	117	106	96	85	75	73	70	68	66
Pre-Cutoff	1	1	1	1	1	1	1	1	1	1	1	1	1
of which: ODA	1	0	0	0	0	0	0	0	1	1	1	1	1
non-ODA	1	1	1	1	1	1	1	1	1	1	1	1	1
Commercial ^{2/}	41	32	34	36	34	32	30	28	25	24	23	22	21
Post-Cutoff	5	5	5	5	4	3	2	1	0	0	0	0	0
Pre-Cutoff	36	27	29	30	30	29	28	26	25	24	23	22	21
Multilateral ^{3/}	1,853	1,757	1,659	1,556	1,412	1,264	1,148	1,046	948	861	798	749	702
CABEI	446	416	379	331	278	221	158	107	62	26	14	8	3
World Bank	509	470	439	421	403	384	370	355	339	324	309	303	296
IDB	765	741	716	690	661	630	599	569	535	500	465	430	396
OPEC	23	21	19	16	14	12	10	8	6	5	3	2	1
IFAD	9	9	9	8	8	8	7	7	7	6	6	6	6
IMF	101	100	97	90	49	9	4	-	-	-	-	-	-
New Borrowing	-	275	554	806	1123	1411	1695	1965	2234	2448	2641	2813	3004
Multilateral	-	242	392	518	632	731	825	907	983	1052	1112	1176	1254
Bilateral	-	32	162	287	491	680	870	1058	1252	1396	1529	1637	1750
Memorandum items:													
Exports of goods and services	2,463	2,245	2,526	2,889	3,236	3,582	3,897	4,221	4,571	4,951	5,363	5,808	6,291
Three-year average	2,184	2,294	2,411	2,553	2,884	3,236	3,572	3,900	4,230	4,581	4,962	5,374	5,821
Central government revenue	952	1,033	1,177	1,326	1,511	1,701	1,902	2,095	2,306	2,535	2,784	3,055	3,352
NPV of debt-to-GDP	61	62	61	57	55	52	50	48	46	44	42	40	38
NPV of debt-to-exports	147	145	148	141	130	118	110	104	98	93	88	83	78
NPV of debt-to-revenues ^{4/}	338	322	303	272	247	225	206	193	180	168	156	146	136

Source: Honduran authorities; and staff estimates and projections.

1/ (i) Assuming a deferral of payment of stock of arrears at end-1998 and maturities due from January 1 to April 31, 1999. Montorium interest are applied to the deferred amount; (ii) a 67% flow rescheduling from April 1999 to April 2002 and (iii) a stock operation in April 2002. Payments on post cut-off date debt are also deferred from January 1, 1998 to January 1, 2002 including arrears at end-1998 and assumed to be repaid under non-concessional terms (over a five-year period with market interest rate).

2/ Comparable treatment is assumed to be provided by non-Paris Club members.

3/ Multilateral arrears outstanding at end-1998, amounting to 0.3 millions of dollar, are assumed to repaid over 1999.

4/ Revenues converted into US\$ using the end-1998 exchange rate.

Table 10: (Continued). Honduras: External Debt Service After Rescheduling, 1999-2018 1/
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1999-2008	2009-2018
	Projected										Average	Average
non-ODA	-	-	-	5	11	11	11	11	11	11	7	9
Other Official bilateral 3/	-	-	-	15	13	12	10	9	8	7	7	5
Post-Cutoff	-	-	-	15	13	12	10	9	8	7	7	5
of which: ODA	-	-	-	7	6	5	4	4	3	3	3	1
non-ODA	-	-	-	8	7	7	6	5	5	5	4	4
Pre-Cutoff 2/	-	-	-	0	0	0	0	0	0	0	0	0
of which: ODA	-	-	-	0	0	0	0	0	0	0	0	0
non-ODA	-	-	-	0	0	0	0	0	0	0	0	0
Commercial 3/	-	-	-	2	3	2	2	2	2	2	1	1
Post-Cutoff	-	-	-	0	0	0	0	0	0	0	0	0
Pre-Cutoff 2/	-	-	-	1	2	2	2	2	2	2	1	1
Multilateral	85	79	74	67	59	51	43	37	33	27	55	13
CABEI	29	28	27	24	20	16	12	8	5	3	17	0
World Bank	22	18	15	13	12	10	9	8	6	5	12	3
IDB	29	28	27	26	25	23	21	20	20	18	24	9
IMF	3	3	3	3	1	0	0	-	-	-	1	-
Others	1	1	1	1	1	1	1	0	0	0	1	0
OPEC	1	1	1	1	1	0	0	0	0	0	1	0
IFAD	0	0	0	0	0	0	0	0	0	0	0	0
New Borrowing	4	9	17	24	33	41	49	57	64	71	37	112
Multilateral	3	7	9	10	12	13	14	16	17	19	12	29
Bilateral	1	2	8	14	21	28	35	42	47	53	25	83
Memorandum items:												
Debt service-to-GDP	4	4	3	5	5	4	4	4	3	3	4	3
Debt service-to-exports	9	8	7	11	10	9	8	8	7	6	8	5
Debt service-to-revenue 5/	21	21	20	32	30	26	24	23	20	19	23	16

Source: Honduran authorities; and staff estimates and projections.

1/ (i) Assuming a deferral of payment of stock of arrears at end-1998 and maturities due from January 1 to April 31, 1999. Moratorium interest are applied to the deferred amount; (ii) a 67% flow rescheduling from April 1999 to April 2002 and; (iii) a stock operation in April 2002. Payments on post cut-off date debt is also deferred from January 1, 1998 to January 1, 2002 including arrears at end-1998 and assumed to be repaid under non-concessional terms (over a five-year period with market interest rate).

2/ Including amortization repayment and interest payment on reschedulings.

3/ Comparable treatment is assumed to be provided by non-Paris Club members.

4/ Multilateral arrears outstanding at end-1998, amounting to 0.3 millions of dollar, are assumed to be repaid over 1999.

5/ Revenues converted into US\$ using the end-1998 exchange rate.

Table 11. Honduras: Baseline Scenario and Sensitivity Analysis

	Prel. 1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
(In millions of U.S. dollars)																					
Total nominal debt	3889	4373	4633	4795	4998	5159	5340	5514	5680	5832	5975	6120	6282	6468	6675	6906	7142	7391	7673	7969	8279
Bilateral and commercial creditors	1474	1575	1695	1761	1935	2096	2255	2408	2559	2693	2807	2904	3004	3117	3247	3403	3568	3746	3959	4188	4440
<u>Multilaterals</u>	<u>2415</u>	<u>2798</u>	<u>2938</u>	<u>3034</u>	<u>3063</u>	<u>3063</u>	<u>3085</u>	<u>3106</u>	<u>3121</u>	<u>3139</u>	<u>3168</u>	<u>3216</u>	<u>3278</u>	<u>3351</u>	<u>3428</u>	<u>3503</u>	<u>3574</u>	<u>3645</u>	<u>3714</u>	<u>3781</u>	<u>3839</u>
IMF	113	216	256	292	272	231	217	189	156	114	70	34	14	2	0	0	0	0	0	0	0
World Bank	815	1055	1085	1138	1189	1240	1295	1350	1402	1456	1503	1558	1610	1667	1719	1767	1812	1855	1894	1932	1963
IDB	1040	1092	1173	1214	1253	1290	1327	1365	1399	1435	1468	1497	1524	1549	1573	1596	1619	1642	1667	1692	1716
Others	448	434	424	390	349	302	246	203	164	134	127	127	130	133	136	140	143	148	153	157	161
Total NPV of debt.																					
Baseline Scenario, Total	3220	3327	3569	3605	3735	3820	3928	4036	4147	4249	4350	4445	4561	4705	4868	5052	5242	5440	5678	5931	6203
Bilateral and commercial creditors	1367	1328	1518	1530	1690	1825	1955	2083	2216	2336	2441	2520	2605	2702	2810	2940	3078	3224	3411	3608	3830
<u>Multilaterals</u>	<u>1853</u>	<u>1999</u>	<u>2051</u>	<u>2075</u>	<u>2044</u>	<u>1995</u>	<u>1973</u>	<u>1953</u>	<u>1931</u>	<u>1913</u>	<u>1909</u>	<u>1925</u>	<u>1957</u>	<u>2003</u>	<u>2058</u>	<u>2112</u>	<u>2164</u>	<u>2215</u>	<u>2267</u>	<u>2323</u>	<u>2373</u>
Lower Growth Scenario, Total	3220	3327	3564	3665	3896	4114	4379	4668	4984	5321	5680	6061	6498	6999	7563	8181	8843	9551	10340	11196	12122
Bilateral and commercial creditors	1366	1328	1512	1590	1851	2119	2407	2715	3053	3408	3771	4136	4541	4996	5505	6069	6679	7335	8072	8872	9749
<u>Multilaterals</u>	<u>1854</u>	<u>2000</u>	<u>2051</u>	<u>2075</u>	<u>2044</u>	<u>1995</u>	<u>1973</u>	<u>1953</u>	<u>1931</u>	<u>1913</u>	<u>1909</u>	<u>1925</u>	<u>1957</u>	<u>2003</u>	<u>2058</u>	<u>2112</u>	<u>2164</u>	<u>2215</u>	<u>2267</u>	<u>2323</u>	<u>2373</u>
Lower Terms of Trade Scenario, Total	3220	3327	3602	3708	3962	4199	4503	4831	5187	5558	5956	6371	6839	7365	7947	8584	9266	9995	10812	11692	12647
Bilateral and commercial creditors	1366	1328	1551	1633	1918	2204	2530	2878	3256	3645	4046	4446	4882	5362	5889	6473	7102	7780	8544	9369	10274
<u>Multilaterals</u>	<u>1854</u>	<u>2000</u>	<u>2051</u>	<u>2075</u>	<u>2044</u>	<u>1995</u>	<u>1973</u>	<u>1953</u>	<u>1931</u>	<u>1913</u>	<u>1909</u>	<u>1925</u>	<u>1957</u>	<u>2003</u>	<u>2058</u>	<u>2112</u>	<u>2164</u>	<u>2215</u>	<u>2267</u>	<u>2323</u>	<u>2373</u>
(In percentage of)																					
NPV debt in percent of																					
Baseline Scenario																					
GDP	61	62	61	57	55	52	50	48	46	44	42	40	38	36	35	34	33	32	31	31	30
Exports	147	145	148	141	130	118	110	104	98	93	88	83	78	75	71	69	66	64	63	61	60
Fiscal revenue 1/	338	322	303	272	247	225	206	193	180	168	156	146	136	128	121	115	110	105	101	97	93
Lower Growth Scenario.																					
GDP	61	62	62	59	59	59	59	59	59	59	59	60	60	61	62	62	63	64	65	65	66
Exports	147	145	147	144	138	132	128	126	125	123	122	121	120	120	120	120	121	123	124	126	128
Fiscal revenue 1/	338	322	306	282	265	251	241	236	231	227	222	218	215	214	213	211	210	209	208	207	206
Lower Terms of Trade Scenario																					
GDP	61	62	62	59	58	58	57	57	57	57	57	57	57	57	57	58	58	59	60	60	61
Exports	147	145	150	148	142	135	133	131	130	129	127	126	125	124	123	124	124	125	127	128	129
Fiscal revenue 1/	338	322	306	280	262	247	237	231	225	219	214	209	204	200	197	196	194	193	192	191	190

1/ Revenues converted into US\$ using the end-1998 exchange rate.

Figure 2. Baseline and Sensitivity Analysis.

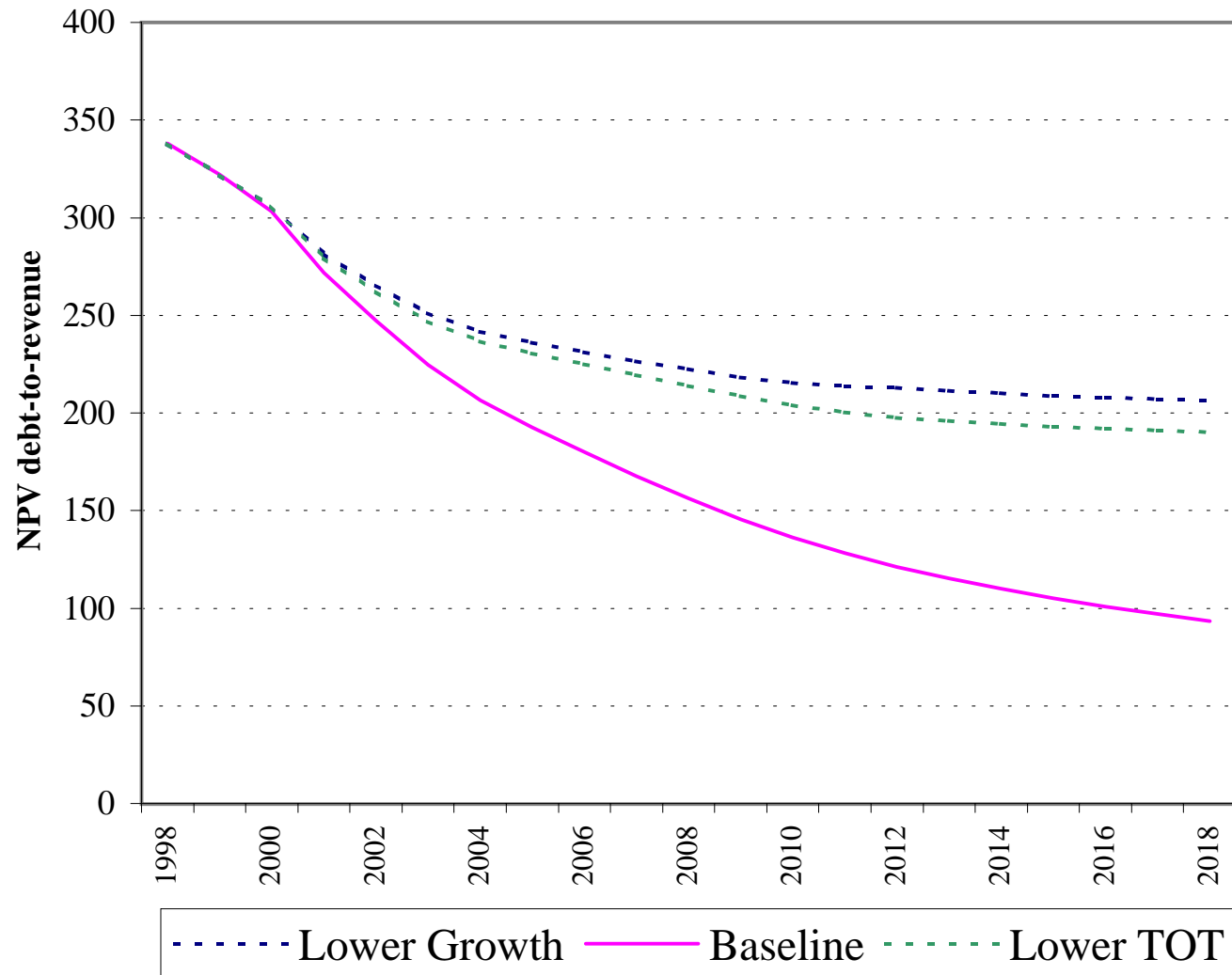


Table 12: Honduras: Net Present Value of External Debt After Rescheduling, 1998-2010 1/
(In millions of U.S. dollars, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total NPV	3,219	3,151	3,298	3,425	3,577	3,696	3,838	3,982	4,127	4,230	4,333	4,428	4,542
Official bilateral and commercial 2/	<i>1,366</i>	<i>1,119</i>	<i>1,086</i>	<i>1,063</i>	<i>1,042</i>	<i>1,021</i>	<i>996</i>	<i>970</i>	<i>944</i>	<i>921</i>	<i>894</i>	<i>867</i>	<i>835</i>
Paris Club	<i>1,100</i>	<i>892</i>	<i>878</i>	<i>867</i>	<i>857</i>	<i>845</i>	<i>829</i>	<i>814</i>	<i>798</i>	<i>785</i>	<i>769</i>	<i>752</i>	<i>730</i>
Post-Cutoff	<i>284</i>	<i>270</i>	<i>260</i>	<i>250</i>	<i>240</i>	<i>229</i>	<i>214</i>	<i>198</i>	<i>184</i>	<i>172</i>	<i>159</i>	<i>145</i>	<i>131</i>
of which: ODA	<i>200</i>	<i>203</i>	<i>203</i>	<i>201</i>	<i>197</i>	<i>191</i>	<i>180</i>	<i>170</i>	<i>160</i>	<i>150</i>	<i>137</i>	<i>125</i>	<i>112</i>
non-ODA	<i>84</i>	<i>67</i>	<i>57</i>	<i>49</i>	<i>43</i>	<i>38</i>	<i>33</i>	<i>28</i>	<i>24</i>	<i>22</i>	<i>21</i>	<i>20</i>	<i>19</i>
Pre-Cutoff	<i>817</i>	<i>622</i>	<i>618</i>	<i>618</i>	<i>617</i>	<i>617</i>	<i>616</i>	<i>615</i>	<i>614</i>	<i>613</i>	<i>610</i>	<i>607</i>	<i>599</i>
of which: ODA	<i>365</i>	<i>397</i>	<i>400</i>	<i>400</i>	<i>399</i>	<i>399</i>	<i>399</i>	<i>399</i>	<i>399</i>	<i>399</i>	<i>399</i>	<i>399</i>	<i>395</i>
non-ODA	<i>452</i>	<i>225</i>	<i>218</i>	<i>218</i>	<i>218</i>	<i>217</i>	<i>217</i>	<i>217</i>	<i>216</i>	<i>214</i>	<i>212</i>	<i>209</i>	<i>205</i>
Other Official bilateral 2/	<i>225</i>	<i>211</i>	<i>195</i>	<i>182</i>	<i>172</i>	<i>163</i>	<i>153</i>	<i>143</i>	<i>133</i>	<i>123</i>	<i>113</i>	<i>102</i>	<i>93</i>
Post-Cutoff	<i>224</i>	<i>210</i>	<i>194</i>	<i>182</i>	<i>171</i>	<i>162</i>	<i>152</i>	<i>142</i>	<i>132</i>	<i>122</i>	<i>112</i>	<i>101</i>	<i>92</i>
of which: ODA	<i>115</i>	<i>112</i>	<i>105</i>	<i>96</i>	<i>89</i>	<i>81</i>	<i>74</i>	<i>66</i>	<i>58</i>	<i>50</i>	<i>41</i>	<i>33</i>	<i>26</i>
non-ODA	<i>108</i>	<i>98</i>	<i>89</i>	<i>85</i>	<i>82</i>	<i>81</i>	<i>79</i>	<i>77</i>	<i>75</i>	<i>73</i>	<i>70</i>	<i>68</i>	<i>66</i>
Pre-Cutoff	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>
of which: ODA	<i>1</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>
non-ODA	<i>1</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>
Commercial 2/	<i>41</i>	<i>16</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>12</i>
Post-Cutoff	<i>5</i>	<i>3</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>
Pre-Cutoff	<i>36</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>13</i>	<i>12</i>
Multilateral 3/	<i>1,853</i>	<i>1,757</i>	<i>1,659</i>	<i>1,556</i>	<i>1,412</i>	<i>1,264</i>	<i>1,148</i>	<i>1,046</i>	<i>948</i>	<i>861</i>	<i>798</i>	<i>749</i>	<i>702</i>
CABEI	<i>446</i>	<i>416</i>	<i>379</i>	<i>331</i>	<i>278</i>	<i>221</i>	<i>158</i>	<i>107</i>	<i>62</i>	<i>26</i>	<i>14</i>	<i>8</i>	<i>3</i>
World Bank	<i>509</i>	<i>470</i>	<i>439</i>	<i>421</i>	<i>403</i>	<i>384</i>	<i>370</i>	<i>355</i>	<i>339</i>	<i>324</i>	<i>309</i>	<i>303</i>	<i>296</i>
IDB	<i>765</i>	<i>741</i>	<i>716</i>	<i>690</i>	<i>661</i>	<i>630</i>	<i>599</i>	<i>569</i>	<i>535</i>	<i>500</i>	<i>465</i>	<i>430</i>	<i>396</i>
OPEC	<i>23</i>	<i>21</i>	<i>19</i>	<i>16</i>	<i>14</i>	<i>12</i>	<i>10</i>	<i>8</i>	<i>6</i>	<i>5</i>	<i>3</i>	<i>2</i>	<i>1</i>
IFAD	<i>9</i>	<i>9</i>	<i>9</i>	<i>8</i>	<i>8</i>	<i>8</i>	<i>7</i>	<i>7</i>	<i>7</i>	<i>6</i>	<i>6</i>	<i>6</i>	<i>6</i>
IMF	<i>101</i>	<i>100</i>	<i>97</i>	<i>90</i>	<i>49</i>	<i>9</i>	<i>4</i>	-	-	-	-	-	-
New Borrowing	-	<i>275</i>	<i>554</i>	<i>806</i>	<i>1,123</i>	<i>1,411</i>	<i>1,695</i>	<i>1,965</i>	<i>2,234</i>	<i>2,448</i>	<i>2,641</i>	<i>2,813</i>	<i>3,004</i>
Multilateral	-	<i>242</i>	<i>392</i>	<i>518</i>	<i>632</i>	<i>731</i>	<i>825</i>	<i>907</i>	<i>983</i>	<i>1,052</i>	<i>1,112</i>	<i>1,176</i>	<i>1,254</i>
Bilateral	-	<i>32</i>	<i>162</i>	<i>287</i>	<i>491</i>	<i>680</i>	<i>870</i>	<i>1,058</i>	<i>1,252</i>	<i>1,396</i>	<i>1,529</i>	<i>1,637</i>	<i>1,750</i>
Memorandum items:													
Exports of goods and services	<i>2,463</i>	<i>2,245</i>	<i>2,526</i>	<i>2,889</i>	<i>3,236</i>	<i>3,582</i>	<i>3,897</i>	<i>4,221</i>	<i>4,571</i>	<i>4,951</i>	<i>5,363</i>	<i>5,808</i>	<i>6,291</i>
Three-year average	<i>2,184</i>	<i>2,294</i>	<i>2,411</i>	<i>2,553</i>	<i>2,884</i>	<i>3,236</i>	<i>3,572</i>	<i>3,900</i>	<i>4,230</i>	<i>4,581</i>	<i>4,962</i>	<i>5,374</i>	<i>5,821</i>
Central government revenue	<i>952</i>	<i>1,033</i>	<i>1,177</i>	<i>1,326</i>	<i>1,511</i>	<i>1,701</i>	<i>1,902</i>	<i>2,095</i>	<i>2,306</i>	<i>2,535</i>	<i>2,784</i>	<i>3,055</i>	<i>3,352</i>
NPV of debt-to-GDP	<i>61</i>	<i>59</i>	<i>57</i>	<i>55</i>	<i>53</i>	<i>51</i>	<i>49</i>	<i>47</i>	<i>46</i>	<i>44</i>	<i>42</i>	<i>40</i>	<i>38</i>
NPV of debt-to-exports	<i>147</i>	<i>137</i>	<i>137</i>	<i>134</i>	<i>124</i>	<i>114</i>	<i>107</i>	<i>102</i>	<i>98</i>	<i>92</i>	<i>87</i>	<i>82</i>	<i>78</i>
NPV of debt-to-revenues 4/	<i>338</i>	<i>305</i>	<i>280</i>	<i>258</i>	<i>237</i>	<i>217</i>	<i>202</i>	<i>190</i>	<i>179</i>	<i>167</i>	<i>156</i>	<i>145</i>	<i>136</i>

1/ Assuming a stock of debt in December 1999.

2/ Comparable treatment is assumed to be provided by non-Paris Club members.

3/ Multilateral arrears outstanding at end-1998, amounting to 0.3 millions of dollar, are assumed to repaid over 1999.

4/ Revenues converted into US\$ using the end-1998 exchange rate.

Table 13: Honduras: HIPC Initiative--Alternative Assistance Levels Under a Proportional Burden-Sharing Approach Under the Enhanced Framework 1/ 2/

NPV of debt-to-revenue-target (in percent)	With a decision point in 2000			Common Reduction Factor at the decision point 4/	Required NPV debt reduction on Paris Club debt assuming comparable action of non-multilateral creditors
	Total 5/ (in millions of U.S. dollars)	Bilateral 3/	Multilateral		
250	569	208	361	18	103
<i>Memorandum items</i>					
NPV of debt 4/	3,151	1,152	1,999		
Central government (in mn. of \$)	1,033	...	...
NPV of debt-to-revenues	305	...	...
NPV at the Decision point			1,999		
Bilateral debt reschedulable		193			

Sources: Honduran authorities and staff estimates.

1/ The proportional burden sharing approach is described in "HIPC Initiative--Estimated Costs and Burden Sharing Approaches" (EBS/97/127, 7/7/97 and IDA/SEC M 97-306, 7/7/97).

2/ Applies a hypothetical stock-of-debt operation on Naples terms and appropriate comparable treatment in December 1999.

3/ Includes official bilateral and commercial creditors.

4/ Based on latest data available at decision point after full application of traditional debt relief mechanisms.

5/ Using the end-of October 1999 exchange rate, total debt relief would amount to US\$ 676 million, of which US\$247 million would be bilateral and US\$429 million would be multilateral.

Table 14: Honduras: Discount Rates and Exchange Rates Assumptions 1/

	Discount Rates 1/2/ (In percent per annum)	Exchange Rates (US\$ to local rates)
Belgium Franc	5.59%	0.0289
Swiss Franc	4.05%	0.7265
Deutsche Mark	5.16%	0.5977
ECU	5.00%	1.1668
Spanish Peseta	5.31%	0.0070
French Franc	5.36%	0.1779
UK Pound Sterling	6.81%	1.6635
Honduras Lempiras	5.25%	0.0724
Italian Lira	5.58%	0.0006
Japanese Yen	2.22%	0.0087
Kuwait Dinar	5.25%	3.3161
Netherlands Guilders	5.78%	0.5294
Special Drawing Rights	5.25%	1.4080
Swedish Kronor	5.66%	0.1241
US Dollars	6.23%	1.0000
Venezuelan Bolivare	5.25%	0.0018
Unit of Account of IaDB	5.25%	1.5463

Sources: OECD and IMF, International Financial Statistics

1/ The discount rates used are the six-month average Commercial Interest Reference Rates (CIRRs) for the respective currencies at end-December 1998.

2/ For all currencies for which the CIRRs are not available, the SDR discount rate is used as the proxy.

Table 15. HIPC Initiative: Status of Country Cases

Country (in order of expected decision point within groups)	Decision Point	Completion Point	NPV of Debt-to- Export Target (In percent)	Assistance at Completion Point (in millions of U.S. dollars, present value, at completion point)					Percentage Reduction in NPV of Debt 1/	Estimated Total Nominal Debt Service Relief (in millions of U.S. dollars)	Satisfactory Assurances from Other Creditors
				Total	Bilat- eral	Multi- lateral	IMF	World Bank			
Completion point reached											
Uganda	Apr. 97	Apr. 98	202	347	73	274	69	160	20	650	Received
Bolivia	Sep. 97	Sep. 98	225	448	157	291	29	54	13	760	Received
Guyana	Dec. 97	May 99	107 2/	256	91	165	35	27	24	410	Received
Mozambique	Apr. 98	Jun. 98	200	1,716	1,076	641	125	381	63	3,700	Received
Decision point reached and assistance committed by IMF and World Bank											
Burkina Faso	Sep. 97	Apr. 00	205	115	21	94	10	44	14	200	Being sought
Côte d'Ivoire	Mar. 98	Mar. 01	141 2/	345	163	182	23	91	6 3/	800	Being sought
Mali	Sep. 98	Dec. 99	200	128	37	90	14	44	10	250	Being sought
Total assistance provided/committed (of seven countries)				3,355	1,618	1,737	305 4/	801	20	6,770	
Preliminary HIPC document issued; targets based on majority view in preliminary discussions at IMF and World Bank Boards; timing and amount of assistance based on preliminary HIPC documents and subject to change.											
Guinea-Bissau	2000 5/	...	200	300	148	153	8	73	73	600	...
Ethiopia	1999 6/	...	200	636	225	411	22	214	23	1,300	...
Mauritania	Jul. 99 7/	...	200	271	114	157	21	43	25	550	...
Nicaragua	2000	n.a.	150	2,507	1,416	1,091	32	188	66	5,000	
Tanzania	2000	n.a.	150	2,485	1,314	1,171	110	728	59	5,000	
Debt judged sustainable under original framework											
Benin	Jul. 97	...	...	...	...	...	...	...	...	...	...
Senegal	Apr. 98	...	...	...	...	...	...	...	...	...	...

Sources: IMF and World Bank Board decisions, completion point documents, decision point documents, preliminary HIPC documents, and staff calculations.

1/ In percent of net present value of debt at completion point, after full use of traditional debt-relief mechanisms.

2/ Eligible under fiscal/openness criteria; NPV of debt-to-exports target chosen to meet NPV of debt-to-revenue target of 280 percent, as projected at the decision point.

3/ Nonreschedulable debt to non-Paris Club official bilateral creditors and the London Club, which was already subject to a highly concessional restructuring, is excluded from the NPV of debt at the completion point in the calculation ratio.

4/ Equivalent to SDR 212 million.

5/ Debt situation needs to be revisited once the current conflict has ended and a new recovery program agreed.

6/ Country case is delayed due to conflict.

7/ Staffs suggested that Mauritania could be considered to have reached the decision point in July 1999 once the new ESAF arrangement is approved by the Board. The formal decision point would be expected in the fall of 1999, when assistance will be committed by the Boards on the basis of the enhanced HIPC Initiative framework expected to have been agreed by that time.

External Debt Policy and Debt Management Issues

The government's external debt management strategy is to (i) limit external borrowing to concessional credits; (ii) contract domestic credits on market terms; (iii) seek further debt relief from Paris Club and other bilateral creditors; (iv) continue negotiations with the Central American Bank for Economic Integration (CABEI) on improving the terms of existing, nonconcessional debt; (v) strengthen, with IDA support through a second IDF grant, the debt management capabilities in the ministry of finance and the central bank; and (vi) seek IDA assistance to buy back commercial debts that are currently in arrears.

The legal basis for the contracting of new credits (domestic or external) is governed by the 1991 Law of Public Credit. The law vests the implementation of public debt policies with the ministry of finance and the central bank, but this has since 1993 been delegated to a National Commission of Public Credit (in which the ministry and central bank are represented). In 1996 a presidential decree (PCM-018-96) established legally binding constraints on the contracting of new external public sector debt. According to the decree, new borrowing can be contracted only if the grant element of the loan is at least 35 percent (using OECD's commercial interest reference rates as discount rates) and the maturity and grace period are at least 14 years, and 6 years, respectively. In exceptional circumstances the minister of finance may, upon the recommendation of the National Commission of Public Credit, accept loans which are less concessional, however, no nonconcessional borrowing is contemplated under the current ESAF arrangement.

Since 1991 the government has borrowed from the World Bank Group only on IDA terms, and since 1995 borrowing from the IDB has been exclusively from the Fund for Special Operations, IDB's concessional window. In 1997, the government renegotiated part of its debt with CABEI which resulted in a cash flow relief of about US\$50 million in that year.

In 1996, the government implemented the first phase of a program for the strengthening of external debt management, financed with an IDF grant. An additional IDF grant was approved in May 1998 for a second phase aimed at converting the existing single-user SYGADE (version 5.0) debt management system to a multi-user system and linking the ministry of finance's and the central bank's debt management systems so that debt data can be transferred automatically between the two systems. However, Hurricane Mitch damaged the ministry of finance's computer facilities, and the project's second phase is currently being redesigned. UNCTAD and bilateral donors are also providing technical assistance to the government in its efforts at strengthening the external debt management capacity.

Honduras: IBRD Loans and IDA Credits in the Operation Portfolio

(As of September 30, 1999; in millions of US Dollars)

Loan/ Credit			IDA	Cancellations	Undisbursed
Number	Approval Date	Borrower/ Purpose			
24520	5-Jan-93	NUTRITION/HLTH	25	-	-
24521	28-Jan-99	NUTRITION/HLTH (supplemental)	10	-	10
24580	16-Feb-93	TRNSPRT SCTR RHB	65	-	2
24581	7-Jan-99	TRNSPRT SCTR RHB (supplemental)	20	-	18
26930	28-Mar-95	ENVIRON. DEVELOPMENT	11	-	4
26940	28-Mar-95	BASIC EDUCATION	30	-	15
27660	11-Jul-95	SOC INV FUND III	30	-	1
28140	8-Feb-96	PUB SEC MOD TAC	10	-	2
28160	8-Feb-96	PUB SEC MOD SAC	55	-	14
28163	15-Dec-97	PUB SEC MOD SAC	14	-	14
29400	20-Mar-97	RURAL LAND MGMT	34	-	22
31180	14-Jul-98	FHIS IV	45	-	2
31590	22-Dec-98	HURRICANE EMERGENCY	200	-	99
32500	17-Jun-99	PROFUTURO	8	-	9
Total for 14 active credits (a)			557	-	212
			Active Loans	Closed Credits	Total
Total Disbursed (IBRD and IDA)			332	1,122	1,454
<i>of which repaid</i>			-	524	524
Amount sold:			-	4	4
<i>of which repaid</i>			-	4	4
Total Undisbursed:			212	-	212

Source: World Bank

(a) All IBRD loans are closed.

Note: Discrepancies are due to exchange rate valuation. Credit amounts reflect the exchange rate at the date of approval, while cancellations are valued at the rate prevailing on the day of cancellation, and in case of undisbursed amounts, they are valued at the end of month SDR/US\$ exchange rate.

Financial Relations with the Inter-American Development Bank

Honduras IDB Loans in the Operation Portfolio

(As of August 15, 1999 in millions of U.S. dollars)

Year	Purpose	Approved	Undisbursed
Eighty loans approved and disbursed prior to 1991 (including cancellations for \$160.6 million)		1,322.9	
1991	Municipal development	50.0	1.3
	Roads	25.0	0.1
1993	Preinvestment Fund	8.0	6.9
	Environment	20.4	10.2
1994	Energy	14.8	9.6
	Environment	19.1	14.5
1995	Family assistance	20.0	0.2
	Public sector reform	160.0	31.6
1996	Modernization of the judiciary system	7.2	4.3
	Agricultural technology modernization	15.0	13.0
1997	Water and sanitation	13.8	11.9
	Education	6.6	6.3
1998	Health	36.0	34.9
	Municipal development	63.0	56.8
	Tax administration	3.0	3.0
	Family assistance	45.2	41.7
	Social Investment Fund	50.0	39.5
	Roads, sanitation reconstruction	18.8	17.2
	Housing reconstruction	10.4	12.2
	Subtotal	586.3	315.2
	Total	1,909.2	315.2
	Repaid	535.5	
	Outstanding balance	1,049.6	

Status of IDA-Supported Structural Reforms

Honduras: Reforms Supported by IDA Adjustment Credits and Waivers

Type of Credit and Approval Date	Key Reforms Supported	Waivers of Conditions
Structural Adjustment Credit (January 1991)	To support additional financing needs, necessitated by the impact of higher oil prices and export shortfalls.	None
Energy Sector Adjustment Program (September 1991)	<ul style="list-style-type: none"> ▪ Establish a comprehensive energy policy and strategy and a sound regulatory framework. ▪ Strengthen the efficiency, planning, and financial soundness of the national power company (ENEE). ▪ Improve electricity pricing and resource allocation in the sector. ▪ Promote petroleum exploration and production. ▪ Liberalize petroleum product trade. ▪ Encourage greater private sector participation in the development of the energy sector. 	Yes (3 rd tranche). Waivers were granted for two conditions that were only partially met: (i) the Operational and Financial Rehabilitation Action Plan (OFRAP) for the state-owned power utility ENEE; and (ii) the Petroleum Liberalization Program (PLP).
Agricultural Sector Adjustment Credit (July 1993)	<ul style="list-style-type: none"> ▪ Improve land use by supporting modifications to the Agrarian Reform Law. ▪ Lay the basis for a sustainable management of the country's rich forest resources. ▪ Help improve sector planning and coordination. 	Yes (2 nd tranche). A waiver was granted on the issuance of all legal instruments to implement operations of Cajas Rurales.
Public Sector Modernization Structural Adjustment Credit (January 1996) 1/	<ul style="list-style-type: none"> ▪ Improve public services through greater private sector participation. ▪ Curtail expenditures by restructuring public institutions and employment. ▪ Improve public management to enhance efficiency, transparency, and accountability. 	Yes (2 nd tranche). Two conditions received waivers (i) the completion of the privatization process of the state-owned telecoms company HONDUTEL; and (ii) the concessioning of airports with regular international traffic.

1/ The Public Sector Modernization Structural Adjustment Credit is still active. The two first tranches have been released.

Adjustment Record Under Fund Arrangements

Based on performance with the two annual ESAF Arrangements in 1992–95 as well as substantial progress on reform starting with the staff-monitored program agreed upon in early 1997 and continuing through the first year of the new ESAF arrangement approved in March 1999, Honduras has established a track record of more than three years which could be used, subject to continued progress, as a basis for eligibility under the Enhanced HIPC. The following summarizes relations with the Fund during its adjustment record.

A three-year ESAF arrangement was approved on July 24, 1992 for SDR 47.46 million (60 percent of quota), out of which SDR 33.9 million were drawn.

- The midterm review of the **first annual arrangement**, originally set for February 1993, was delayed because of policy slippages. The review was completed on July 23, 1993.
- On December 1, 1994 the authorities requested the **second annual ESAF Arrangement**, (the delay was due to significant policy slippages developed in the last months of the outgoing administration which left at end-1993). In addition, there was an increase from SDR 13.6 million (14.3 percent of quota) to SDR 20.4 million (21.5 percent of quota). The commitment period for the three-year arrangement was extended from July 23, 1995 to July 24, 1997.
- **The 1994–95 program supported by the second annual arrangement was implemented successfully.** Honduras observed most benchmarks for end-December 1995, except for two which were waived: those on reschedulable arrears and central government expenditure. A number of structural performance criteria were met after short delays.
- Discussions on the **third annual ESAF arrangement** initiated in March 1996 were not completed because election-related policy actions soon gave rise to a fiscal gap that was inconsistent with the objectives of the program.

A **staff-monitored program** aimed at reestablishing a record of performance and policy implementation and laying the basis for a 1998–2000 ESAF-supported program was agreed upon in February 1997. Most of the key macroeconomic targets of the staff-monitored program were achieved, but there were delays in the privatization of the telecommunications and electricity sectors.

In October 1998 negotiations were about to be finalized on the first year of a new ESAF arrangement, when hurricane Mitch struck. A disbursement from the General Resources Account of SDR 47.5 million under the Fund's **emergency assistance policy** was made on December 7, 1998.

On March 26, 1999, a new **ESAF arrangement (1999–2001)** for a total of SDR 156.75 million was approved after negotiations were resumed in the aftermath of Hurricane Mitch. SDR 59.85 million were disbursed on March 26, 1999. All quantitative performance criteria through June and September were met, however, there were delays in meeting the structural performance criteria.

Listing of Structural Reform Measures

1. Rural Development and Environment

a. Reforms

- Eliminated all remaining administrative controls and trade permits for agricultural commodities (1992)
- Enacted regulatory framework for management of timber resources and protected areas (1992)
- Modernized procedures/management practices for public forest lands (1992)
- Enacted a general environmental law (1993)
- Promulgated environmental protection regulations for oil and gas exploration (1993)
- Promulgated regulations to fully implement the new Agricultural Modernization Law, in particular to guarantee land and forestry property rights, and accelerated titling procedures for smallholders (1994)
- Progress in the implementation of the Forestry Action Plan (1994)
- Finalized and implemented a National Environmental Action Plan (1993–1995)
- Consolidated annual operating programs for all sector agencies and subjected them to the joint approval of the Agriculture Development Committee and the Ministry of Finance (1995)
- Issued regulations for phytosanitary controls based on technical reasons (1996)
- Issued regulations for regularization of rights to land and forest of the forest population (1996)
- Updated the National Environmental Action Plan (1996)
- Finalized at least eight new management plans for about 100,000 has. of national forest and formalized all usufruct rights of communities in those areas (1996)
- Initiated actions to reposition BANADESA to serve small rural borrowers with no access to commercial banking services, while reforming it to become a self-sustaining rural banking institution (1996)
- Completed action plan to reposition BANADESA (1997)
- Maintained liberalization of all agricultural markets (1996–1999)
- Government income resulting from the sale of forest products collected by the treasury (1996–1999)
- Completed the institutional strengthening of SEDA and environmental units of all main executing agencies (1999)

b. Future mileposts

- Improve land titling and registration (2002)

- Pilot market-based assisted land reform to reduce the skewedness of land distribution (2001)
- Establish a rural investment fund (2002)
- Improve watershed management and river course stabilization (1999-2002)
- Restructure forestry sector agencies to ensure the sustainability of the sector (2001)

2. Energy and Water Sector

a. Reforms

- Achieved an average electricity tariff level equivalent to long run marginal cost, with no tariff category less than 90 percent (except residential consumers using less than 300 kWh per month) (1993)
- Implemented Petroleum Liberalization Plan (1993)
- Established a National Energy Commission, a Technical Secretariat, and a Public Utilities Regulatory Commission (1992–1995)

b. Future mileposts

- Contract investment bank to advise on higher private sector participation in electricity distribution (1999)
- Approve tariff increase for electricity (1999)
- Maintain in nominal terms the value of subsidies for electricity consumption at L280 million (1999)
- Submit to Congress legislation to reform the water and sanitation sector (2000)

3. Transport and Telecommunications

a. Reforms

- Continued reductions of staff in SECOPT's maintenance department (1992–1993)
- Identified mechanisms to permit free entry of vehicle operators into the trucking industry (1993–1994)
- Continued use of private contractors for road maintenance (1992–1995)
- Presented to Congress plan for the privatization of HONDUTEL (1995)
- Established a policy on cost recovery to finance roads (1996)
- Established a new institutional framework to operate the national airports on a commercial basis through concessions to private operators (1997)
- Continued to increase the use of private contractors for road maintenance and reductions of staff in SECOPT's maintenance department (1996–1999)

b. Future mileposts

- Approve decree authorizing sale and commence privatization process for HONDUTEL (1999)
- Conclude bidding process and select strategic partner for HONDUTEL (2000)
- Approval by HONDUTEL board of increases in domestic telephone tariffs to compensate for ongoing reduction in international tariffs (1999)
- Advertise bids for the concession of the airport system to private sector (1999)

4. Financial Sector

a. Reforms

- Eliminated ceilings on lending rates for basic grains (1992)
- Liberalized service fees charged by banks (1992)
- Adopted a bi-weekly program of open market operations (1992)
- Began auctioning externally funded credit lines (1993)
- Gradual reduction in domestically funded directed credit lines of the Central Bank (1993)
- Approved a financial intermediation law (1995)
- Approval by Congress of amendments to Central Bank Law to enhance flexibility of monetary policy (1995)
- Approval by Congress of legislation to enhance the autonomy of the Central Bank (1996)
- Implementation of program to eliminate losses generated by Trust Funds (1996)
- Implemented measures to develop the market for domestic securities (1996)
- Reduced the legal reserve requirements by 1 percent a month (1996-1997)
- Issued regulations governing the operations of insurance companies (1999)

b. Future mileposts

- Implement and enforce regulations on banks' connected lending, risk-weighted capital, external indebtedness, and open foreign exchange positions (1999)
- Complete examination of all banks' post-hurricane loan portfolios (1999)
- Complete CAMEL-based examination of all banks (2000)
- Finalize a manual of supervision and bank examination (1999)
- Issue regulations governing the operations of the stock exchange (1999)
- Submit for approval legislation setting up a deposit insurance scheme (1999)

5. Exchange rate and trade policies

a. Reforms

- Fiscal incentives for export promotion and Industrial Development (1987)
- Adjustment of import tariffs (1991)
- Elimination of foreign exchange certificate CEFEX (1991)
- Allowed commercial banks and foreign exchange houses to conduct all types of transactions at freely determined rates, with the exception of foreign exchange proceeds surrendered to the Central Bank (1992)
- Elimination of 10 percent import tax surcharge and all export permits (1994)
- Continuation of policy of no foreign exchange allocations; no export permits and no quantitative restrictions on imports (1995)
- Implemented a more flexible exchange rate policy (1996)

b. Future mileposts

- Ensure full flexibility of exchange rate within the band (1999)
- Continue preparatory work on interbank market in foreign exchange (1999)
- Phase out restrictive practices in the coffee sector (1999)
- Avoid contracting or guaranteeing of nonconcessional external debt (1999)
- Eliminate arrears on external debt service (1999)

6. Tax and tariff reforms

a. Reforms

- Adopted a 18 month tax administration reform program (1990–1991)
- Submitted to Congress a bill of law to revise the tax system (1992)
- Progress in strengthening the tax collection capacity (1992)
- Examined the desirability of harmonizing corporate income tax policy with regional levels (1993)
- Introduced a new tax code involving stiff penalties for tax evasion (1997)
- Raised sales tax from 7 percent to 12 percent (1998)

7. Public sector reforms

a. Reforms

- Prepared a public sector reform with World Bank assistance including public administration, planning, procurement, and personnel management (1994)
- Agreed with World Bank on implementation of annual public Investment Program each year of ESAF (1993–1995)

- Reduced the number of permanent public employment positions by 4 percent of total (1995)
- Developed and agreed with the World Bank and IDB on a public sector reform program (1995)
- Abolished budgetary rules linking automatically-authorized expenditure to availability of external financing (1996)
- Restructured the Secretariat of Economics, and eliminated the regulatory body for the petroleum sector (1996)
- Approved Law of Public Administration (1996)
- Continued with census/audits of secretariats, teachers, and doctors (1996–1997)
- Established operative mechanism to define guidelines and policy for programming and budgeting revenues; decentralize budget execution to operative units; strengthened budget, accounting, treasury, public debt functions; designed and implemented an integrated system of financial information (1997)
- Introduced legislation that will require all public sector external borrowing to have prior authorization from Ministry of Finance (1996–1999)
- Rationalized employment and personnel expenditures as dictated by the “Law of Restructuring of Public Sector Revenue Mechanism and Expenditure Reduction”. (Decree135/94) (1996–1999)

b. Future mileposts

- Approve 1999 fiscal plan consistent with ESAF objectives (1999)
- Continue institutional strengthening of the DEI, and customs office and ensure full application of the tax code (1999-2002)
- Limit wage bill of the central government to 7.5 percent of GDP, or adopt measures to compensate for any increase in the wage bill in excess of this level (1999)
- Contract the services of a firm of external auditors to ensure full accountability and transparency of the use of external resources received to help the relief and reconstruction efforts (1999)

8. Private sector reforms

a. Reforms

- Improved the investment environment and eliminated differential treatment of foreign investors (1992)
- Approved the Tourism Incentives Law that provides for greater private sector participation (1988)
- Approved the National Mining Law that provides for greater private sector participation (1988)

b. Future mileposts

- Implement the Tourism Incentives Law and remove legal obstacles for the acquisition of coastal land by foreigners (1999)
- Implement the National Mining Law (1999-2002)
- Create the Mining Development Agency, produce the new mining and geological map, and elaborate the mining development plan. (1999–2002)

9. Health

a. Reforms

- Evaluated the different nutritional intervention programs and established a medium-term plan for integrating and consolidating efforts (1993–1994)
- Expanded and strengthened maternal/child care and reproductive health programs (1993–1995)
- Strengthened programs and increased availability of supplies aimed at birth spacing (1993–1995)
- Increased the hiring of nurses for health center network and expanded training programs for auxiliary nurses and midwives (1993–1995)
- Increased the share of expenditures devoted to basic health services (1993–1995)
- Evaluated the existing nutritional programs and established a long-term strategy for integrating and consolidating their effort (1996)
- Consolidated special procurement unit of Ministry of Health and streamlined procurement practices for basic drugs (1996)
- Completed study on the health sector, including epidemiological profile, assessment of the primary care system and financing of the sector (1997)
- Expanded and strengthened maternal/child care, reproductive health and prevention of maternal mortality programs (1969–1999)

b. Future mileposts

- Separate financial accounts of the pension and health funds (1999)
- Continue implementation of the vaccination campaign (1999-2001)
- Implement pilot programs of cost management and cost recovery (2000)
- Implement pilot program to decentralize management operations of the Ministry of Health (2000)

10. Education

a. Reforms

- Increased the share of expenditures devoted to primary education, and teaching materials (1993–1995)
- Developed and approved criteria for teacher performance assessment (1996)

- Carried out standardized academic achievement tests of a sample of primary students on an annual basis (1997–1999)

c. Future mileposts

- Establish a decentralized system in rural areas to allow community participation (1999)
- Design and implement a plan to decentralize the administrative functions of the Ministry of Education (2000)
- Apply technical criteria for hiring and promotion of new teachers (2000)
- Expand objective standards to monitor student achievement (2001)

11. FHIS

a. Reforms

- Issued guidelines on maintenance procedures for subprojects that needed to be in place prior to the approval of investments by FHIS (1996)
- Developed an improved poverty targeting formula reflecting population, literacy, malnutrition and access to water and sanitation (1996)
- FHIS, in coordination with the Ministry of Education and the Ministry of Health, produce by November each year, operating plans for the following year (1996–1999)