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TRADE AND COMMERCIAL LAW ASSESSMENT – HONDURAS

FINAL REPORT



January 2005

This publication was produced for review by the United States Agency for International Development by Booz Allen Hamilton

UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT



Trade and Commercial Law Assessment Honduras

FINAL REPORT

December 2004

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Contract No. PCE-I-00-98-00013
Task Order No. 13 The Seldon Project

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I. EXECUTIVE SUMMARY

Honduras faces both challenges and opportunities. There is, at this time in Honduras, a particular urgency in pursuing the current economic reforms: assuming the agreement is ratified implementation of the Central American Free Trade Agreement (CAFTA) is imminent, a series of high-profile initiatives pertaining to property rights are being implemented, and new demands on institutions that have been ineffective or corrupt are challenging the country to take even greater strides toward meaningful change. The near future will show whether Honduras is to be pushed forward by the energy, commitment, and forward-thinking acts of many of its officials or whether self-interested groups will obstruct these critical reforms and dominate the economic landscape for the remainder of this decade.

At the request of the United States Agency for International Development (USAID), Booz Allen Hamilton conducted an assessment in September 2004 to analyze strengths, weaknesses, and opportunities for change in two critical areas in Honduras: commercial legal and institutional reform (CLIR) and trade facilitation. The Assessment was conducted by a team of legal and trade reform specialists as one part of a five-country Central American regional assessment. A report prepared for the region presents the team's findings and recommendations directly pertaining to Honduras. This report addresses common issues in trade facilitation and CLIR, along with regional approaches to reform and development in these areas.

First, the report identifies certain overriding themes in Honduras's Commercial Law and Institutional Reform (CLIR) and trade environment that should be incorporated into reform programs on a cross-cutting basis. These issues include (a) the significance of the enactment in 2004 of the *Ley de Propiedad* (LdP) and other real property reforms, and the long-term importance of monitoring and supporting their implementation; (b) a lack of public confidence in the judiciary; (c) difficulties in establishment and growth faced by small and medium-sized enterprises (SME), due particularly to the lack of access to capital; (d) a series of constraints against foreign direct investment; and (e) difficulties Honduras may face in preparing for implementation of the CAFTA.

Second, the report examines 13 CLIR and trade-related areas designated for assessment by USAID—namely, company law, contracts, real property, collateral law, commercial dispute resolution, bankruptcy, competition policy, international trade, flow of goods and services, flow of people, flow of money, financial crimes, and supporting infrastructure. Each topic is analyzed from a four-part perspective: framework laws, implementing institutions, supporting institutions, and social dynamics. The four-part analysis not only allows a multidimensional understanding of specific CLIR and trade-related challenges but also creates the basis for certain general themes to emerge.

A. THE TRADE AND COMMERCIAL LAW ACTIVITY ASSESSMENT PROCESS

The assessment process was carried out through much of 2004 in each of the CAFTA countries by a team of expatriate specialists. In order to gain the highest quality information possible, the CLIR portion of the Trade and Commercial Law Assessment (TCLA) also employed teams of local experts in each country, which included lawyers, judges, government officials and business leaders, to assist in the collection of data. The process began in March with a methodology

seminar where local experts from the region were introduced to the CLIR methodology. Following this process, the local experts performed the base assessment for the CLIR portion of the analysis. With the completion of the base assessment, the expatriate team used this information as well as their own research to discern particular areas of focus prior to arrival in each country. The expatriate team members and their areas of specialization are presented in the following table:

NAME	ORGANIZATION	SUBJECT AREA FOCUS*
Aimee Carter, Team Leader	Booz Allen, International Development Specialist	CLIR
Andrew Mayoock, Co-team Leader, TradeStream™	Booz Allen, Legal Reform Specialist	Flows of People and Money, TradeStream™
James Newton, Assessment Coordinator	Booz Allen, Legal Reform Specialist	Commercial Dispute Resolution (CDR), Financial Crimes, other CLIR areas
John Corley	Booz Allen Hamilton, Engineer	Infrastructure
John Baker	Louisiana State University, Commercial Law Specialist	CDR, Financial Crimes, Competition
JoAnne Cornelison	Independent Customs Consultant	Flows of Goods and Services
Maria Coppola	Federal Trade Commission, Legal Reform Specialist	Competition
Dale Furnish, Boris Kozolchyk, Maria Alejandra Rodriguez, Mariana Silveira	National Law Center for Interamerican Free Trade, Legal Reform Specialists	International Trade, Bankruptcy, Collateral
Omar Garcia	BG Consulting, Legal Reform Specialist	Property, Contracts, Company Law
Irina Swift	Independent Customs Consultant	Flow of Goods and Services

* Given the extended nature of the assessment process, team members served as back-ups for each other as not all experts were able to participate in each country.

During September 2004, while the assessment team was being conducted in-country, they interviewed numerous government officials, nongovernmental organizations, multilateral and bilateral donor agencies, judges, lawyers, notaries, investors, associations and chambers of numerous industries, trade and customs experts, and other domestic and international businesspeople to assess the trade and commercial legal environment of the each country.

1. Background of the Diagnostic Methodology Used

The Trade and Commercial Law Assessments are the latest in a series of assessments applying USAID's CLIR methodology, as refined by Booz Allen Hamilton, to gauge the status of CLIR in developing and transitioning countries. Additionally, Booz Allen Hamilton designed a proprietary metric tool, TradeStream™ to assess the trade facilitation capabilities of a country. While the CLIR and TradeStream™ diagnostics are two separate, stand-alone tools, they have both been applied in the TCLA assessments to generate a comprehensive snapshot of the overall situation and context for domestic and international business.

Both the CLIR and TradeStream™ methodologies have been subjected to field testing and peer review on a regular basis. Moreover, they have been adapted to the exigencies and realities of the

area of the world in which they are to be applied; in the case of the TCLA, the CLIR methodology was adopted to better fit the Central American legal context, as opposed to that of Eastern Europe, for example, where the methodology was originally applied.

In addition, new areas of law continue to be added to the methodology. Along with the first application of TradeStream™, TCLA saw the further development and application of the newest CLIR section, Financial Crimes, which focuses primarily on those issues surrounding terrorist financing and money laundering, and have become more relevant in the wake of September 11, 2001.

2. Scope of the Methodology

The diagnostic assessment was designed to help USAID missions, the countries themselves, and other donors, achieve the following objectives:

- ♦ To provide a factual basis for characterizing the degree of development and the status of trade commercial law reforms in a country;
- ♦ To provide a methodologically consistent foundation for identifying and describing the root causes of the "implementation/enforcement" gap among the CAFTA countries; and
- ♦ To provide analytical and planning tools and metrics that will help USAID, the countries themselves, as well as other donors to design new approaches to sustainable, cost-effective interventions and reform programs.

While the subject matter areas have varied from country to country, for the purposes the TCLA, "commercial law" and CLIR is defined to include the following substantive legal areas:

- ♦ **Bankruptcy.** Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets, and rehabilitation of insolvent debtors
- ♦ **Collateral.** Laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability, and simplicity in creating, identifying, and extinguishing security interests in assets
- ♦ **Commercial Dispute Resolution.** Laws, procedures, and institutions relating to the settlement of commercial disputes, whether through courts or alternative dispute resolution mechanisms, and the enforcement of judgments and decrees
- ♦ **Company Law.** Legal regimes for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals
- ♦ **Competition.** Rules, policies, and supporting institutions intended to help promote and protect open, fair, and economically efficient competition in the market, and for the market
- ♦ **Contract.** The legal regime and institutional framework for the creation, interpretation, and enforcement of commercial obligations between one or more parties.
- ♦ **Financial Crimes.** The legal regime, institutional infrastructure, and methods of international cooperation employed to prevent the financing of terrorist activities and laundering of criminal assets.

- ♦ **Real Property.** The laws, procedures, and institutions responsible for establishing, maintaining, and preserving rights in real property, including land, buildings, easements, liens, and other interests in real property
- ♦ **International Trade.** The laws, procedures, and institutions governing cross-border sale of goods and services.

With respect to the TradeStream™ diagnostic, the areas of inquiry are as follows:

- ♦ **Flows of Goods and Services.** Analyzes a nation's ability to move goods and services smoothly through ports of entry and throughout the country.
- ♦ **Flows of Money and Flows of People.** Similar to Goods and Services, these two sections look at a nation's ability to facilitate the entry and exit of financing and short and long term business persons, respectively.
- ♦ **Supporting Infrastructure.** Assesses the capacities of a country's physical infrastructure relevant to trade, including sea- and airports, roads, railways, communications, and postal services.

Within each of these substantive areas, four dimensions of CLIR were examined as a conceptual framework for comparison. These include the following:

- ♦ **Framework Laws.** Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Collateral, etc.)
- ♦ **Implementing Institutions.** Governmental, quasi-governmental, or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework laws is vested (e.g., bankruptcy court, collateral registry)
- ♦ **Supporting Institutions.** Governmental, quasi-governmental, or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework laws (e.g., bankruptcy trustees, notaries)
- ♦ **Social Dynamic/Market for reform.** The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

B. THE METHODOLOGY OF ASSESSMENT: A 360° REVIEW

The methodology employed in examining Honduras's CLIR and trade environment provides a comprehensive but flexible framework for analyzing a complex, dynamic development challenge. Taking data from a broad spectrum of stakeholders, the Assessment builds a 360° picture of the challenge, drawn from the following areas:

- ♦ **Legal Framework.** The Assessment first examines the laws and regulations that Honduras has in place that serve as the structural basis for its achievement of market-based development. Often this review discovered opportunities to make relatively small changes that could produce significant openings for business development and expansion.
- ♦ **Implementing Institutions.** Next, the Assessment examines the administrative bodies with primary responsibility for implementing and enforcing the legal framework and

subsidiary laws, regulations, and policies governing one or more of the areas addressed in this report. For example, courts are usually a crucial institution in the examination of CLIR. Problems uncovered often relate to bureaucratic inefficiency, lack of resources and training, and, of paramount concern, real or perceived corruption. With respect to the flow of goods, services, and people, Customs and Immigration authorities are the chief implementing institutions.

- ♦ **Supporting Institutions.** The Assessment then considers the environment of organizations, individuals, or activities without which the legal framework or policy agenda cannot be fully developed, implemented, or enforced. Examples include notaries, banks, consumer groups, chambers of commerce, professional associations, and other similar ancillary service providers. Of particular interest with respect to supporting institutions is whether the institutions have any meaningful involvement in *what the law says*. Where there has been buy-in from affected constituencies, a law is more likely to be understood, to be used properly, and to achieve its purpose.
- ♦ **Social Dynamics.** Finally, the Assessment studies social dynamics, which entails asking whether the affected constituencies of a law or policy perceive a need for change and, if so, how they are demonstrating this need. For example, Are they effectively lobbying institutions that can make a change? Are the media seizing the issue as a topic of public concern? Are individuals speaking out? On the other hand, have social dynamics taken a less positive approach (for example, is the “gray economy” growing in response to burdensome conditions for market entry)? Analysis of social dynamics can affect how an assistance project is ultimately designed. Where outside participation is strong and public understanding high, a reform program might involve a relatively small number of government officials who are capable of meeting the demands. In contrast, where mistrust and misunderstanding are abundant, an approach that involves significant engagement of “end users” will likely be necessary.

C. SUMMARY OF SUBJECT-SPECIFIC FINDINGS

Based on this multifaceted review process, reports for each area were completed and quantitative indicators scored. It should be noted that some repetition of material occurs in the various sections so that each chapter reads as a complete whole. The general findings in the 13 subject matter areas addressed in this report are as follows:

- ♦ **Company Law.** Although the Commercial Code in Honduras (i.e., the Honduran Code of Commerce of 1950) is modern by regional standards, sections of the code remain outdated. Specifically, the code does not provide for fully owned subsidiaries, requires equity capital, and lacks mechanisms to protect minority shareholders and enforce principles of corporate governance. These issues keep private sector participants in Honduras from meeting their economic potentials, and should be addressed through legislative reform. In addition, a variety of institutional weaknesses, including the Commercial Registry, the courts, and the tax system, combine to deter foreign investment and domestic business growth on the margin, and encourage the trend toward operating in the informal economy. Access to credit is scarce for formal businesses and nearly nonexistent for informal firms. The stock market, which could be used as an alternative

source of capital, is underdeveloped. Income taxes are high and the tax system overly complicated, and the government has imposed direct taxes on consumers to compensate for inadequate collection.

- ♦ **Contracts.** Although it is not difficult to enter into contracts in Honduras, barriers to company growth emerge from (a) the absence of legal provisions for modern contract types and (b) inadequate implementing and supporting institutions. First, the current legal framework does not address modern contracts, such as leasing, franchising, factoring, and electronic contracts. Distribution agreements are claimed to be unfavorably regulated on behalf of local distributors. Powers of attorney granted in a foreign country, including Central American countries, must pass through a complicated process of legalization and permits before they are deemed valid. Moreover, the process of enforcing contracts is complicated, slow, and expensive. Second, the legal system, including both judges and lawyers, requires change to meet the demand of modern international commerce. The system that empowers notaries to profit from political connections is in particular need of reform.
- ♦ **Real Property.** The entry into force in June 2004 of Honduras's Property Law (*Ley de Propiedad*, or LdP) represents an important new initiative for rationalizing the country's property system by recognizing settlers' rights, resolving title disputes, and modernizing the Property Registry. The law includes the creation of a new entity in charge of property matters, *Instituto de Propiedad*, which will have authority over both the Real Property Register and a national cadastre map. The LdP began its reforms by concentrating on real property registries, with an ambitious plan to convert the entire system to electronic entries, coordinated with a national cadastral survey. This effort is supplemented by important administrative reforms underwritten by the World Bank. Currently, perhaps because of the complexity of the issues involved, there is a lack of public understanding about the intentions and anticipated benefits of property reform as it pertains to the daily lives of Hondurans. There are also significant challenges to the authority of the new law: its ultimate impact awaits the resolution of cases challenging its constitutionality. As of the date of completion of this report, these cases were still before the Supreme Court.
- ♦ **Collateral Law (Secured Transactions).** Financing in Honduras relies today on mortgage-based loans or loans guaranteed by individuals, with immovable collateral as their guaranty. With the exception of automobile loans to consumers, there is only a small private credit market in Honduras that is secured by *movable* property. The lenders who occupy the vacuum left by this deficit tend to be public foundations and business associations that do not have lending philosophies that support and encourage development and growth. Rather, these last-resort lenders tend to provide holdover loans that permit borrowers to survive at their current levels of operation but not to expand. Thus, legal and institutional reforms in the area of collateral law are greatly needed to help businesses and entrepreneurs remain competitive.
- ♦ **Commercial Dispute Resolution.** The judicial system in Honduras requires broad reforms to create an environment conducive to private sector growth. The system suffers from untenable delays, inadequate training of both professional and administrative staff, a perception of political influence and corruption, and under-qualified personnel in important positions. While public confidence in the judiciary remains low, certain steps

can be taken to re-establish public confidence. Necessary reforms include prosecuting corruption and reconsidering the issue of separation of powers, in particular the method of appointing judges; educating attorneys, law students, and the business community in commercial law topics *and* the benefits of alternative dispute resolution (ADR); updating the Commercial Code, including incorporation of oral proceedings; and reviewing the notary practice to ensure that the licensing of notaries is impartial and ethical.

- ♦ ***Bankruptcy.*** Although Honduras has a well-drafted, detailed insolvency law, which was promulgated as part of its Commercial Code in 1950, the country has virtually no bankruptcy practice. Typically, businesses in Honduras carry out de facto insolvency proceedings by simply shutting their doors and ceasing to exist. One of the major reasons for this lack of a formal bankruptcy practice is that insolvency proceedings fall to Honduras's all-purpose trial courts, which may not have the capability to handle complex bankruptcy cases. These courts have no experience with insolvency proceedings. With respect to banks, the failure of certain institutions in recent years has resulted in more careful scrutiny and control by the Commission for Banking and Insurance. Banks do not now fall under insolvency laws.
- ♦ ***Competition Law and Policy.*** Recognizing the benefits of a competition law and policy, the Government of Honduras has engaged in significant efforts to adopt a competition law. Substantial initial efforts began in 2001, with renewed interest and activity in 2003. The well-publicized anticompetitive practices in the cement sector in 2004, combined with pressures created by the preparations for CAFTA and related internal and external concern about the lack of a competition law, have all driven forward the process of adopting a competition law. In September 2004 a draft competition law was "officialiated," i.e., submitted to the Economics Committee of the Legislative Assembly, where it remained as of December 2004.
- ♦ ***International Trade.*** Many steps remain before Honduras will have a complete legal and administrative structure for its international trade. To date, Honduras's foreign trade concerns have focused on promoting and facilitating export operations to the relative exclusion of import controls other than simple tariffs. Honduras has enjoyed Generalized System of Preferences (GSP) privileges in industrialized markets for which it did not have to reciprocate by opening its borders. At these conditions change, necessary improvements will include (a) encouraging the growth of cooperation between the private and public sectors; (b) encouraging and supporting increased efficiency and transparency in Customs administration and operations; (c) addressing the lack of a national legal framework for international trade, perhaps first through internal administration and development of procedures for applying countervailing duties; and (d) engaging in further regionalization of Honduras's international trade practices and structures.
- ♦ ***Flow of Goods and Services.*** Notwithstanding certain recent improvements, trade-related institutions in Honduras still encumber traders with unnecessary transaction costs through delays and administrative burdens. By eliminating unwarranted and onerous constraints embodied in laws, regulations, and procedures, Honduras can capture greater savings and efficiencies. In fact, improving the trade facilitation environment could reduce trade costs by as much as 15 percent of the value of traded goods. Even in Honduras's relatively

small market, where just over \$6 billion in goods and services were exchanged in 2003¹, improved trade facilitation could lead to *significant* savings. In turn, these savings could improve Honduran economic development in several ways: making Honduran exports more competitive, resulting in more exports; lowering prices for Honduran consumers; and enhancing Honduras's overall attractiveness as an investment environment.

- ♦ ***Flow of People.*** Honduran laws, public agencies, and private institutions generally facilitate the flows of trade-related people. In an additional effort in this direction, Honduras is streamlining processes at land border crossings, upgrading its automation, and amending its laws. However, Honduran people-flow institutions are insufficiently professional and overly politicized. Also, Honduras could further simplify its system for handling highly skilled visitors seeking longer stays. Work permits now require more than 12 separate pieces of paperwork and involve five or more government agencies. Further, the issue of illegal people flows remains a significant problem. Honduras's borders with Guatemala, El Salvador, and Nicaragua are long and porous.
- ♦ ***Financial Crimes.*** Money laundering in Honduras results from a variety of crimes, including drug-trafficking, auto theft, kidnapping, bank fraud, prostitution, and corruption. The banking sector, which had until recently been largely unregulated, has been one focus for money laundering. Vigilance is necessary to ensure that Honduran financial institutions are protected from illicit opportunists seeking to abuse the financial system.

Flow of Money. Cross-border goods and services transactions reflect a significant amount of monetary exchange that pays for the goods and services traded (more than \$6 billion in goods and services traded in 2003). Of the goods flows, \$1.37 billion was exported and \$3.08 billion was imported.² Services include \$1.09 billion in exports and \$687 million in imports.³ Free zones accounted for \$560 million of services exports (51 percent)⁴, which are included because they are a value-added category. Tourism makes up another \$291 million in service exports (27 percent).⁵ Remittances also represent a major trade-related financial flow; in 2003, an estimated \$773 million poured into Honduras through remittances of workers and families abroad.⁶ Overall, Honduras's laws, public agencies, and private institutions support these trade-related money flows.

- ♦ ***Supporting Infrastructure for Trade.*** Honduras's stock of trade infrastructure presents two pictures, depending on one's perspective within the country. There are two primary production/consumption zones in Honduras: one located within the nation's capital, Tegucigalpa, and the other along the nation's Caribbean coast at Puerto Cortez/San Pedro Sula. These locations present a stark contrast to each other with respect to installed capacity, infrastructure quality, and overall effectiveness. Installed infrastructure within the Tegucigalpa consumption/production zone suffers from capacity constraints and poor

¹ Economic Intelligence Unit (2004), Country Profile for Honduras.

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

service quality, ultimately hurting the nation's overall competitiveness. In contrast, installed infrastructure in the Puerto Cortez/San Pedro Sula consumption/production zone benefits from more thoughtful planning and targeted investment and provides a comparatively solid competitive environment. That said, it is important to note that the nation's overall stock of trade infrastructure experiences organizational issues that are prevalent across the nation. These issues include a high level of direct government involvement in implementing and operating many of the nation's key infrastructure components.

II. CLIR AND TRADE: CROSS-CUTTING THEMES

Along with the specific findings in the 13 subject matter areas (which are detailed in Sections III–XV), certain cross-cutting themes emerged with respect to CLIR and trade in Honduras. It is important to consider and incorporate these themes in any reform efforts, but not necessarily through stand-alone initiatives. Rather, it would be prudent to address these themes within the context of any reforms undertaken, as described further below.

A. MONITORING AND SUPPORTING CURRENT PROPERTY INITIATIVES

The crucial role that property plays in the ability of businesses to grow and expand has been of enormous interest since Hernando de Soto published his groundbreaking work *The Other Path*, in 1986. As summarized in an article published by the Center for International Private Enterprise,

Mr. de Soto identified the barriers to private sector growth that had been invisible to others. The key barrier, he argued, has long been weak institutions . . .

Perhaps the most important—and least noted—of these institutions is property rights. Owners of land, corporate shares, and even intellectual property are loathe to invest in the upkeep and improvement of their property if their rights as owners are insecure. Just as importantly, if property cannot be bought and sold with the confidence that the authorities will uphold the transaction, the market itself will fail to generate dynamic growth. Indeed, the absence of property rights is one factor that drives people out of formal markets into the informal sector.⁷

Clear property rights represent a fundamental precondition for market-based economic activity. The grant of ownership rights in real property to rural or urban residents makes it possible to realize the full value of the property, both in its primary role (housing, infrastructure for business, garden plots, crop cultivation, etc.) and in its secondary role as collateral for consumer or commercial credit. Similarly, the registration of movable collateral in a state-sponsored institution reduces the risk of issuing credit, leading to increased availability of credit on improved terms.

In Honduras, only about 14 percent of the population occupies property legally.⁸ The remaining 86 percent holds property outside the scope of the law, amounting to \$12.4 billion in extralegal land possession.⁹ Of properties held legally, only 30 percent are registered.¹⁰ Indicative of the vast gap in property registration is one department where, out of 146,000 lots, 45,000 are registered, and only 15,000 are registered correctly.¹¹ Thus, only a very small percentage of the population in Honduras currently has access to credit through formal channels, since in most cases credit is only available to those individuals holding valid title to real property.

⁷ Center for International Private Enterprise, *An Interview with Hernando de Soto*, Economic Reform Today (1996) available at <http://www.cipe.org/publications/fs/ert/e19/desoto.htm>.

⁸ Based upon local interviews. See also the Honduras Country Diagnosis report, *Instituto Libertad y Democracia* available at http://www.ild.org.pe/eng/hon_post_en.htm.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

In response to these issues, major reforms in the area of real property are currently being implemented. The enactment of the Property Law, or *Ley de Propiedad* (LdP), which entered into force on June 29, 2004, and a \$25 million interest-free loan from the World Bank to support real property rights, along with other initiatives geared at securing property rights, each warrant monitoring and support over the years to come.

The primary purpose of the LdP is to rationalize the country's property system by recognizing settlers' rights, resolving title disputes, and modernizing the Property Registry. The law includes the creation of a new entity in charge of property matters, *Instituto de Propiedad*, which, as early as January 2005, will have authority over real property registration and the national cadastre map. This new law creates a transition period during which information from current registries will be transferred into the new system.

The World Bank's credit to Honduras was issued in February 2004 for the purpose of expanding access to formal land titling, surveying, registration, and conflict resolution mechanisms, as part of an integrated and decentralized land administration system. Called the Honduras Land Administration Program, the initiative is designed to support an integrated and decentralized land administration system that provides users with accurate information on urban and rural land parcels, as well as effective land administration services in a timely and cost-effective manner. The project specifically aims to benefit poor and non-poor urban and rural property owners in the departments of Choluteca, Comayagua, Cortés, and Francisco Morazán and to expand access to land titling and administration services to indigenous and Afro-Honduran populations on the Atlantic coast.

Specifically, under the auspices of the World Bank, Honduras recently initiated a project to automate, consolidate, and make public all property information. The project, *Proyecto de Administración de Tierras de Honduras (PATH)*, has a duration of 12 years. *PATH* is meant to strengthen the *Instituto de Propiedad* and contains an experimental project to create a unified system of registration. This system, called *Sistema Unificado de Registro (SURE)*, will be accessible online. With the new system, a data query, which previously took 6 to 9 months, was completed in 1 minute. Under *PATH*, it is expected that property information, currently dispersed among 26 entities, will be consolidated and accessible through *SURE* within 4 years.

The implementation of both the legislative reforms and the World Bank programs not only impact the real property market per se but also affect the extent to which businesses and individuals will be able to access capital in the future. The LdP aims to reform not only the Real Property Register and cadastre system but also the existing registry for movable property. Implementation of the LdP will make important demands on lawyers and the judiciary, who will need to recognize its authority and understand its provisions and impact. The willingness and ability of the judiciary to administer the LdP will directly affect the way that banks assess risk in the future, and thus will ultimately affect whether and to what extent capital is made more accessible in Honduras.

Vigilant donor monitoring and support will contribute to the realization of the goals of these property reform initiatives. Indeed, new reform programs pertaining to commercial law, support for SMEs, or rule of law and governance generally should be fully in step with these property-related initiatives already in progress. New programs should leverage resources and recognize

the importance of avoiding duplication or conflict of effort. Properly implemented, these initiatives can serve as a model for other countries in the region and beyond.

B. URGENT NEED FOR JUDICIAL REFORM

In virtually every section of this report—contracts, collateral, real property, bankruptcy, flow of goods and services, and others—the difficulty of the Honduran courts to facilitate the prompt resolution of commercial disputes and the enforcement of its own judgments is identified as a problem. The many aspects of this issue include a low degree of confidence in judges, inefficiency and sluggishness of court processes, and a lack of significant automation in the courts.

In Honduras, more resources should be devoted to improve training opportunities for judges. Further, the lack of a career judiciary makes it more difficult to develop competence over a significant period. There is a judicial school under the authority of the Supreme Court, but its courses need updating.

Currently, reliable information transfer from local registries for use by the courts is relatively slow and bureaucratic. This impacts the degree of confidence that lenders will be able to enforce debts. In some instances, the use of collateral may be so restricted that even entrepreneurs with sound business plans could have difficulty finding access to capital.

Until the commercial community in Honduras trusts that the courts are capable of affording remedies in the event of defaults on loans and breaches of contracts, there will be fewer loans and fewer contracts than the market could otherwise support. In short, the great risks involved in extending credit or engaging in an arms-length transaction will result in less economic activity and less growth. Even the development of ADR mechanisms will be affected if decisions are not handed down in a clear and efficient manner, and if such delays erode confidence that parties can enforce ADR agreements and awards.

Thus, future programs in commercial legal and institutional reform need to address the judicial component of this issue. Addressing this element would include leveraging the resources of existing court reform programs to emphasize the relationship between court reform and economic growth and, where gaps remain, formulating technical assistance efforts that do the following:

- ♦ Develop a commitment to professionalism, competence, and integrity among judges through support for professional organizations, continuing education in skills pertaining to judging, and increased judicial independence
- ♦ Improve the commercial capacity of courts through administrative and automation processes that make the process of dispute resolution faster, more predictable, and more transparent
- ♦ Train judges in areas pertaining to commercial activity, particularly with respect to modern types of commerce and newer laws, such as competition law, potential laws pertaining to modern contracts or electronic commerce, and laws concerning money laundering

- ◆ Establish codes of conduct among judges and court staff
- ◆ Endeavor through training and statutory reform to address the overly formalistic aspects of the law and the judiciary
- ◆ Through outreach and demonstrable results, persuade the public that the courts in Honduras can be trusted to uphold their commercial agreements.

Continued reforms in the courts and judicial system will help Honduras secure more benefits from increased regional trade.

C. HELPING SMEs ACCESS CAPITAL: AN IMPERATIVE FOR ECONOMIC GROWTH

Businesses in Honduras—particularly SMEs—face numerous obstacles within the legal, bureaucratic, and trade environments that inhibit their ability to become formally established under the law and to grow and expand. That almost 50 percent of businesses in Honduras operate in the informal sector—compared with fewer than 17 percent in Organization for Economic Cooperation and Development (OECD) countries—reveals the difficulties enterprises face.¹² An entrepreneur seeking to establish a company in Honduras confronts procedural inefficiencies and corruption when trying to register, enormous restrictions in using collateral to secure debt, and grave threats to the property interest in the very parcel of land on which the new company may operate. Companies that wish to expand their opportunities through international trade face inefficiencies within the agencies that are charged with regulating and facilitating their transactions, along with constant threats to the security of their goods. These inefficiencies can raise costs significantly for smaller companies seeking to engage in trade.

As reported herein, encumbrances specifically facing SMEs in Honduras include the following:

- ◆ SMEs, especially informal ones, have great difficulty obtaining credit because of a lack of lender confidence in their ability to collect on collateral. Microfinance institutions provide a potential alternative source of credit, but interest rates are often prohibitively high (up to 80 percent). Interviewees have stated that even banks charge approximately 35-percent to 40-percent interest or higher.
- ◆ Currently, no single entity is tasked with organizing the quality control standards to remain updated on international industrial standards. Because of their small size, SMEs do not individually have the resources to remain current on such topics. Creating such an entity would significantly increase the likelihood of SME participation in international commerce. This is also a basic requirement for global competitiveness.
- ◆ SMEs disproportionately bear the costs of institutional inefficiency and the politicization of institutions. In establishing registration and notary costs, along with other administrative fees, officials and notaries do not take into consideration the relatively greater impact that such fees have on small-sized companies. For example, current law requires the signature of a notary in many situations of questionable necessity. As small

¹² See World Bank, Snapshot of Business Environment—Honduras, at <http://rru.worldbank.org/DoingBusiness/ExploreEconomies/BusinessClimateSnapshot.aspx?economyid=86>.

companies, SMEs have less resources and less liquid capital to spend on transaction costs.

Throughout this report, obstacles facing SMEs are identified, and recommendations for change are suggested that would lessen the administrative burdens and unnecessary transaction costs forced on SMEs. The theme that emerges from these individual points is that even relatively small changes could result in significant improvements to the business environment. The costs and challenges involved in implementing the recommended changes vary, but each recommendation should be considered in the context of the overall environment for enterprise growth. As summarized recently in the *Economist*,

Laggards sometimes argue that reforms would be difficult and costly to enact. But what could be simpler than scrapping a stupid rule? Simplifying procedures is harder, but not too hard. There are plenty of examples to learn from, and the World Bank estimates that the benefits of the reforms it advocates are 25 times the costs.¹³

A nationwide effort to streamline procedures and otherwise remove damaging constraints on business start-up and operation would encourage more new businesses to formalize their operations, thereby increasing opportunities to do business and improving access to capital. The needs of SMEs—which employ at least 600,000 people in Honduras—should be considered at all junctures of the CLIR and trade facilitation process.

D. FOREIGN DIRECT INVESTMENT

The political stability of Honduras in recent years, along with its participation in a regional market of 36 million people, makes it a location of increasing interest to outside investors. Unfortunately, as noted throughout this report, foreign direct investment faces a number of constraints Specifically—

- ♦ Distribution and representation contracts are subject to a special law passed in the 1970s that is disproportionately protective of the interests of local distributors. To validate this type of contract, parties must register the contract at the Industry and Trade Ministry. If the contract is terminated by the foreign company, the local distributor is entitled to compensation equal to the average annual net income it has received over the past 5 years of the contract's life. In addition, in cases of unilateral cancellation by the foreign company, the local distributor can obtain an injunction to prohibit further distribution of the products he was distributing before the contract was terminated. On the other hand, distribution contracts are not subject to foreign jurisdiction and cannot be governed by foreign entities. As a result, many foreign companies are reluctant to introduce their products in the Honduran market.
- ♦ The Law on Administrative Simplification, passed in 2000, requires companies to have a minimum of two shareholders. Thus, wholly owned subsidiaries are not possible. This limitation affects foreign investments, since most foreign companies operate through companies in which shares are wholly owned.

¹³ “Measure First, Then Cut,” *The Economist* (September 9, 2004) (summarizing World Bank, *Doing Business in 2005: Removing Obstacles to Growth* [2004]).

- ◆ The Honduran chambers of commerce have proposed a reduction in the number of bureaucratic steps required to notarize powers of attorney granted from abroad, thus reducing the transaction costs borne by foreign investors. Steps have not been taken, however, to reduce or simplify these procedures.
- ◆ Most Honduran lawyers and judges are not well versed in international business transactions, leaving many foreign businesses unable to access sound local legal representation and unsure of trial outcomes.
- ◆ A perception of corruption and over-politicization in various commercial law and trade-related institutions affects foreigners' interest in investing in Honduras.

Thus, future reform efforts, in addition to considering the interests of SMEs, should make the concerns of foreign investors a matter of continuous, cross-cutting concern.

E. CENTRAL AMERICA'S PREPAREDNESS

Continued progress in economic development and poverty reduction requires greater economic growth and productivity gains throughout Central America. Greater trade and investment provide an opportunity for stronger economic growth, and the Central American Free Trade Agreement can be a key part of this opportunity. Working together, the countries of the Central American market can achieve economies of scale. Central America's prior efforts, through the Central American Common Market, provide a foundation on which CAFTA-related efforts can build.

To fully benefit from freer trade under CAFTA, member countries must face institutional, regulatory, and operational changes covering a range of critical issues, such as macroeconomic concerns, trade policy, education, health, environment, agriculture, trade facilitation, and the commercial environment. Without a favorable business environment, domestic entrepreneurs and interested foreign investors cannot seize new opportunities. Without a more efficient and secure trading system, these entrepreneurs and investors cannot efficiently and securely move their goods and services.

As detailed in this report, Honduras needs to better prepare some of its sectors, such as business and agriculture, for implementation of CAFTA. Examples include the following:

- ◆ Private sector representatives in Honduras claim that the government has not been active enough in modernizing and reforming the practices that diminish the relative competitiveness of Honduras. Although there seems to be significant political will to change, more urgency should be given to reform. More dynamic initiatives to decrease bureaucratic procedures and decentralize decision-making are required.
- ◆ Exporters could be better organized as a unified constituency. The export community appears splintered and polarized into various organizations. The lack of a single, representative organization inhibits the presentation of an effective collective voice on policy and procedures affecting the export community, particularly because there is little communication between the groups.

- ◆ Honduran people-flow institutions need improvement. Honduras could do more to simplify its system for handling highly skilled visitors seeking longer stays. Work permits now require more than 12 pieces of paperwork and involve five or more government agencies.
- ◆ Most of the private, and even the public sector, lacks a clear idea of what CAFTA is and what it will require of them.

One significant way in which Honduras can improve is through an ongoing effort to integrate regional practices and harmonize its laws with those of the other CAFTA countries. Although this report proposes solutions to various problems as they apply in their national context, the suggestions are all made against the vital backdrop of *regionalism*. That is, without harmonization of better commercial legislation and practices throughout the region, neither home-grown businesses nor outside investors will be able to seize the economic opportunities presented in this emerging market region of 36 million people.

III. COMPANY LAW

A. INTRODUCTION

Although the Commercial Code in Honduras is modern by regional standards, sections of the code remain outdated and in some cases leave significant legislative voids. Specifically, the code does not allow for fully owned subsidiaries, requires equity capital, and lacks mechanisms to protect minority shareholders and enforce principles of corporate governance. These issues detract from the country's business climate and should be addressed through reform of the Commercial Code.

Problems associated with the legal code are exacerbated by the poor functioning of the Commercial Registry. The excess of requirements imposed by the registry deters foreign and domestic business growth and has encouraged the trend of businesses' operating in the informal economy.

Lack of access to credit further inhibits business growth. Access to credit is scarce for formal businesses and nearly nonexistent for informal firms. The stock market, which could be used as an alternative source of capital, is underdeveloped.

Income taxes are relatively high and the tax system is complex. The government has also had problems in tax collection and has imposed direct taxes on consumers to compensate for low collection rates.

The unreliability of the judicial system further weakens the code. In fact, companies are reluctant to take cases to court because of the unpredictability of the judicial system.

B. LEGAL FRAMEWORK

The majority of company law in Honduras is found in the Commercial Code, a comprehensive set of rules drafted in 1950, which provides the legal framework for business organizations, commercial instruments, and trade. The code contains certain provisions, such as those related to appearance,¹⁴ that are very progressive for regional standards.

The Commercial Code allows for the majority of common forms of business organization, such as limited liability partnerships and limited liability corporations. The latter type of corporation is known as *Sociedad Anónima* and is the most widely used organizational structure in Honduras. Most *Sociedades Anónimas* are family owned.

Honduras imposes capital requirements to incorporate a company. For example, a minimum equity of \$1,500.00 is required for registration of *Sociedades Anónimas*. A company cannot

¹⁴ With respect to the provision on appearance, if an act appears to be something that it is not, and has created reasonable expectations among good faith third parties that it *is*, under the code, the act would be considered that which it purported to be. This provision has an impact on the liability of informal business because it means that lack of registration does not protect a firm against the claims of good faith parties that contracted with the entity under the assumption that it was officially recognized. This is the case for so-called de facto companies; that is, the parties affected by the actions of the unregistered company are entitled to sue the person who acted on its behalf and to reach his or her assets to enforce a favorable judgment.

initiate operations if it does not meet its capital requirement. This requirement was intended to provide creditors with a form of guarantee in case of default. Companies comply with minimum capital requirements by submitting evidence that money has been deposited into a bank account. After incorporation, however, the money is usually used for other purposes and thus is no longer available to guarantee the rights of the company's creditors.

To complete the incorporation of a company, founding parties must consent to the company's articles of incorporation and bylaws. These documents outline the rules regarding management structure, duties of directors, shareholders meetings, and the rights of shareholders. Articles of incorporation and bylaws must be filed with the Commercial Registry for a company to be granted full legal personality'. If a company fails to register the articles of incorporation, it is considered irregular but can still operate without the full rights associated with registration. The consequence of not registering is that shareholders and administrators are jointly and fully liable for the actions of the company. This condition is important in the case of a *Sociedad Anónima* where shareholders are not liable if the company is fully registered.

The legal personality of a company is considered, in words of a prominent local lawyer, "the Berlin wall." It can hardly be pierced even when a company has been used for fraudulent purposes. Only in few cases, such as when a bank has defaulted on its clients and the bank is a subsidiary totally owned and controlled by a parent bank, can the banking regulatory entity consider lifting the corporate veil and imposing sanctions on the parent bank. Creditors of the subsidiary, however, still could not reach the assets of the parent bank.

Sociedades Anónimas can be private or public; however, no company has ever issued shares publicly. There are some private companies with many shareholders, but ownership tends to remain within families. Companies are able to issue bearer shares but rarely do so, choosing instead to issue nominal shares. Companies can issue preferred shares if their total assets are greater than \$27,000. Preferred shares do not grant voting rights to shareholders, but instead grant preferred rights on dividends or to the liquidated assets after the company has been dissolved. Companies are not authorized to buy their own shares.

Until 2000, the Commercial Code required that *Sociedades Anónimas* have at least five shareholders. The Law on Administrative Simplification, passed in 2000, changed this provision so that companies now must have only two shareholders. Nonetheless, wholly owned subsidiaries are still not possible. This limitation affects foreign investments because most foreign companies operate through companies in which shares are wholly owned. The code also does not provide for incorporation of companies without equity, as is the tendency now in many countries.

Although the Commercial Code provides for joint venture contracts,¹⁵ lawyers rarely use these structures. In some cases, banks use financial trusts to devise corporate structures where there is interest in organizing a business and having partners but not on creating a company.

Although the Commercial Code has provisions for mergers and acquisitions,¹⁶ mergers rarely occur because the tax law is not favorable to them. The code does not have provisions for

¹⁵ Commercial Code (CdCom) Art. 1283.

divestiture. As a consequence, when asked to spin-off a department or division of a company, lawyers create a new company or dissolve the whole original company and create different entities.

Corporate governance principles are not strict. The code requires that companies appoint internal auditors, *comisarios*, to supervise administrators, but these auditors are rarely appointed. When *comisarios* are appointed, they usually are not independent and in many cases are shareholders of the company in question. *Comisarios* do not need to be certified public accountants (CPA).

Companies are not required to publish financial statements. In addition, although it is mandatory to maintain corporate account books, most companies do not do so. Banks are the only companies required to publish annual audited financial statements. Even though banks face more stringent regulations than do other companies, it has been reported that corporate governance principles for financial institutions are lax. However, under the new Law on Financial Institutions, *Ley Reguladora de Instituciones Financieras*, to be passed shortly by Congress, the National Commission on Banks and Insurance Companies, *Comisión Nacional de Bancos y Seguros* (CNBS), will be able to issue regulations that impose stronger corporate governance principles, define and prohibit conflicts of interest, and establish the extent of the liability of related persons.

According to the Commercial Code, *Sociedades Anónimas* are governed by an administrative body, and the shareholders assembly is the highest authority.¹⁷ In practice, however, many companies do not have an administrative body and have never had a meeting of a shareholders assembly. There is no penalty for such a violation.

Protection of minority shareholders is weak. Only shareholders holding at least 25 percent of shares are able to appoint directors.¹⁸ Shareholders owning less than 25 percent of shares cannot call for shareholders meetings unless a general meeting has not been held during the year.¹⁹ If no such meeting has been held, shareholders owning less than 25 percent of shares can ask the administrative body to call the meeting.²⁰ If administrators refuse the request, shareholders can make the request to the *comisarios*, and if they refuse or there are no *comisarios*, the request can be made to a judge. If shareholders disagree with a decision made in a shareholders assembly, such as capital increase or change of the company's activities, the shareholders can request that their shares be bought back.²¹ However, it is not clear whether the shares would be bought at market value or at face value.

To operate, companies must obtain a great number of permits from various governmental entities. Business operation permits, issued by the municipalities, are expensive by local standards and require that the company have a physical address for operations, for which a property deed or lease agreement must be presented. The majority of companies are unable to present either of these documents. In San Pedro Sula, the municipality has threatened to close

¹⁶ CdCom. Art. 344.

¹⁷ CdCom. Art. 165.

¹⁸ CdCom. Art. 175.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

700 stores because they lack the municipal permit to operate. In addition, in the past a judicial review was required to legally operate a business, but this requirement was eliminated by the Law on Administrative Simplification. The law also includes the principle of *afirmativa ficta*, according to which certain requests to the government must be responded to within a given time period. (If there is no response within the given period, the request would be considered approved.) Before the Law on Administrative Simplification was passed, it took 9 months to obtain the required permits to start a business, but since the law's passage it takes 3 months, according to individuals interviewed for this report. In Tegucigalpa, however, it can still take up to a year to obtain the municipal business license, although temporary licenses are available during the approval process. An environmental permit, which takes roughly 6 months to obtain, is required for most activities in Honduras.

Because of all of these obstacles, businesses in Honduras often are not formalized. Estimates of informal operations range from about 50 percent to 89 percent of all businesses.²² In fact, a business association interviewed reported that of the 2.8 million economically active inhabitants in Honduras, three-quarters are in the informal economy. According to interviews, roughly 600,000 Hondurans are employed by SMEs, while the large apparel companies known as *maquilas* employ about 130,000 people.

Only 5 percent of the population has access to credit, according to an interviewee. SMEs, especially informal ones, have great difficulty obtaining credit because of a lack of guarantees. Microfinance institutions provide a potential alternative source of credit, but interest rates are often prohibitively high (up to 80 percent). Funds managed by microfinance institutions charge interest of up to 3 percent monthly. Other options include credit card financing (with \$5,000 credit limits and interest rates of 2.75 percent annually) and special programs offered by some banks that grant \$30,000 loans to be paid back in 5 years at 9 percent and require a guarantee such as a mortgage on real property. In the case of each of these options, stringent requirements often prevent their use.

Companies pay income tax at a rate of 25 percent, sales tax at a rate of 12 percent, a solidarity tax (used to pay for social services) of 5 percent, and a business asset tax that is independent of profits. In an unusual provision, incomes accrued by companies operating a food franchise are untaxed. Dividends paid to shareholders are tax exempt. Due in part to the heavy tax load, tax evasion is prevalent.

Overall, this account makes clear that the legal framework of Honduras needs to be modified and that obstacles to doing business need to be removed.

C. IMPLEMENTING INSTITUTIONS

Companies are required to register with the Commercial Registry to be considered fully legal. Articles of incorporation, bylaws, the minutes of shareholders assemblies, and various other documents must be registered. The Commercial Registry in Honduras is in poor condition. It is

²² See Instituto libertad y democracia. at www.ild.org.pe; World Bank, Snapshot of Business Environment – Honduras, at <http://rru.worldbank.org/DoingBusiness/ExploreEconomies/BusinessClimateSnapshot.aspx?economyid=86>.

not automated and lacks financial resources. The Commercial Registry is part of the property registry and falls in the portfolio of the Supreme Court.

In Tegucigalpa, the Commercial Registry receives more documents than it can handle. Approximately 400 documents are received daily, with only one computer available to process them. As a result of these limited technological resources, most operations are recorded manually, delaying registration. According to the registry's officers, registration of a company takes roughly 45 days. Lawyers interviewed, however, say that the process typically takes 2 to 3 months. In addition to the time associated with registration, registration costs are high. The minimum cost to register a company is \$1,500.00.

One lawyer reported that sophisticated business structures, such as international trusts combined with joint venture contracts, are denied registration because the registry's officers are unfamiliar with international business transactions. At the same time, lawyers have reported that corruption is a problem.

Regional commercial registries exist throughout the country; however, there is no integration between offices. Indicative of this lack of integration between registries is the duplication of names of companies that have been registered in different offices. This has created uncertainty among creditors who do not know which of the companies is responsible for payment.

Under the umbrella of the LdP, the *Instituto de Propiedad* will soon hold authority over all the national registries, including the Commercial Registry. The *Instituto de Propiedad* will begin full operations in January 2005. A recently initiated 5-year, \$44 million competitiveness project financed jointly by the World Bank and the Inter-American Development Bank will devote some funds to modernizing the Commercial Registry. In addition, automation of the registries is being pursued under a land regularization project financed by the World Bank. The latter effort has had some success in rationalizing the real property framework; however, this program has focused primarily on the Property Registry, not on the Commercial Registry.

Starting a Business (2004)

The challenges of launching a business in Honduras are shown below through four measures: procedures required to establish a business, the associated time, the associated cost, and the minimum capital requirement. Entrepreneurs can expect to go through **13** steps to launch a business over **62** days (on average), at a cost equal to **72.9** percent of gross national income (GNI) per capita. They must deposit at least **37.0** percent of GNI per capita in a bank to obtain a business registration number, compared with the regional average of **28.9** percent of GNI and the OECD average of **44.1** percent of GNI.

Nature of Procedure (2004)	Proc #	Duration (days)	US\$ Cost
Procure a certificate of deposit at a local bank	1	1	0
Constitute the company before a notary public	2	2	326.31
Publish the registration in <i>La Gaceta</i>	3	1	15.00
Purchase the stamps	4	1	0
File the articles of incorporation with the Mercantile Registry	5	25	61.13
Apply for tax identification code	6	1	0
Acquire legal accounting and minutes books	7	1	180.00
Apply for an operational permit	8	30	132.96
Obtain authorization of the company books	9	7*	0

Register at the Hand Labor Training Institute	10	1*	0
Register at Social Security Institute	11	7*	0
Register at Social Fund for Housing	12	1*	0
Register with local and national chambers of commerce	13	1*	0
Totals:	13	62	\$715.40

* This procedure runs simultaneously with previous procedures.

Source: World Bank

The Commercial Code provides that company-related disputes are to be managed by courts.²³ The judicial system, however, tends to be inefficient, and slow. In addition, there are no courts specializing in commercial matters. It is perceived that Honduran business people do not trust the efficiency of the court system. Lack of trust increases transaction costs. When business people lack trust in formal mechanisms for enforcing obligations, the alternatives are to remain informal or to use alternative dispute resolution (ADR) mechanisms, though concerns over enforcement of agreements may cast a doubt on the effectiveness of ADR mechanisms.

For the latter, Honduras has two arbitration centers, one in Tegucigalpa and one in San Pedro Sula. The arbitration center in Tegucigalpa has handled only eight cases in 3 years. Arbitration is perceived as expensive and there is generally low awareness of ADR.

According to the Constitution, a Superintendency of Companies is to be created to supervise companies operating in Honduras. Some lawyers have asserted that the Superintendency of Companies should provide a better mechanism for improving corporate governance principles. Currently, however, because of the cost associated with setting up a new government office, Congress has not established this agency.

To conclude, implementing institutions in Honduras require significant improvements to cope with the new business that CAFTA might attract. In addition, the present state of the Commercial Registry and the judicial system discourages the growth of local business.

D. SUPPORTING INSTITUTIONS

Articles of incorporation and bylaws must be authenticated by a notary before a company presents them to the Commercial Registry. Notaries certify the identity of parties and the content of documents. In Honduras, not all lawyers are notaries. The Supreme Court is in charge of appointing notaries, who are required to pass an oral examination. The business community has criticized involvement of notaries in the incorporation process; one businessman critical of the role of notaries in transactions stated, “It does not add anything but transaction costs.”

The Tegucigalpa Chamber of Commerce is very critical of the current state of company law in Honduras, and was instrumental in the approval of the Law on Administrative Simplification. The chamber of commerce has expressed interest in reforming the Commercial Code and would like to repeat the experience of other Latin America countries in which the Commercial Registry is managed by the chambers of commerce. The chamber has a help desk that provides assistance in obtaining municipal business licenses. It has also entered into an agreement with the municipality to expedite the process for its affiliates. Obtaining business licenses typically takes

²³ CdCom. Art. 199.

3 months to a year, but with the assistance of the chamber's help desk, the wait can be reduced to 7 days.

The Honduran Council of Private Enterprise, *Consejo Hondureño de la Empresa Privada* (COHEP), is an essential organization for fostering business growth. COHEP makes proposals for policy reform, specifically lobbying for reforms of the Property Law and the Law on Administrative Simplification. COHEP has \$200,000 available for SME financing. With these funds, provided by the Government of Taiwan, the organization grants loans of up to \$5,000 to SMEs under flexible terms.

The National Association of Industry, *Asociación Nacional de Industriales de Honduras* (ANDI), an organization of manufacturing companies, has played an important role in economic and political changes, such as the transition from dictatorship to democracy. ANDI also has extended its influence to promote growth of SMEs. For example, the organization promoted the creation of the *Fundación Coveló*, a foundation for financing SMEs, which has accumulated almost \$25 million to assist small businesses. *Fundación Coveló* provides SMEs with credit lines of up to \$16,000.00 on favorable terms (monthly interest rates of 3 percent versus the 10-percent daily rates that some microfinance institutions charge). The foundation seeks loan guarantees, but guarantees are not required. *Fundación Coveló* is about to launch a bank specializing in SMEs in which credits of more than \$16,000 can be obtained. Currently, the foundation is raising capital to set up the bank.

In Honduras, there are two stock markets: one in Tegucigalpa and one in San Pedro Sula. Neither stock market has the capacity necessary to meet the demands of the private sector in Honduras. The Tegucigalpa market is the larger of the two but is not automated and mostly trades government bonds. Issuance of bonds is expensive and highly regulated. To date, there have not been any equity-based issuances, although a bank recently announced intentions to make such an issuance in the future. It was reported that there are only 144 stockholders in the Tegucigalpa stock market, most of which are banks. In 1999 there was a major financial crisis after hurricane Mitch caused extensive damage to Honduras. The hurricane caused bond holders to liquidate to pay costs associated with the damage. This mass selling caused a liquidity crisis in banks, and the government was forced to bail out many of these financial institutions, spending what amounts to half of the country's gross domestic product (GDP). A new Law on Stock Market was passed as a result of the 1999 crisis, but the market remains in poor condition.

Officials interviewed for this assessment estimated that there are approximately 700 CPAs and 30,000 registered bookkeepers in Honduras. There is an association of CPAs, which certifies and sets the standards for CPAs. This association is drafting a law on accounting and auditing that will create a board to establish standards in those two areas. Currently, accountants nominally follow Generally Accepted Accounting Principles (GAAP), but there is no uniformity in GAAP application and use is not mandatory. The association of CPAs has issued resolutions urging members to follow the international rules of accounting, International Accounting Standards (IAS) and International Standards on Auditing (ISA), but these standards are rarely used.

The *Comisión Nacional de Bancos y Seguros* (CNBS) has supervisory authority over banks, insurance companies, and the stock market. It requires banks, insurance companies, and stock markets to submit audited financial statements. However, not just any accounting firm may audit

statements; only CNBS-certified firms are allowed to do so. In addition CNBS requires that financial statements audited by CPAs be presented for a bank to grant a credit.

E. SOCIAL DYNAMICS

The Tegucigalpa Chamber of Commerce has expressed concern about the Commercial Code. It has asked the national government at the executive and legislative level for a new Commercial Code that would not require companies to submit evidence of equity capital, would allow divestiture and wholly owned subsidiaries, and would provide stricter corporate governance principles. A group of lawyers has made the same demand and has proposed that instead of an overall reform of the Commercial Code, a law on companies be passed to address these issues.

The Commercial Registry requires reform and automation. The Law on Administrative Simplification has helped but does not address all salient issues. The World Bank–Inter-American Development Bank project on competitiveness will be of some help in reducing regulatory hurdles, but the project does not direct sufficient attention to the Commercial Registry to drive the comprehensive changes that are necessary.

Honduran firms need access to capital, and the current stock market does not provide such means. To create a mechanism to fill this gap, the stock market should be modernized and properly regulated. The pending law on the stock market would increase corporate governance principles for participating firms, and the CNBS would maintain regulatory responsibilities; however, there will still be a need to automate securities transactions. Illustrating the continuing problems, *Transportes Aéreos Centroamericanos* (TACA), the Salvadoran airline, tried to issue bonds in Honduras guaranteed with credit cards and accounts receivable. In the end, TACA was unable to issue the bonds because of excessive regulations and the unsophisticated market and instead made the issuance in Panama.

SMEs hold the potential to be an enormous engine of growth but are currently limited by various factors. Bureaucratic requirements, low access to credit, and heavy tax burdens now limit SME growth. There are roughly 64 entities devoted to financing SMEs, but high interest rates, guarantee requirements, and lack of coordination among these organizations have limited their ability to provide SMEs with needed assistance.

The tax system also is in need of reform. The tax burden is scattered among many different taxes, and collection rates are low. The government has attempted to compensate for this low collection rate by creating new taxes, which only serve to increase the complexity of the tax system, thus making collection more difficult and encouraging further evasion. In an effort to increase revenue, the government has increased easily enforceable direct taxes, which tend to increase the burden on low income groups who traditionally consume a larger percentage of their income than higher income groups.

Finally, the judicial system must be reformed to make it faster, automated, reliable, and independent. All Hondurans, even members of the judiciary, demand a better judicial system and quicker judicial procedures. But nothing is happening. ADR mechanisms need to be accessible to all Hondurans and well known by the whole business community, regardless of the size of the business.

F. RECOMMENDATIONS

- ◆ The Commercial Code needs reform to cope with new corporate realities. An alternative to a comprehensive reform of the Commercial Code would be to pass a law on companies. Regardless of the type of reform, the capital equity requirement and the requirement that companies have a minimum of two shareholders should be removed. Companies should also be allowed to own their own shares. Minority shareholders should be granted greater protection, mainly in connection with the 25-percent ownership requirement to participate in the appointment of a director. In the case of disagreement with administrators, minority shareholders should also have the clear legal option to sell their shares at market value. The reform should include provisions for divestiture, provisions to prevent the abuse of legal personality, and an increase in corporate governance principles.
- ◆ The Commercial Registry should be modernized. The World Bank–Inter-American Development Bank competitiveness project and the pending establishment of the *Instituto de Propiedad* should be monitored, and current efforts to improve the registry should be complemented by more comprehensive changes. The El Salvador Commercial Registry provides a good regional benchmark for reform of the registry.
- ◆ There is need for a comprehensive examination of the regulatory steps involved in doing business. While these steps have already been reduced, there is still too much red tape associated with conducting business. The World Bank–Inter-American Development Bank competitiveness project will address some of these issues, and the project should be monitored and complemented when needed.
- ◆ The stock market should be revamped. First, the market should be automated. In addition, trading companies should be subject to stringent monitoring of market use. In addition, a promotional campaign about the advantages of the stock market should be directed at businesses of all sizes. Regulations of the market should be harmonized with those of the rest of the region. A regional stock market should be considered a priority. The Central American Stock Market, already in place in Honduras, should be strengthened from the standpoints of regulatory and technological standards.
- ◆ The tax system should be evaluated, and institutional and legal reforms should be considered. Regarding legal reform, the unfavorable tax treatment of mergers should be removed. An assessment of the business asset tax and the solidarity tax that considers the possibility of consolidating taxes is necessary. Institutionally, the tax collection agency should be automated, and strategic planning and management techniques for tax collection should be introduced.
- ◆ A thorough assessment of the status of the SMEs and the size of the informal sector is needed. The study should pay particular attention to issues such as access to credit, regulatory burdens, and the potential for cluster development. Providing SMEs with the option of obtaining special status, similar to the 8(a) certificates issued by the Small Business Administration in the United States, that would provide preferential access to credit and government contracts, could help harness the latent potential of small firms. Such a process would also increase the propensity of SMEs to formalize by providing

incentives for incorporation. A regional donors' conference to generate capital for the establishment of financing institutions specializing in assisting SMEs could address some of the credit issues faced by small businesses and increase integration of micro-finance institutions.

IV. CONTRACTS

A. INTRODUCTION

Although it is not difficult to enter into contracts in Honduras, problems lie in the absence of legal provisions for novel contract types and in inadequate supporting institutions.

Modern contracts, such as leasing, franchising, factoring, and electronic contracts, are not addressed by the current legal framework for contracts. Distribution agreements are unfavorably regulated on behalf of local distributors. Powers of attorney granted in a foreign country, including other Central American countries, are not valid unless they pass through a complicated process of legalizations and permits.

Contract enforcement is complicated, slow, and expensive. The judicial system is ill prepared to deal with international business. Although the Supreme Court was recently appointed through a transparent mechanism, public concerns remain that reforms may meet resistance. Alternative dispute resolution mechanisms for contract enforcement are neither widely present nor widely utilized.

Lawyers, in general, are not well trained in international business principles.

B. LEGAL FRAMEWORK

The Civil Code provides the main legal principles for contracting. This code allows parties to form contracts on anything, provided it is not expressly prohibited or contrary to public order or custom.²⁴ If the parties to the contract are companies or businesspeople, or the contract pertains to commercial matters, the Commercial Code applies accessorially to the Civil Code.

To form agreements that are not explicitly covered by law, such as leasing, franchising, factoring, and electronic contracts, parties devise custom-made contracts. Without explicit law, the potential for enforcement of such customized contracts is dubious. Electronic commercial transactions are at risk of not being recognized because there is no legal certainty as to when an electronic contract has formed, and about the legality of electronic signatures. There is fear that fraud could be committed electronically in the course of commercial transactions given the absence of legal protection.

There are references to leasing in the Law on Financial Institutions and the Law on Sales Tax; however, there is no comprehensive law governing these contracts. There is a Law on Sell by Installment without Transferring Title through which a person can buy a movable asset such as a car by paying in installments. In these cases, property can be used during payment, but title is not transferred until the entire price is paid. Such contracts differ from leasing contracts because, in the latter, there is no commitment to transfer property. If an asset is returned in a Sell by Installment without Transferring Title, the buyer can receive a portion or sometimes the complete payment.

²⁴ CdCom. Art. 1564.

Although the system is formalistic in many regards, parties are free to assign any name to a contract. A contracting party will sometimes disguise a contract by assigning a name that would enhance that party's rights, but courts are supposed to look at the nature of the agreement rather than its assigned name to determine the contract's effect. For example, it is common for landlords to disguise rental agreements as not-for-payment loans supplemented with letters of credit to facilitate eviction of a tenant. Such contracts should not be honored by a court if it is proved that the nature of the contract is that of a rental agreement.

Distribution and representation contracts are subject to a special law passed in the 1970s, which is disproportionately protective of the interests of local distributors.²⁵ To validate such a contract, parties must register the contract at the Industry and Trade Ministry. If the contract is terminated by the foreign company, the local distributor is entitled to compensation equal to the average annual net income it has received over the last 5 years of the contract's life. In addition, in cases of unilateral cancellation, the local distributor can obtain an injunction to prohibit further distribution of the products it was distributing before the contract was terminated. Similarly, distribution contracts are not subject to foreign jurisdiction and cannot be governed by foreign entities. As a result of these conditions of distribution and representative contracts, many foreign companies are reluctant to introduce their products in the Honduran market.

In general, contracts do not require notarization. But certain kinds of contracts, such as sale of real property and mortgages, do require authentication. Entering into oral contracts is nominally possible for amounts of less than \$10. Such a low threshold serves to make the allowance of oral contracts irrelevant.

Powers of attorney are required whenever someone is authorized to undertake an activity on behalf of another party. In Honduras, powers of attorney must be authenticated by a public notary. Because Honduras is not a signatory of the Inter-American Convention on the Legal Regime of Powers of Attorney Abroad, a power of attorney granted in a foreign country, even a Central American country, must be legalized by the Honduran consulate in the foreign country and then authorized by the Ministry of Foreign Affairs. The process of authenticating foreign powers of attorney is long, tedious, and expensive and tends to discourage their use. If a power of attorney is to be used abroad the authentication process is even more tedious. First, the statement of power of attorney between parties must be notarized. It then must be taken to the Supreme Court for approval and notarized by a notary recognized in Honduras. Next, the document must be taken to the Ministro de Gobernación to verify the authorization of the Supreme Court. The document must then be ratified by the Ministry of Foreign Affairs. Finally, the power of attorney is taken to the consulate of the foreign country for approval.

The Law on Government Contracts governs contracts with the government for sale or purchase of goods and services. Under the terms of this law, government contracts are subject to special requirements, such as a public bidding process. In some cases, the bidding process has been perceived by interviewees to be corrupt. Suits can be filed against an allegedly unfair bid, but the risk of being blacklisted because of such actions is so high that no suit has ever been brought

²⁵ See the Law of Agents, Distributors, and Representatives of National and Foreign Enterprise, *Ley de Representantes, Distribuidores y Agentes de Empresas Nacionales y Extranjeras*.

against the bidding process. In fact, the challenging party is ineligible for government contracts for a period of up to 2 years after issuing the suit.

The Law on Government Contracts favors the government in many respects. If the government is found liable for a suit against it, the compensation it pays carries interest rates that are below market rates. The same treatment does not apply if a private party is found liable and needs to compensate the government.

In labor matters, parties are not free to contract at their discretion. Parties cannot waive certain stipulations, and some provisions are automatically included in labor contracts regardless of the content of written agreements. For example, contracts cannot allow for night shifts, nor can employers typically dismiss an employee without paying large compensation.

Honduras's legal framework for contracts should be improved to meet the needs of domestic and foreign commerce; modern contracts are not included in the legal framework, distribution agreements are biased toward local parties, government contracts are unfair, and powers of attorney from abroad or to be used abroad are hindered by bureaucracy.

C. IMPLEMENTING INSTITUTIONS

In Honduras, lawyers are allowed to practice law immediately after graduating from law school. Interviewees estimate that there are around 16,000 lawyers in Honduras. Although, in the past, lawyers had to fulfill certain requirements before being admitted to practice law, there are currently no requirements besides graduation from law school. Lawyers are ill prepared in matters relating to international business transactions. Approximately 90 percent of lawyers have never taken a course in international business law and lack knowledge regarding basic business principles. According to interviewees, deficiencies in commercial law training are due, in part, to an educational emphasis on local criminal law.

Lawyers become notaries after passing an oral examination administered by the Supreme Court. Several sources have alleged that this examination is biased.

Notaries are supervised by the Supreme Court, but supervision is weak because the court is unable to devote much attention to its supervisory role because of other responsibilities. According to interviewees, a lack of sufficient supervision has led to instances of fraudulent behavior by notaries. For instance, many persons reported that it is common practice for notaries to state that they have verified a transaction before the transaction has occurred. As a result of this practice, one person's right—usually that of the person whose document is fraudulently authenticated—can appear to prevail over other's right.

Court procedures are slow. It was reported that it could take up to 5 years to reach a trial court decision on credit collection in a purely written procedure. Appellate and Supreme Court procedures could add an additional 10 years to the wait. The constitutional action of *amparo*, which in theory is a mechanism to quickly rule on a constitutional offense, can take the Supreme Court up to 2 years to conclude.

The Supreme Court is composed of 15 justices serving 7-year-terms. These judges are elected by Congress from a list of 45 candidates provided by civil society organizations. Candidates are meant to reflect the best of the legal profession, having been selected by independent groups after a close examination of professional and academic credentials. Currently, eight justices are members of the ruling party and seven are members of the opposition party.

Lower court judges are selected by the Supreme Court after an open submission of credentials in accordance with the provisions of the Law on Judicial Career passed in 1980. However, the merit-based system the law intended to create has not improved the perception that judges are selected mainly on the basis of political recommendations. In addition, through a narrowly approved Supreme Court resolution, judges are now appointed by the President of the Supreme Court rather than by the court as a whole. Similarly, judges can be removed at the discretion of the President of the Supreme Court.

Comments from many sources suggest that judges are poorly paid and trained. There is a judicial school under the authority of the Supreme Court, but its courses are outdated and do not provide practical training. Because they are appointed through political connections and can be removed by the same means, some judges may be influenced by politicians. Bribery has also been mentioned as a growing problem, which might be linked to the issue of low pay for the judiciary.

Enforcing Contracts (2004)

The ease or difficulty of enforcing commercial contracts in Honduras is measured below, using three indicators: the number of procedures counted from the moment the plaintiff files a lawsuit until actual payment; the associated time; and the cost (in court and attorney fees), expressed as a percentage of debt value.

Indicator	Honduras	Regional Average	OECD Average
Number of procedures	36	35	19
Time (days)	545	462	229
Cost (% of debt)	33.1	23.3	10.8

Source: World Bank

In summary, most lawyers and judges are not well versed in international business transactions, leaving many foreign businesses unable to access sound local legal representation and unsure of trial outcomes. Notaries have authority to authenticate a contract, but this authority is not monitored, leaving room for the emergence of fraud. Each of these factors impedes the flow of foreign investment and consequently affects the possibility for economic growth and alleviation of poverty.

D. SUPPORTING INSTITUTIONS

After the Law on Alternative Dispute Resolution was passed in 2001, two arbitration centers were created in Honduras: one in Tegucigalpa and one in San Pedro Sula. The center in Tegucigalpa is part of the local chamber of commerce and has been in place for 3 years; it has 28 listed arbitrators and has handled 8 arbitration cases and about 20 conciliations. Cases are typically settled within 3 months, although one case lasted 18 months because an *amparo* was filed to annul the arbitration clause. No annulment procedure has been initiated against any

arbitral award. It is expected that the Tegucigalpa arbitration center will be operating at full capacity in 5 years. The center is focused on national arbitration and arbitrators' training. The director of the center has said that foreign language arbitrations can be handled, provided that awards are translated into Spanish, but foreign language arbitration has yet to take place.

In Honduras it is mandatory to be part of the bar, *Colegio de Abogados (Colegio)*, to practice law, although there are no special requirements for gaining admission to the *Colegio*. The *Colegio* has authority to suspend lawyers through the *tribunal de honor* but rarely does so.

The *Colegio* has a division specializing in issues related to notaries called *Instituto de Notariado*. The *Colegio* provides training to lawyers but has no mandatory requirements for continued legal education.

The federation of private business, *Consejo Hondureño de la Empresa Privada (COHEP)*, has organized conferences on rule of law issues and has presented documents with relevant proposals. COHEP has also lobbied the government for various reforms.

E. SOCIAL DYNAMICS

Binational chambers of commerce, such as the Honduran-American Chamber of Commerce, have demanded changes in the law on distribution contracts to make them fair to the owners of the products and hence to foster opportunities associated with the introduction of foreign goods and firms. There are, however, no pending initiatives that would correct the imbalance in these contracts. If CAFTA is approved, the domestic law for distribution contracts would be indirectly repealed by the treaty's negotiated provisions related to distribution contracts.

Banks have requested legal certainty for electronic transactions and electronic signatures to provide a clear legal context for incorporating such transactions and avoiding fraud. As in the case of distribution contracts, however, such provisions have not been adequately addressed by the government.

The chambers of commerce have proposed a reduction in the bureaucratic steps needed to notarize powers of attorney granted from abroad and those to be used abroad. Nevertheless, steps have not been taken to reduce or simplify these procedures.

There is wide agreement regarding the need for judicial reform. Nonetheless, no substantial reform initiatives are imminent. The Law on Judicial Career is not applied by the Supreme Court and has thus been largely unable to create the changes it was intended to make.

The business community demands quicker judicial procedures. Some proposals point to the need to implement oral procedures. The Supreme Court is working on a new civil procedure code, but although the new code incorporates some oral procedural steps, procedures will remain primarily of a written nature.

Arbitration centers should be promoted as an alternative means of enforcing contracts. There is a sense among some businesspeople that arbitration could help solve disputes quickly and allow businesses to circumvent the judicial system until improvements are made.

F. RECOMMENDATIONS

- ◆ Legal reforms are needed in contract law to provide legal certainty to modern business practices. Laws on leasing, franchising, factoring, electronic contracts, and electronic signature should be drafted and approved.
- ◆ The Law on Distribution Contracts should be reformed to eliminate bias against foreign actors. If CAFTA is not approved, a working group should be set up and a new law on distribution contracts should be drafted and approved.
- ◆ The steps needed to notarize a power of attorney to be used abroad and to legalize a foreign power of attorney should be reduced. A working group should be appointed to address this issue and to determine whether Honduras should become a signatory of the Inter-American Convention on the Legal Regime of Powers of Attorney Abroad.
- ◆ The judicial system is in need of significant reform. An independent body should be created to appoint, train, and monitor judges. Civil society should be significantly represented therein. The Law on Judicial Career should be applied.
- ◆ The legal profession in general should undergo reform. Admissibility requirements for lawyers and notaries should be stiffened and rigorously enforced. Consideration should be given to international practices such as an admission or bar examination and mandatory continuous legal education for lawyers. Similarly, law schools should be subject to strong control and supervision.
- ◆ Legal education should be reformed and modernized. Law schools should both have a required core curriculum and be allowed to implement modern legal themes into their programs. Law schools should promote student specialization during the final portion of programs through provision of elective courses. Existing lawyers and judges should be trained in the importance of rule of law, basic legal principles, international law, international business law, foreign jurisprudence, and doctrine such as “substance over form,” and economic analysis of law. Using a case methodology to teach lawyers and judges allows greater flexibility in interpretation of the law and should be encouraged. Overall legal education reform should include training in basic legal principles for common citizens to give civil society the means of monitoring the rule of law and shaping the greater legal climate.
- ◆ More arbitration centers should be created. Specialized arbitration centers devoted to settling disputes of SMEs should be created to handle the specific needs of this important economic sector. Similarly, a promotional campaign on the use of alternative dispute mechanisms could increase the use of these valuable alternative means of legal settlement. Through legal reform and training of judges, the use of *amparo* should be restricted to exceptional cases when an arbitration award or arbitration clause is involved.
- ◆ The draft civil procedure code should be updated. Oral procedures should be the standard. International experts should advise on cases in which oral procedures are viable as well as on the types of oral procedures to be included in the civil procedure code. The new code also should allow official communications to occur electronically, by fax, and

by certified mail to expedite the processes. Judges and lawyers should be trained to handle oral procedures.

V. REAL PROPERTY

A. INTRODUCTION

A major reform in the area of real property is currently being implemented in Honduras through the Property Law, (*Ley de Propiedad*, or LdP), which entered into force on June 29, 2004. The primary purpose of this law is to rationalize the country's chaotic property system by recognizing settlers' rights, resolving title disputes, and modernizing the Property Registry.

The LdP includes the creation of a new entity in charge of property matters, *Instituto de Propiedad*, which will have authority over, *inter alia*, real property registration and a national cadastre map. The new property system is expected to be fully in place in January 2005. The LdP created a transition period during which information from current registries would be transferred into the new system. During the period of the assessment, registries' employees reported that the procedures during the transition period were unclear and that they thus used the old property and registry system by default.

The real property system has a profound effect on credit markets because mortgages are the primary form of guarantee accepted by creditors. Because land tenure is usually unclear mortgages and thus credit are difficult to obtain. A survey conducted by a World Bank project in 2004 showed that only one in nine property titles is free of discrepancies.²⁶ In cases in which credit is provided, the ambiguity of ownership creates added risks for creditors, which in turn charge high interest rates, further decreasing access to credit. Securitization of land or land titles does not occur.

An added problem, as recounted elsewhere in this report, is that the judicial system in Honduras is unreliable. Execution of real estate guarantees is slow and difficult, thus discouraging investments in real estate.

Overall, the current state of the Honduran real property system discourages foreign investment and the growth of local business. Current reform initiatives, if successful, could play a large part in enhancing the business climate and allowing for economic growth.

B. LEGAL FRAMEWORK

Since June 29, 2004, two sets of law have had authority over real property in Honduras: the Civil Code and the LdP.

1. The Civil Code

The Civil Code provides for real property purchase, acquisition, donation, use, rent, mortgage, lien, and legal protection.

²⁶ The survey was conducted in 2004 by the World Bank's *Programa de Administración de Tierras de Honduras* (PATH) project, which is discussed on page V-5 of this report.

Under the code, property can be transferred by owner consent without governmental authorization.²⁷ However, for a title transfer to be valid vis-à-vis third parties, the transaction must be registered.

Foreigners cannot acquire coastal property within 40 kilometers of the shoreline. If a transaction involving such an acquisition took place, it would be considered null and void. Under the Constitution, however, the Tourist Law contains special provisions regarding foreign purchase of urban properties regardless of their proximity to coastal zones. For example, the Bay Islands were declared urban territory and are thus purchasable by foreigners. The provision regarding urban land is an important safeguard for foreigners purchasing land on the islands of Roatan and Utila.

2. The Property Law

Only 14 percent of Hondurans who occupy properties do so legally.²⁸ The remaining 86 percent of Hondurans hold property outside the scope of the law, with extralegal land possession amounting to \$12.4 billion.²⁹ Of properties held legally, only 30 percent are registered. Indicative of the vast gap in property registration are the statistics for Comayagua Department where, of 146,000 lots, only 45,000 are registered and only 15,000 are registered correctly.

A repercussion of the property rights system is its effect on credit attainment. Because banks almost always require mortgages to secure credit, low rates of land ownership and confusing land ownership denies credit to the majority of Hondurans. The ambiguity of the systems increases banks' risk; therefore, creditors ask for guarantees of 150 percent of the value of loans. Even when borrowers meet high guarantee requirements, interest rates are the highest of any Central American country at 14 percent for US dollar-denominated loans.

Registering a property is slow and expensive. It was said to take an average of 2 years and \$1,000 (added to the cost of the property) to purchase, subdivide, and begin building on a property.³⁰ Confusion in the title system is seen in the prevalence of double and, in some cases, triple title holders, errors which are attributable both to clerical error and to fraud.

In the face of this precarious system, in 2001 a presidential commission was entrusted with the responsibility of designing the legal and institutional framework for a new property system. On May 27, 2004, the National Congress unanimously approved the LdP. The LdP switches the tenure system from a per-person filing land tenure system (*folio personal*) to the current property filing system (*folio real*).

The LdP recognizes property rights for settlers on municipal land who have maintained possession for longer than 5 years. In addition, it provides for a system to individualize pieces of rural properties upon which rights to use but not property rights were granted to different persons over many generations.

²⁷ Civil Code (CC), Art. 1630.

²⁸ See the Honduras Country Diagnosis Report by the *Instituto Libertad y Democracia*, available at http://www.ild.org.pe/eng/hon_post_en.htm.

²⁹ *Id.*

³⁰ *Id.*

Lawyers' and judges' objections to the new system seem to stem, in part, from the fact that the role of notaries would be largely eliminated in the system. Some justices have expressed concern about reforming the traditional Spanish-colonial registry but were unable to provide evidence that changes would violate the Constitution. One justice admitted that the LdP was necessary but foresaw problems in integrating registries and a national cadastre. The same justice said that if the LdP were declared unconstitutional, it would only be declared so in a partial sense.

Currently, perhaps because of the complexity of the issues involved, there is a lack of knowledge regarding the intentions and forecasted benefits of the LdP as it pertains to the daily lives of Hondurans.

The Supreme Court's ruling on the law may be a source of conflict. Supreme Court decisions regarding unconstitutionality must be published by Congress to take effect.³¹ When asked about their contingency plan if the Supreme Court were to declare the law unconstitutional, a member of the presidential commission in charge of drafting the law stated that the court's failure to ratify the law could create a constitutional crisis if Congress refused to publish the mandate of the Supreme Court. The Supreme Court disputed Congress's ability to circumvent its decisions stating that its decisions are valid immediately and that failure to publish does not affect the validity of a ruling. A Supreme Court justice said that if Congress denied publication of the decision, the Supreme Court could order its publication.

Honduras has a National Zoning Law *Ley de Ordenamiento Territorial*, to cover all zoning issues. Under the Law on Municipalities, or the *Ley de Municipios*, municipal authorities encourage participation of civil society before issuing zoning plans. Building of any kind requires a construction permit, which must accord with the municipal zoning plan.

Under the old system, valid until January 2005, there was a tax on transfers of real property based on the property's value. The tax was 4 percent for urban unimproved property, 3 percent for urban built property, 3 percent for rural unimproved property, and 2 percent for rural built property. If the LdP is passed, the tax will be reduced to 1.5 percent of the value of purchase price for all land categories. Registry fees, currently at \$0.30 for each \$50 of the property's value, will be eliminated entirely. There is also an annual municipal tax on land use, calculated at 3 percent of land value for properties valued at greater than \$5,400.

Non-liquid rights on real property, such as a portfolio of mortgage credits, cannot be secured and converted into tradable instruments. Securitization of real property rights and issuance of bonds secured with mortgage portfolios are prevented by the absence of laws on securitization and an underdeveloped stock market.

In summary, Honduras has a chance to dramatically improve its property system through the correct and peaceful implementation of the LdP. Such changes would provide access to capital and credit for millions of the country's citizens. Besides providing access to capital and credit, the LdP would improve the business climate and create an environment conducive to growth. There is, however, a need to build political consensus to avoid a constitutional crisis and ensure implementation of the LdP.

³¹ Const. Art. 216.

C. IMPLEMENTING INSTITUTIONS

The LdP created the *Instituto de Propiedad* as an independent body to govern the registration of real property. This entity will oversee real property registries, which are now dependencies of the Supreme Court.

The registry of Tegucigalpa, which has authority over property and commercial matters, is in poor condition. Within the registry, transactions are recorded manually by staff in books in which information is indexed according to the persons involved in the transaction (i.e., *folio personal*). The registry's books are kept in an insecure form, and some of the books are damaged and contain loose documents. The registry is not automated and only two computers, used for word processing, are present in the facility. Inadequate staffing exacerbates the lack of automation. According to interviewees, a permanent staff of 59 employees is responsible for processing, by hand, the 400 documents received daily.

Registration of property can take as long as 3 months, and submission of a cadastre map is not required. Because of uncertainty regarding procedures during the current transition period, the registry has continued to operate under the old property system.

Some lawyers interviewed complained that the LdP has created chaos during the transition period. One lawyer stated that, although the new law states that registry fees should be 1.5 percent of land value, the old 3-percent fee is still charged because of poorly trained staff and lack of supervision. Evidence of poor training is found in the comments of registry employees, who said that even though property transactions should be recorded in a pre-written form based on the new law, they would reject a transaction presented in such a form. Lawyers also mentioned that the new law's creation of the *Instituto de Propiedad* creates additional bureaucracy for which the government lacks funds. The presidential commission for property reform disputes the notion that the *Instituto de Propiedad* increases bureaucracy and maintains that the new body will have sufficient funds to modernize registries and pay registry employees based on the increased number of property transaction registrations that will result from the reform.

The LdP is intended to be fully in force by January 2005. According to the plan outlined for the transition period during the last quarter of 2004, registries will be evaluated, staff will be changed and trained, and the society at large will be advised about the benefits and changes associated with the LdP. At the State Reform Commission, it was reported that it would take from 2 to 3 years to strengthen the property system.

Registering Property (2004)

The ease with which businesses can secure rights to property is measured below using the following indicators: the number of procedures necessary to transfer a property title from the seller to the buyer and the time and the costs as a percentage of the property value

Indicator	Honduras	Regional Average	OECD Average
Number of procedures	7	6	4
Time (days)	36	56	34
Cost (% of property per capita)	8.8	5.6	4.9

Source: World Bank

In contrast to the registry of Tegucigalpa, the registry of the city of Comayagua is automated thanks to an automation process that began 12 years ago. The executive officer of the *Instituto de Propiedad* said that two other registries would be automated by the end of the year.

There is no national cadastre although there is a cadastre law. Municipalities have cadastre maps that are used to determine municipal taxes on land use. Interviewees estimate that 62 percent of the territory of Honduras is recorded in some kind of cadastre map, but information between cadastres is not integrated and often outdated.

Under the auspices of the World Bank, Honduras recently initiated a project to automate, consolidate, and make public all property information. The \$140 million, 12-year project, named *Programa de Administración de Tierras de Honduras (PATH)*, is meant to strengthen the *Instituto de Propiedad*, which will be in charge of registries, cadastres, and land dispute resolutions. An experimental project within PATH recently created a unified system of registration, called *Sistema Unificado de Registro (SURE)*, which will be accessible online. Using the new system, a data query, which previously took 6 to 9 months, was completed in 1 minute. Under PATH, it is expected that property information, currently dispersed amongst 26 entities, will be consolidated and accessible through SURE within 4 years. It is expected that automation and information consolidation of the registries of Tegucigalpa and San Pedro Sula, the two largest cities, will be finished in 2 years and that automation and consolidation of the registry of the Bay Islands will be finished in the next 6 months.

A fully functional version of *SURE* could decrease fraud by providing a mechanism to measure the dimensions of the land electronically and allow property transactions to occur via the Internet by use of specialized scanners. The *Instituto de Propiedad* would certify persons allowed to use the scanners, expected to be banks and real estate brokers, to send information to the Property Registry electronically. Interviewees estimate that this electronic system would reduce registration time from three months to one day.

Concerns exist regarding the current Supreme Court and its commitment to reform. New justices were appointed two years ago through a transparent process that involved the civil society, yet even though their mandate was to change the judicial system, these justices have not yet engaged in such reforms. The Supreme Court has rejected many reforms, and indirectly opposed reform in cases in which they lack final authority. In one case, the *Colegio* disbarred all 15 justices over its resistance to proposed reforms to the legal profession.

The U.S. Heritage Foundation gave Honduras a score of four on protection of property rights (five being the lowest possible score).³² The foundation pointed out, "Protection of property is somewhat weak. According to the Economist Intelligence Unit, "[T]he judicial system in Honduras has long been criticized for its biases, inefficiency and lack of independence. It can

³² See Heritage Foundation Index of Economic Freedom, available at <http://www.heritage.org/research/features/index/country.cfm?id=Honduras>

take years to prosecute and pass judgment on a case, and the number of cases pending resolution has increased considerably over the past few years.”³³

Expropriation of property is possible. According to the U.S. Department of State, “The Honduran government generally expropriates property for purposes of land reform (usually related to a land invasion by farmer groups) or for public use such as construction of an airport. Land disputes related to actions by the Honduran National Agrarian Institute (INA) are common for both Honduran and foreign landowners. According to the National Agrarian Reform Law, idle land fit for farming can be expropriated and awarded to landless poor. Generally, an INA expropriation case begins after squatters target and invade unprotected property. In most cases, claimants have found that pursuing the subsequent legal avenues is costly and time consuming, and rarely leads to positive results. Compensation for land expropriated under the Agrarian Reform Law, when awarded, is paid in 20-year government bonds. Based on newly available evidence of significant expropriation, Honduras’s property rights score is 1 point worse this year.”³⁴

Alternative dispute resolution mechanisms are available to settle property claims. In 2002 a law was passed providing for conciliation and arbitration. There are two arbitration centers in Honduras—one in Tegucigalpa, one in San Pedro Sula. The chamber of commerce manages the arbitration center of Tegucigalpa. It is expected that the Tegucigalpa center will be operating at full capacity within 5 years. The center has been in place for almost 3 years and has managed eight cases. There have been workshops to promote the arbitration centers, but only businesses have shown interest in their services.

The institutions that implement the real property legal framework are disorganized. Passing and implementing the LdP, however, along with the creation of the *Instituto de Propiedad*, would mark a significant step in making registration of property transactions an easy, timely, and inexpensive process. Such improvements will tremendously enhance opportunities for wealth creation, investment attraction, and economic growth.

D. SUPPORTING INSTITUTIONS

Until the LdP is fully in place, real estate transactions need to be public, that is, they must be authenticated by a public notary.

Notaries in Honduras are lawyers that have been approved by the Supreme Court after passing an oral examination. The Supreme Court devises the examination on a case-by-case basis. Within the *Colegio* there is division for notaries named *Instituto de Notariado* meant to study and analyze notary-related issues.

Under the LdP, notarization and registration of property transactions could be completed electronically. In addition, the *Instituto de Propiedad* will issue electronically formatted documents for commonly requested forms, to be accessed online by the registering party.

³³ *Id.*

³⁴ Heritage Foundation, Economic Freedom Index for 2004.
<http://www.heritage.org/research/features/index/countries.html>

A Real Estate Brokers' Chamber of Commerce has existed for 10 years. The chamber has 78 corporate members, which played an important role in lobbying on behalf of the LdP. In general, the chamber's members are enthusiastic about the benefits the new law will bring and look forward to the opportunity of "professionalizing" their profession. Interviewees expressed a belief that many of the frauds committed regarding real property are performed under auspices of purported brokers. To increase professional standards, the real estate chamber of commerce has developed a special 5-month diploma course for would-be brokers. In addition, the chamber is working on a bill to regulate, enhance professional standards, and set admissibility requirements for the profession of real estate brokers.

Several companies provide escrow and title guaranty services devoted to protecting the potential buyer and indemnifying losses.

E. SOCIAL DYNAMICS

Regularization of land tenure is a national priority, and the national government has built significant popular support for the LdP. Unfortunately, cases before the Supreme Court threaten to delay the law. The Supreme Court will decide on two or three challenges to the constitutionality of the law in the near future. The Attorney General issued a nonbinding legal opinion in support of the law and civil groups have threatened to demonstrate at courthouses if the law is repealed. The World Bank *PATH* project will assist in the automation and integration of registries planned under the LdP. However, the fact that the LdP could be declared unconstitutional places many of the existing reforms at risk.

Under the LdP, authentication of transactions will still be necessary. Because the law allows for electronic authentication, however, persons besides notaries will be authorized to validate and process property registrations. The Supreme Court is working on a statute under which stronger admissibility requirements would be imposed on notaries. The bill would restrict non-notary authentication of property transactions, however, and in fact would undermine the efficiencies the LdP was intended to create.

The Law on Judicial Career, *Ley de Carrera Judicial*, offers the legal framework for accountability and monitoring of legal professions, but judges are allegedly still appointed and removed through outdated procedures that no longer comply with the law. The business community has voiced demands for quicker judicial procedures. The Supreme Court is now working on a draft civil procedure code; however, this does not provide for oral procedures, but rather for a combination of written and oral procedures. The reluctance to embrace a full-scale oral-based system is attributable to the perception of the change as a costly reform for which there are no funds.

There is a housing deficit in Honduras. The size of the deficit is formidable, but there have been no comprehensive studies to determine the extent and distribution of the crisis. Properties can be bought for as little as \$20,000 at an interest rate of 24 percent in local currency and 14 percent in US dollars, according to interviews conducted for this assessment. There are currently no government-led plans to supply housing to those in need. The *Fundación Covelo*, a philanthropic entity set up by the industry association, is working with a nongovernmental organization

(NGO), International Action, to build low-income housing, but the scale of the effort will leave the majority of the housing deficit untouched.

F. RECOMMENDATIONS

- ◆ Ongoing regularization efforts of the Honduras property system should be monitored and supported. Further consensus needs to be built to assist reform. Working groups of justices, lawyers, members of the presidential commission on property reform, members of the chambers of commerce, and civil groups should be created to push and discuss reform. These working groups should be aided by international experts on property reform, who should mediate discussions between the LdP's supporters and opponents. Working groups on additional reforms pertaining to the property system, such as guarantees and judicial procedures, also should be established, with aid from international experts. Workshops on the LdP should be offered in law schools, the *Colegio*, lawyers associations, and the *Instituto de Notariado*.
- ◆ Pending initiatives, such as reform of the Property Registry, integration of cadastre data, establishment of a unified national registry system, and establishment of the *Instituto de Propiedad* should be monitored and complemented where necessary. The World Bank project seems to be the right assistance at the right moment.
- ◆ The Honduran judicial system needs reform. First, appointment of judges should be in accordance with the Law on Judicial Career. An assessment of the current condition of the judge selection process is needed. In addition, establishment of an independent body for administration of the judiciary should be considered. Moreover, a new civil procedure code should be drafted under which civil procedures, in general, and property dispute procedures in particular, are conducted orally.
- ◆ A law on securitization of real estate rights is necessary to create financing mechanisms for construction projects. Such a law should be drafted and consensus built for its approval.
- ◆ Honduras received \$1 billion in remittances last year.³⁵ Allowing remittances to be directly invested in local real estate would provide Hondurans living abroad with the opportunity to invest locally while contributing to the development of a real estate market. To allow for such investments, the *Instituto de Propiedad* should coordinate necessary reforms. An action plan should be designed and implemented to supply the technological capacity to banks and stock markets for electronic purchases and to strengthen the institutions involved with the new investments through management, information technology, and financial training. Finally, the *Instituto de Propiedad* should conduct an educational campaign for Hondurans living abroad about the opportunities available through the real estate electronic investment mechanism.

³⁵ Honduras Comportamiento Económico 2004, Banco Central de Honduras, available at http://www.bch.hn/download/comportamiento_economia_2004.pdf.

- ◆ A law on real estate brokers should be enacted to increase performance and admissibility standards. Through an agreement between the United States and Honduran real estate brokers, Honduran properties could be offered in the United States.

VI. COLLATERAL

A. INTRODUCTION

Honduras has legal mechanisms capable of creating security interests in the various movable goods that provide the bulk of the world's wealth today. However, these mechanisms have not been developed in practice and use. The laws also lack the refinements that drive modern secured transaction schemes. Specifically, the system lacks provisions that would (a) permit securitization arrangements, or loans secured by a set of debt or title instruments (such as mortgages, to cite a common example); (b) enable registration of a summary reference form that would fix the priority of a given creditor for a series of transactions secured against the movable assets of a given debtor; (c) allow purchase money security interests to preempt earlier security interests; or (d) permit buyers in the ordinary course of business to take collateral free of a creditor's guaranty.

Moreover, the legal procedures for execution in the case of default, while relatively expeditious, are out of step with recent developments in this area. Even within the limited possibilities presented by Honduran laws, the risk-averse attitude of lending institutions has stunted the credit market in Honduras, although banks and other credit institutions reported enjoying liquidity of funds that otherwise might support a vigorous supply of credit for SMEs. Inexplicably, given the laws and the liquidity, interest rates run extremely high in Honduras, in the neighborhood of 35 percent to 40 percent, and higher.

Contributing significantly to the lack of an active market in secured credit, the Honduran courts need significant improvements, particularly related to sophisticated commercial operations. Thus, although the letter of Honduran laws and procedures might appear to support collateral guaranties for credit, in practice there is insufficient credit to support commercial growth. The lack of available credit represents a serious barrier to more dynamic development in Honduras.³⁶

Financing in Honduras relies today, on mortgage-based loans or loans guaranteed by individuals with immovable collateral to back up their guaranty.³⁷ This is true of agricultural production loans and other loans in which collateral guaranties may be used as backup security, but not as the basis for the loan—a phenomenon not uncommon in the CAFTA region as a whole. With the exception of automobile loans to consumers, there is virtually no private credit market in Honduras that relies on collateral guaranties. The lenders who occupy the vacuum left by this practice tend to be public foundations and business associations that do not have lending philosophies that support and encourage development and growth. Rather, such last-resort

³⁶ Illustrating how lack of credit inhibits growth, a medium-sized business (a manufacturer, wholesaler, and exporter of non-patent drugs and food supplements) indicated it did not have a line of credit, stating (a) that interest rates were too high to make feasible anything other than short-term credit to meet occasional extreme situations, and (b) that guaranty requirements were so stringent that any loan would have correlated to only a small percentage of the movable assets. The owner of the business estimated that its sales would have been at least four to five times more if the company had access to a line of credit charging a reasonable rate of interest on a loan amount equal to 80 percent or more of the movable assets of the enterprise.

³⁷ Two separate interviewees mentioned a popular saying in Honduras, that between borrower and lender, “*Amor se escribe con ‘h’ de hipoteca.*” That is, “Love is spelled with an ‘m’ for mortgage.”

lenders tend to provide holdover loans that permit borrowers to survive at their current levels of operation, but not to expand.

Honduras has begun meaningful reform in the laws controlling collateral guaranties, but there is some doubt about whether the reform will be permitted to take effect. Through the Property Law, *Ley de Propiedad* (LdP), the legislature passed a sweeping reform of the commercial and other registries, removing them from the administration of the Supreme Court and placing them in a new Institute of Registries. The legislature also provided for the use of new electronic land-title registration and a national cadastre. Although all agree that the existing registry suffers from corruption, delay, and inaccessibility, vested interests threatened by the reforms have mounted constitutional challenges to the new laws, which knowledgeable observers believe may well be sustained by the Honduran Supreme Court.³⁸ Nonetheless, the current administration is drafting a reform law for collateral guaranties against movable property with the goal of having it in place within a year. Although the presidential team manifests a sense of urgency and commitment concerning these reforms, most Hondurans seem indifferent, and some are even resistant to reform. Interviews conducted for this assessment revealed a common perception that the current system does not require urgent reform.

Honduras has an inefficient credit market despite the presence of factors that could support a dynamic, efficient market. Much of the problem seems to stem from custom and practice and the attitudes that perpetuate them. At least at the executive level, and perhaps at the legislative level, Honduras seems prepared to push for reforms such as those embodied in model laws such as the Organization of American States (OAS) Model Law of Secured Transactions (2002), the Model Inter-American Rules for Electronic Documents and Signatures (2002), and other uniform laws from United Nations Commission on International Trade Law (UNCITRAL) and United Nations International Institute for the Unification of Private Law (UNIDROIT) that might harmonize the laws of the region and even the hemisphere thereby greatly simplifying credit and trade on a regional, hemispheric, and global basis. Whether the executive initiative can bring about reforms in both the letter of the law and its application remains to be seen, but such reforms should be encouraged in every possible way.

B. LEGAL FRAMEWORK

1. Honduras' Substantive Law on *Garantías Reales Mobiliarias*

Honduras enjoys a well-drafted and relatively modern Commercial Code (*Código de Comercio* Adopted in 1950, the drafters of the Commercial Code included the noted Spanish expatriate Mexican commercial jurist Joaquín Rodríguez y Rodríguez and the distinguished Honduran jurist Roberto Ramírez. The Commercial Code does not include a regime for collateral guaranties that could support a modern credit system. In addition, while the Commercial Code is 54 years old, the Honduran regime for secured transactions in movable property—generically known in the law as *garantías reales mobiliarias*—also depends on provisions found in such fundamental sources as the Civil Code (*Código Civil*, or “CC”) and the Code of Procedures (*Código de Procedimientos*, or “CdPro”), which were promulgated in 1906 as a set.

³⁸ Please note, at the time of this assessment, none of the cases had been decided regarding the constitutionality of the law.

Código Civil: Within its Book IV on Obligations and Contracts, the CC establishes rules for most of the basic collateral guaranty mechanisms known to the law. It includes provisions for the pledge (*prenda*)³⁹ and the mortgage (*hipoteca*).⁴⁰ It includes provisions for: leases (*contratos de arrendamiento*);⁴¹ third-party guaranties (*fianzas*);⁴² assignments of rents (*anticresis*);⁴³ and deposits of movables with a third party (*depósitos*).⁴⁴ The CC specifies that all of the above guaranty mechanisms must be created by contract,⁴⁵ and further specifies the necessary elements that make up a valid contract for those purposes,⁴⁶ and all of the rights and duties created thereby.⁴⁷ The CC also recognizes the right of setoff (*cesión de derechos*) wherever the debtor agrees.⁴⁸

The CC includes basic rules for the creation of contracts establishing the sorts of *garantías reales mobiliarias* mentioned above. Often, private contracts are sufficient; *i.e.*, the contracts need not be registered,⁴⁹ although they generally do need to be executed in writing.⁵⁰ The *prenda*, the *hipoteca* and the *anticresis* are exceptions; to create effects against third parties, they must be inscribed in the registry as public documents created by a notary.⁵¹ The CC provides an especially expeditious procedure for extrajudicial execution on a pledge, where the parties have agreed on a third party who shall carry out a public sale.⁵²

Código de Comercio: While the CC contains a range of guaranty concepts that have changed little since Roman times, the Commercial Code introduces a variety of forms, many of which are quite modern in their possibilities and effects. The Commercial Code applies to all commercial acts—generally, those involving a merchant—while the CC’s provisions apply to acts involving only consumers, although they establish principles and rules which also apply to commercial transactions.

Like the CC, the Commercial Code also recognizes the *prenda*,⁵³ or pledge, but expands its possible applications when the collateral consists of commercial goods. The debtor who creates a commercial pledge need not turn over possession of the collateral to the creditor—a mechanism

³⁹ CC, Arts. 2056-2097. The Civil Code recognizes as a proper pledge only that in which the debtor surrenders possession of the collateral to the creditor. CC, Art. 2056.

⁴⁰ CC, Arts. 2098-2163.

⁴¹ CC, Arts. 1681-1735.

⁴² CC, Arts. 2021-2055.

⁴³ CC, Arts. 2164-2196.

⁴⁴ CC, Arts. 1939-1971.

⁴⁵ CC, Arts. 1919, 1932-1938, 1681, 1919, 1941, 2026, 2059-2060, 2099 and 2165.

⁴⁶ CC, Arts. 1552-1575 and 1586-1604.

⁴⁷ See notes 39-44 *supra* and the specifics for each of the various legal concepts in the respective provisions of the CC cited there.

⁴⁸ CC, Arts. 1440-1450, esp. 1444. This possibility gives banks a right against their debtor’s accounts (*retención bancaria*), for example, but requires judicial approval. CC, Art. 1441.

⁴⁹ CC, Art. 1575.

⁵⁰ Apparently, a third party guarantor’s obligation (*fianza*) may arise without a written contract. CC, Art. 2022.

⁵¹ CC, Arts. 2062 (*prenda*), 2099 (*hipoteca*), 2165 (*anticresis*). A public document is defined in CC, Art. 1497.

⁵² CC, Art. 2087. The CdProc requires at least eight days’ notice for the sale. CdProc, Art. 807.

⁵³ CdCom, Arts. 1289-1307.

known as a *prenda sin desplazamiento*.⁵⁴ The Honduran Commercial Code also provides that a pledge may take the form of a floating lien against a rotating stock of fungible goods, such as an inventory,⁵⁵ and may guaranty conditional or future obligations,⁵⁶ and that a *prenda* may affect any kind of goods “tangible or intangible,”⁵⁷ all striking provisions for their time and consistent with modern practice today.⁵⁸ The Commercial Code creates a broader form of the pledge in the mortgage against a commercial establishment, a floating lien which “shall comprehend all the elements of the [enterprise],⁵⁹ without necessity of nominal description.”⁶⁰

Despite these forward-looking provisions, the Honduran Commercial Code could not foresee many standard contemporary provisions. Specifically, it conceives each pledge-secured transaction as a standalone deal, with a new priority each time the new *prenda* is registered. Modern laws accommodate secured transactions that consist of a series of deals—such as a line of credit, which may go on for years—between creditor and debtor, all in contemplation of an established priority against third parties dating from the time of the initial loan and valid for all guaranties securing subsequent loans.

Again advanced for its time, the Commercial Code provides for relatively expeditious foreclosure when a debtor defaults on payment. Although it does require a judicial order,⁶¹ execution against the pledged item may take place by public sale, with notice to the debtor, carried out by notary, certified broker or even “two merchants established in the market, at the price set by an exchange or at market price.”⁶² Honduran legal practitioners and bankers indicated that under this procedure they could execute on a commercial pledge within 30-45 days. Although the Honduran law on execution against collateral compares quite favorably to that of other Central American countries, it still lags behind contemporary practice that would utilize procedures even more liberal than those enabled by Honduran CC article 2087—specifically by permitting the creditor to possess the collateral and liquidate it without participation of a third party.

The *Código de Comercio* recognizes another kind of floating lien used extensively in Honduras’s important agricultural sector, to guaranty credits that enable the debtor to produce crops or livestock or manufacture industrial products by purchasing the necessary inputs, machinery and installations (in general, *créditos a la producción*,⁶³ often referred to by more specialized categories as *créditos de habilitación o avío*,⁶⁴ which refer to annual or periodic loans for crop,

⁵⁴ CdCom, Art. 1297.

⁵⁵ CdCom, Art. 1294.

⁵⁶ CdCom, Arts. 887, 1291.

⁵⁷ CdCom, Art. 1292 (*corporales o incorporales*).

⁵⁸ On the other hand, the CdCom also provides that transfer of a key to the facility in which the pledged goods are kept is the equivalent of transferring the goods themselves, a vestige of bygone times. CdCom, Art. 1299.

⁵⁹ CdCom, Art. 648 lists the “elements” that make up a commercial enterprise: essentially everything of economic value pertaining to the business.

⁶⁰ CdCom, Art. 1315.

⁶¹ The CdCom nullifies any contractual clause that would permit the creditor to take possession of the pledged assets or dispose of them by any method not involving a judicial order. CdCom, Art. 1305.

⁶² CdCom, Art. 1303.

⁶³ CdCom, Arts. 916-928.

⁶⁴ CdCom, Arts. 916-917.

livestock and industrial operations, and *créditos refaccionarios*,⁶⁵ which refer to loans for more permanent operations, machinery, improvements and installations). The guaranty then follows into not only the production assets acquired with the credits, but also into the goods produced with those assets and their proceeds. Production credits may be created by a private document, but must be inscribed in both the real property and the commercial registries before the guaranties associated with them take effect against third parties.⁶⁶

The legal figure of production credits is known in other Latin American countries as well, but the Honduran Commercial Code includes one of the clearest legislative treatments of it. Among notable provisions, the Commercial Code gives guaranties for *créditos de habilitación o avío* precedence over those for *créditos refaccionarios*, and the latter precedence over all other guaranties.⁶⁷ It also places responsibility on the creditor to assure that the credit is used for production purposes, at the risk of losing the special priority if it is not,⁶⁸ but the special priority so gained follows the guaranteed assets into the hands of third party purchasers who purchase directly from the debtor and also affects subsequent purchasers who “knew or should have known of the guaranty created against them.”⁶⁹

Another mechanism developed in the Honduran Commercial Code beyond its treatment in many Latin American Commercial Codes even today is the *fideicomiso de garantía*, or guaranty trust.⁷⁰ In Honduras, only authorized banks may act as a trustee.⁷¹ The trustee “shall exercise powers of disposition over the goods and rights given in trust,”⁷² according to the terms and conditions of the trust instrument.⁷³ The statute specifically recognizes trust arrangements that “signify acquisition or substitution of goods and rights, or investment of money or liquid funds,”⁷⁴ operations that easily correspond to collateral guaranties.

The guaranty trust under Honduran law permits virtually immediate, extra-judicial execution against collateral upon debtor’s default. In the event of debtor-settlor’s non-payment, the trustee may simply sell the collateral and turn over the proceeds to the beneficiary-creditor, so long as the trust instrument provides for such process.⁷⁵ Among more sophisticated lenders and their lawyers in Honduras, the guaranty trust is a favored form for structuring secured transactions, although its costs make it prohibitive for most small and medium enterprises seeking credit.

⁶⁵ CdCom, Arts. 918-919, 927.

⁶⁶ CdCom, Art. 921.

⁶⁷ CdCom, Art. 923.

⁶⁸ CdCom, Art. 922.

⁶⁹ CdCom, Art. 925.

⁷⁰ CdCom, Arts. 1033-1062. The statute does not refer specifically to the *fideicomiso de garantía*, but in a nice turn of legislative phrase the statute does state, “The trust may be constituted to serve all purposes imaginable as legal activities, so long as they are licit and specified.” (*El fideicomiso puede constituirse para servir todas las finalidades imaginables como actividades jurídicas, siempre que sean lícitas y determinadas.*) CdCom, Art. 1049. Consistent with its unlimited purposes, the trust may operate against “all class of goods and rights.” CdCom, Art. 1048.

⁷¹ CdCom, Arts. 1040, 1054. While no bank may serve both as trustee and beneficiary of the same trust, CdCom, Art. 1038, one bank may serve as trustee to the benefit of another bank.

⁷² CdCom, Art. 1037.

⁷³ CdCom, Art. 1048.

⁷⁴ CdCom, Art. 1056.

⁷⁵ CdCom, Art. 1057.

Honduran law would permit many forms of secured transactions, particularly through application of the more agile and imaginative provisions written into the Commercial Code, which contemplate development of new mechanisms as new commercial circumstances emerge over time. In fact, however, the Honduran credit market has not exploited even the statutory bases available to it, because of its strong aversion to risk. Banks and other credit sources simply do not make many loans, and usually turn away potential borrowers with movable collateral to offer as guaranties. These policies regarding risk analysis and lending are characteristic of the attitude of Honduran lenders, rather than justified by Honduran laws.

2. Enforcement Procedures

Honduras's legal system provides for summary execution of guaranties against collateral, and creditors' lawyers and bankers seem reasonably satisfied that they can obtain relatively expeditious execution against collateral goods in the event of a debtor's failure to pay. Although both the Civil Code and the Commercial Code prohibit the *pacto comisorio*, defined as any contractual provision that authorizes a creditor to repossess and dispose of collateral without judicial process, available procedures come close. Liquidation of a guaranty trust provides essentially the same extrajudicial, self-help execution available in the United States under the Uniform Commercial Code.

In Honduras, the constitutional guarantee of due process (*debido proceso*) and a right to a hearing (*derecho de audiencia*) before a party may be deprived of any rights in property seem to be satisfied by minimal judicial participation and notice to debtors with a right to object when a non-trust guaranty is foreclosed. The constitutional guarantee may be vindicated by allowing debtors to invoke a hearing if they feel that they have viable defenses against the creditor's claims. However, where a debtor recognizes that the debt is delinquent and the creditor's claim against the collateral is appropriate—a very common reaction—the creditor should be able to proceed extrajudicially and execute against the collateral in a matter of days, thus radically reducing the risk of nonpayment and the associated enforcement costs.

C. IMPLEMENTING INSTITUTIONS

Until promulgation of the LdP in June 2004,⁷⁶ Honduras had an antiquated, nonfunctional registry system administered by the Supreme Court (for which it provided a source of revenue).⁷⁷ The LdP created an *Instituto de Propiedad*, which will administer all registries for Honduras. The LdP has begun its reforms by concentrating on real property registries, with an ambitious plan to convert the entire system to electronic entries, coordinated with a national cadastral survey. The reform of the Commercial Registry, which will include inscription of guaranties against movable property, should occur in the near future if the Honduran executive branch can carry out its program. Some doubt exists, however, concerning the constitutionality of the reforms; and vested interest groups—who view the new LdP as a serious threat to their professional role and revenue—have hurried to file cases raising constitutional challenges. As of the date of this assessment no decisions had been handed down by the Supreme Court in this matter.

⁷⁶ *Ley de Propiedad, Decreto* No. 82-2004, 15 June 2004.

⁷⁷ *Ley de Propiedad, Decreto* No. 82-2004, 15 June 2004.

If the reform passes the constitutional test, it should bring about salutary change and a new, responsive electronic registry system. The system should move beyond real property to encompass guaranties against movable property and other juridical acts, but in its current state the registry creates a serious stumbling block to any attempt to create a dynamic credit market engaged in serious risk analysis.

D. SUPPORTING INSTITUTIONS

1. Notaries and Government Institutions

Notaries are repositories of public faith (*fe pública*) and have exclusive power to certify and authorize acts where their participation is required by law, including the constitution of many of the public legal documents that create *garantías reales mobiliarias*. In Honduras, unlike in other Latin American countries, there is no limit on the number of lawyers who may become notaries.⁷⁸ Almost any lawyer may be a notary, and any lawyer with a commercial practice is expected to be. Among the better law firms and lawyers, however, notarial practice occurs at high levels of competence and the legal requirements are scrupulously adhered to.

2. Professional and Business Associations

Honduras has an official bar association to which lawyers must belong (i.e., the *Colegio de Abogados*). It also has several excellent boutique law firms that engage in commercial practice and a solid core of lawyers educated in the United States or Europe at the top of the profession. The *Colegio*, however, because of its popular composition, is not a force for change.

On the other hand, business and industrial organizations seem to be well organized and quite effective. Among these is the Honduran Council of Private Enterprise, an umbrella organization with active participation in policy-making. In addition, medium, small, and micro enterprises have associations. These associations have often been successful in fostering special sources of credit, funded by government or outside agency donations. A notable association of this type is *Fundación Coveló*,⁷⁹ which offers loans of up to \$20,000 to small and micro enterprises.

E. SOCIAL DYNAMICS

Honduras has various approaches to reform, depending on whom you talk to. Some persons—principally within the government—are quite specific in their targets for reform and quite intent in their desire to carry it out. By and large, private professional players in the Honduran credit market are not very concerned with its reform—although they are quick to recognize its deficiencies and the barriers it presents to socioeconomic growth in Honduras. Many government agencies share their attitude. These vested professional classes are precisely the groups most

⁷⁸ In some countries, the title of notary public designates a lawyer of exceptional capacity and experience in commercial law and other notarial functions, selected through stiff competition for official designation as a member of an elite at the top of the profession. In Honduras that is not so, and it appears that the test administered by the Supreme Court to become a notary is often more political than professional in nature, according to Honduran lawyers.

⁷⁹ *Fundación Coveló* is a nonprofit organization whose mission is to assist and participate in the economic development of small and micro enterprises in Honduras. See further, www.fcoveló.org.

inclined to criticize the new LdP and advocate its overthrow. Whether they will ultimately encourage reform or act as a permanent stumbling block to change remains an open question.

F. RECOMMENDATIONS

Honduras has laws on its books that would support a reformed credit market and—especially if the registry reform begun for real property by the LdP can be extended into movables and collateral guaranties by new laws now in draft form—could lead to greatly reduced risk in its credit market. The law now requires the following reforms:

- ◆ A new law of secured transactions, shaping the draft law of *garantías reales mobiliarias* to make sure that it is consistent with all aspects of the OAS Model Law of Secured Transactions. This should include participation in an effort to regionalize key credit institutions, such as the Commercial Registry
- ◆ A new law of civil and commercial procedures, currently in draft form before the Supreme Court, that maintains and even improves current expeditious judicial enforcement of collateral guaranties
- ◆ A wholesale overhaul of the judicial system, with major programs for training of judicial officials and promoting the concept of a judicial career. Currently, judges view their positions as temporary political sinecures and anticipate moving on when the administration changes, despite the fact that the law provides permanent tenure to judges.

VII. COMMERCIAL DISPUTE RESOLUTION

A. INTRODUCTION

As in other Central American countries, in Honduras the process of commercial dispute resolution is hampered by the judiciary, out-of-date laws, and a lack of use and understanding of alternative methods of dispute resolution.

B. LEGAL FRAMEWORK

The Courts

1. The Constitution

The Judicial Power, addressed in Article 303-320 of the Constitution, provides for a Supreme Court of Justice, courts of appeal, and other courts established by law. A change in the Constitution increased the number of judges on the Supreme Court from 9 to 15 and their terms from 4 to 7 years.⁸⁰ However, as before, the judges of the Supreme Court are elected by the National Congress, a unicameral body. The Constitution formally provides for separation of powers (Article 4), an independent judiciary (Articles 303 and 304), and judicial review (Articles 313 and 319). As discussed below, however, the independence of the judiciary is not effectively institutionalized.

2. Legislation

a. Organization of the Courts

The operation of the courts is governed by the Law on the Organization and Powers of the Courts, *Ley de Organización y Atribuciones de los Tribunales* (LOAT), which took effect in 1906. This law establishes the powers of small claims judges, civil law judges, appellate court judges, and Supreme Court justices. It also establishes the requirements that must be met by those who will be appointed as small claims judges or civil law judges or elected as senior judges.

LOAT provides the legal framework under which all courts in Honduras operate. It establishes, not only the duties of the judges and senior judges, but also the authority of and limitations applicable to the other judicial officials. It also establishes the jurisdiction of the courts. With regard to salary raises, promotions, and job security, they are subject to the Law on Judicial Career.

1) Small claims courts

Every municipal seat whose jurisdiction does not exceed 4,000 inhabitants will have one regular small claims judge and one alternate. Departmental seats, or *municipios*, with populations

⁸⁰ The current number of judges and term of years is taken from the local reporter. The earlier number of judges and term of years is found in Articles 304 and 305 of the Constitution of the Republic of Honduras 1982, Decree No. 131 of January 11, 1982 as amended to Decree No. -91 of January 30, 1991. *Constitutions of the World* (N.Y.; Oceana Pub., 1997).

exceeding 4,000 will have two regular judges and two alternates. Small claims judges will hear, in the first instance, civil suits in oral proceedings, if the object of the complaint does not exceed 49,999 lempiras (at present, approximately US\$2,700). They can also exercise voluntary and contentious jurisdiction in cases where the laws expressly authorize them to do so.⁸¹

2) Trial courts

Each departmental or divisional seat has one or more trial courts. The professionally qualified judges will hear, in the first instance, civil suits, if the object of the complaint exceeds 50,000 lempiras. They will hear, in the second instance, matters heard in the first instance by the small claims judges. The trial courts for civil matters include at least one judge assigned to the court, one clerk, one or more process servers, and one or more typists, depending on workload.

3) Courts of Appeal

The courts of appeal consist of three senior judges, presided over by a chief judge, who is one of the regular members. The chief judge serves in that capacity for 1 year, starting January 1, and the judges rotate into the position on order of seniority.

There are six courts of appeals in Honduras. They hear, in the first instance, complaints and accusations against professionally qualified judges in order to enforce, civilly or criminally, their official responsibilities. They will hear, in the second instance, appeals from civil matters, heard in the first instance by the professionally qualified judges.

4) The Supreme Court

The Supreme Court has four divisions: Labor, Constitutional, Civil, and Criminal. It exercises the following authorities:

- ♦ Hearing cases involving offenses committed by members of the judiciary in the course of the administration of justice and ordinary offenses of high-ranking state officials when the Congress has declared that there is a basis for initiation of a criminal complaint
- ♦ Authorizing notaries to practice their profession
- ♦ Hearing motions to vacate in accordance with law
- ♦ Hearing *amparo* appeals and appeals for judicial review in accordance with law
- ♦ Appointing the senior judges of the courts of appeals and the departmental and divisional professionally qualified judges
- ♦ Hearing cases involving prisoners or extradition and other cases that must be tried in accordance with international law
- ♦ Granting petitioners written approval to use a license or privilege and declaring the authenticity of the judicial and notarial documents that come from abroad for application in the Republic and vice versa

⁸¹ Drawn from the report of the local reporter, discussing pertinent part of the current Code of Civil Procedure (1906).

- ♦ Suspending, for disciplinary reasons, and dismissing officials it appointed for misconduct or gross negligence in the performance of their duties.

The Supreme Court also considers appeals from the cases heard in the first instance by the courts of appeal.

b. Commercial Law and Procedure

The civil procedure section of the 1906 Code of Procedure governs civil and commercial litigation, except in cases involving enforcement of pledges. The 1950 Commercial Code provides for enforcement through direct sale by a notary, sales agent, or two merchants, if the contracting parties have so agreed.

The civil procedures portion of the Code of Procedures is said to be obsolete; and, of course, it is to be expected that any procedural code that is almost 100 years old *would* be obsolete in many respects. The reform desired by many involves not merely updating the existing model, but converting to a new approach. Specifically, this will involve a switch to an oral procedure. Latin American countries have traditionally followed the written procedure adopted from Spain. Honduras, however, has switched in criminal cases to an oral procedure. Part of the critique of the existing civil procedures involves advocacy of a similar move to an oral procedure in the expectation that this will speed the process.

One way in which the current civil procedures are viewed as obsolete is its establishment of time limits that are routinely disregarded by the courts. The failure of judges to adhere to time limits, however, points less to a technical problem that can be solved by legislation than to more fundamental administrative problems in the judicial system.

Arbitration

1. The Constitution

Article 15 of the Honduran Constitution states, “Honduras proclaims as ineludible the validity and obligatory execution of arbitral and judicial awards of an international character.” Under Article 16, international treaties are part of domestic law without any implementing legislation. Article 137 of the Constitution provides “...an obligation to promote, organize and regulate conciliation and arbitration procedures for the peaceful settlement of labor disputes.”

2. Legislation

A new law on arbitration, Decree No. 161-2000, was approved in 2000. This law is modeled on the law of Colombia. It provides for arbitration organized by arbitration centers. The law also authorizes chambers of commerce, professional associations, trade associations, and institutions of higher education to organize such centers. To date, only two centers have opened, one in Tegucigalpa and another in San Pedro Sula, both operated by the chamber of commerce. Notaries are also able to organize arbitrations on their own.

C. IMPLEMENTING INSTITUTIONS

A Report on the Honduran Judiciary issued in October 2003 by the International Commission of Jurists (ICJ) and the Centre for the Independence of Judges and Lawyers (CIUL) "...found that the most serious problem facing the Honduran judiciary and legal profession is their extreme politicization."⁸² That report did recognize that recent reforms had established new procedures for nominating judges and had lengthened the term of members of the Supreme Court to extend beyond that of a single administration. Those changes, however, do not address conditions that are inconsistent with judicial independence: (a) judges are elected by the legislative body, rather than being appointed by the executive power, subject to confirmation; (b) their appointment is for a term of years, rather than for life; and (c) the Supreme Court issues advisory opinions on pending legislation.

The Supreme Court may be more insulated from political influence from Congress, because its longer, 7-year, term overlaps the 4-year terms of the President and the Congress. However, interviewees claim that a degree of political influence is perceived to be exerted on the judiciary. The Supreme Court has the power to appoint magistrates, judges, public prosecutors, and others. Article 319 (9) of the Constitution formally protects the independence of the lower court judges, specifically providing that they "may not be removed, suspended, transferred or retired except" for cause. However, in practice, judges are generally ordered to transfer to other positions following elections. Routinely, they resign rather than remove to another locale.

D. SUPPORTING INSTITUTIONS

Lawyers and Notaries

The ICJ/CILJ report stated that politicization improperly influences the legal profession. That 2003 report, in fact, was issued by a fact-finding team responding to a confrontation that had occurred between the *Colegio* and the Supreme Court.

In this conflict, members of the *Colegio* had called for the resignation of all members of the Supreme Court. The lawyers were demanding that the Supreme Court give up its powers to appoint notaries. In Honduras, the practice of law requires only graduation from an approved law school. To be a notary, a lawyer must pass an oral examination before members of the Supreme Court. Although there are approximately 10,000 lawyers in Honduras, there are only about 3,000 notaries. The complaint against the Supreme Court was that the notary examination was unfair and political. It was said that members of the Supreme Court were able to and did decide to admit or deny lawyers to the notary on a political basis. This politicization was facilitated by the face-to-face oral examination process, in which the judges could ask virtually any question related to the law. In this forum, the judges effectively could pass or fail candidates on an arbitrary basis.

The notary profession is quite lucrative. According to Honduran attorneys interviewed for this assessment, the law requires the signature of a notary in many situations of questionable necessity. Notaries charge a percentage of the transaction amount.

⁸² http://www.icj.org/news.php3?id_article=3103&lang=en. Visited 9/17/04.

The Law Schools

For many years, Honduras's only law school operated within the National University. Now, according to local attorneys, Honduras has six law schools, four in Tegucigalpa. Legal education in Honduras does not seem to prepare lawyers to handle a commercial practice. Quite a number of the better law graduates come to the United States for graduate legal education. Lawyers in Honduras will need continuing education to cope with increased transnational transactions expected in the future.

Arbitration Centers

Under the new arbitration law (*Ley de Conciliación y Arbitraje*), which took effect in 2000, the Honduran Chamber of Commerce has established arbitration centers in Tegucigalpa and San Pedro Sula. These are the only arbitration centers in Honduras. The establishment of these centers is the result of the chamber's efforts from 1997 to 2001, with funding from the InterAmerican Development Bank to promote alternative dispute resolution (ADR). The chamber promoted passage of the law and later trained and certified arbitration and mediators. The centers run by the chamber have been in operation since October 2001. Currently, the chamber of commerce has certified 28 arbitrators, most of whom are lawyers. It has conducted eight arbitration cases. The time required has ranged from 2 to 18 months.

The cost of arbitration, which is 4.5 percent of the amount in dispute according to the Chamber of Commerce, may inhibit the use of arbitration. Another problem with arbitration may be the lack of "technical" arbitrators. When parties provide for arbitration, using the center's process, they can choose to have a "technical" or a "legal" process. A technical process involves arbitrators who are experienced in the field (e.g., construction) but who are not lawyers. Those arbitrations would proceed according to "equity," rather than law. This option reflects the recognition that certain cases are more appropriate for a technical expert than for a lawyer. A notary, however, can avoid this difficulty with a properly crafted arbitration clause. Notaries can conduct arbitrations without having to operate through the centers. As a result, apparently, more arbitration has occurred than the eight completed by the chamber's centers.

The chamber's centers also conduct conciliations, or mediations. In fact, more of the chamber's activity in the centers has been in this area, with 25 conciliation cases. Conciliation costs are lower. Conciliation also occurs in the courts.

E. RECOMMENDATIONS

- ◆ Prosecute corruption and reconsider the structural arrangement of the judiciary, including the method of appointing judges, to provide more effective separation of powers.
- ◆ Educate attorneys and law students in commercial law and arbitration and the business community in the benefits of alternative dispute resolution.
- ◆ Update the Commercial Code to modern standards, including the addition of oral proceedings.

- ♦ Reform the administration and operation of contracts and commercial transactions to ensure that the need for notaries does not place too large a burden on the contract itself. The notarial practice itself should be reviewed to ensure that the licensing of notaries is in accordance with ethical standards
- ♦ Consider joining with other Central American nations to create a Central American Court of Commercial Arbitration, which would have jurisdiction over commercial disputes between parties who are citizens of different countries.

VIII. BANKRUPTCY

A. INTRODUCTION

Honduras has virtually no bankruptcy practice. Lawyers interviewed for this assessment remembered only a single insolvency proceeding in the country within the past few years.⁸³ Typically, businesses in Honduras carry out de facto insolvency proceedings by simply shutting their doors and ceasing to exist.

According to lawyers interviewed for this assessment, several banks have failed within recent memory, and banks have since come under much more careful scrutiny and control by the Commission for Banking and Insurance. Currently, insolvency laws do not cover bank insolvencies.⁸⁴ The Commission for Banking and Insurance is prepared to step in if a bank or insurance company goes bankrupt by acquiring the stricken institution and transferring it to a healthy bank or insurance company. The commission is rigorous in its auditing and oversight of Honduran banks and insurance companies and its requirements for reserve funds to cover obligations. It could be argued that the restrictions imposed by the commission contribute to the extreme risk aversion and the conservative lending policies of Honduran banks.

No lawyers interviewed had ever handled an insolvency proceeding, let alone considered such practice part of their own expertise or normal workload. Further, no lawyers knew of any other attorneys who did. One of the major reasons for the lack of bankruptcy practice is that insolvency proceedings fall under the jurisdiction of Honduras's all-purpose trial courts,⁸⁵ which have a reputation for inefficiency. Such courts have no experience with insolvency proceedings, which are relatively complicated and lengthy.

Honduras has a well-drafted and detailed insolvency law, promulgated as part of its Commercial Code in 1950, but its statutes lack many aspects present in modern bankruptcy laws around the world.

⁸³ The debtor in that insolvency proceeding was Industrias Metálicas, S.A., or IMSA, in San Pedro Sula. In addition, some 10 years before, a clothing store known as Moda de París had declared bankruptcy in Tegucigalpa.

⁸⁴ The Commercial Code includes a special section for "banking establishments and insurance businesses," at Articles 1675–1678, which defers to special regulations set out in the Law for Banking Establishments for the insolvency of banks. *Id.*, at Arts. 1675 and 1678.

⁸⁵ There are no specialized mercantile courts in Honduras, where ordinary trial courts accept all matters from criminal to civil to family to commercial matters.

- ♦ First and most important, Honduras's insolvency laws do not provide debtors with a full and final discharge of their debts. This leaves the debtor with little incentive to initiate insolvency proceedings, since they help creditors but add costs that reduce the payoff and leave debtors responsible for any deficiency.
- ♦ Second, Honduras's insolvency laws retain a vestige of ancient bankruptcy law that is absent from modern statutes: extensive provisions for assigning blame and even criminal penalties based on a presumption of blameworthy conduct on the part of any debtor who cannot pay his or her debts.
- ♦ Third, modern insolvency regimes depend on creditors' effective remedies in collecting debts, most notably the ability to foreclose on collateral guaranties, to drive honest debtors to seek relief in insolvency proceedings. Honduras's debtors lack such an incentive—first, because insolvency offers no discharge from their debts and, second, because creditors use forms of guaranty that elude insolvency proceedings (*e.g.*, *fideicomisos de garantía*) or cannot collect debts in a manner efficient enough to pressure debtors into such proceedings.
- ♦ Finally, modern bankruptcy laws in other countries operate in tandem with collateral guaranty laws to provide two major elements lacking in Honduras: (a) the clear demarcation of priorities among creditors and (b) the vindication of those priority claims. Honduran insolvency and collateral laws lack such internal pressure points and therefore cannot exert the proper leverage on modern creditor-debtor relations.

Honduras's lack of a bankruptcy practice and updated legislation hampers business and investment by leaving creditors without an effective ultimate remedy against defaulting debtors and by leaving debtors without the means of making a fresh start after financial failure. A desirable credit dialectic should run from (a) default by debtor, to (b) foreclosure against collateral by creditor, forcing (c) bankruptcy by debtor that temporarily stops foreclosures but leads to the recognition of secured creditors' collateral claims and means that all debts will be resolved in the relatively short term, and (d) leaves the debtor finally discharged from all responsibility for the debts. Without effective bankruptcy creditors cannot foreclose, even on debts secured by movable collateral, let alone assert unsecured claims, with any hope of payment in a realistic time frame. The attendant increased risk to any lender reduces the supply of credit offered to potential borrowers and weeds out a number of such borrowers even when their collateral should be sufficient to guaranty a needed loan. In addition, debtors who might return to economic viability by shedding their obligations through insolvency enjoy no such alternative.

B. LEGAL FRAMEWORK

Honduras has on its books a quite sophisticated set of insolvency laws. The Honduran Code of Commerce of 1950 devotes almost half of its substantive provisions to insolvency, providing a rich and extensive legislative treatment of the subject. Consistent with the date on which they entered into force, however, the Honduran insolvency laws lack important aspects of modern bankruptcy laws.

Insolvency proceedings in Honduras include three distinct proceedings: the *concurso*, or *concurrancia*, a consumer (or non-merchant) bankruptcy under the Civil Code;⁸⁶ *quiebra*, or merchant bankruptcies under the Commercial Code;⁸⁷ and *suspensión de pagos*, or merchant reorganizations under the Commercial Code.⁸⁸ As confirmed by the relatively small number of its articles on *suspensión de pagos*, the Commercial Code does not contain an extensively developed law for merchant reorganization through restructuring of debts. However, its provisions are open and flexible enough that they would permit an active and commercially savvy judge to oversee an effective reorganization.

Both the Honduran Civil Code and the Honduran Commercial Code treatments of insolvency retain a vestige of classic bankruptcy law, the skeptical presumption—largely absent from modern insolvency statutes beginning in the mid 20th century—that the debtor who cannot pay his or her debts is probably guilty of improper conduct.⁸⁹ The codes both provide for proceedings to determine the debtor’s degree of responsibility for the financial failure. The Commercial Code in particular includes rather extensive provisions for assigning blame and even criminal penalties in cases of merchant bankruptcy and imposes an obligation on the court to determine the degree of responsibility of those with administrative control of the debtor, ranging from “fortuitous” bankruptcies to “culpable” bankruptcies and, at the extreme, bankruptcies in which criminal fraud is present.⁹⁰

1. Code of Procedures

Promulgated in 1906, the Code of Procedures includes both civil and criminal procedures. Its civil section includes careful provisions for both consumer and commercial bankruptcies before the trial courts of general jurisdiction.⁹¹ Specifically it provides for a debtor to turn over non-exempt assets to the estate administered by the court.⁹² The court then gives notice and holds a meeting of all creditors to sort out claims against the debtor and to permit the debtor to propose to the creditors a plan for restructuring his or her debts, if he or she wishes to do so.⁹³ The court also supervises the appointment of a trustee in bankruptcy (*síndico*) to liquidate the debtor’s assets in favor of creditors’ proven claims⁹⁴ and presides over the determination of whether the

⁸⁶ CC [Civil Code], Libro IV (*De las Obligaciones y Contratos*), Título XV (*De la Concurrancia y Prelación de Créditos*), Arts. 2244-2262.

⁸⁷ CdCom [Commercial Code], Libro V (*Quiebra y Suspensión de Pagos*), Títulos I-V, Arts. 1318-1640. Nonetheless, the *síndico*, or bankruptcy trustee, may propose the continuation of the business instead of its liquidation, a form of reorganization under bankruptcy proper. CdCom, Art. 1357(III).

⁸⁸ CdCom, Libro V (*Quiebra y Suspensión de Pagos*), Título VI, Arts. 1641-1674.

⁸⁹ The term “bankruptcy,” derived from the Latin for “broken bench,” came from the medieval practice of breaking the insolvent merchant’s bench so that he could no longer carry on commerce in the marketplace. The same presumptive anathema attaches to the consumer who cannot pay his or her debts, although perhaps not to the same level. See CC, Art. 1442.

⁹⁰ See CdCom, Arts. 1392, 1398-1421, 1628-1640 (stripping bankrupt merchants of their civil rights and prohibiting them from engaging in commercial acts until and unless they are “rehabilitated,” either by a finding that the bankruptcy was “fortuitous” or by repayment of all debts in the case of “culpable” or “fraudulent” bankruptcies).

⁹¹ *Código de Procedimientos* (CdProc), Libro III (*De los Juicios Especiales*), Título II (*Del Concurso de Acreedores*), Arts. 524-644, and Título III (*De los Procedimientos de la Quiebra*), Arts. 645-654.

⁹² CdProc, Arts. 536-537, 588-592.

⁹³ CdProc, Arts. 538(2), 543-556, 567.

⁹⁴ CdProc, Art. 569.

debtor has responsibility for negligent or criminal conduct leading to his or her failure to pay the debts.⁹⁵ Applicable to both natural and juridical persons and to all forms of insolvency involving both consumers and merchants,⁹⁶ the procedure simply is not used in current Honduran practice. In the estimation of Honduran commercial lawyers, no current sitting Honduran judge has experience in or knowledge of how to go about presiding effectively over any of the various bankruptcy proceedings.

2. Civil Code—Concurso or Concurrencia

Promulgated in 1906, like the Code of Procedures, the Honduran Civil Code derives from the French Civil Code of 1804 as adapted in Chile,⁹⁷ where it became effective in 1855. Its venerable insolvency provisions can affect only private citizens who are not merchants.⁹⁸ The Civil Code denominates these consumer bankruptcies *concurso*s or *conurrencias*.⁹⁹

The consumer bankruptcy procedures provided in the Civil Code consist principally of the debtor's turning over all non-exempt¹⁰⁰ assets in an act known as the *cesión de bienes*, to create a bankruptcy estate that will be liquidated to pay claims.¹⁰¹ Once the turnover has occurred, the proceedings consist of three separate *ramos*, or different aspects of the proceeding: (a) overall administration of the *concurso*,¹⁰² (b) establishment of priorities among various creditors' claims,¹⁰³ and (c) determination of the debtor's possible responsibility for his or her insolvency.¹⁰⁴

The successful conclusion of the *conurrencia* does not discharge the debtor from responsibility for any debts not paid in full, and creditors with deficiency claims may pursue assets acquired by the debtor subsequent to the *concurso*.¹⁰⁵

Creditors may initiate the *conurrencia*,¹⁰⁶ and might have more incentive than the debtor to do so, since the court and its appointed trustee should then take charge of marshaling all of the debtor's non-exempt assets and liquidating them to generate funds to pay off all claims. Apparently, however, creditors favor more efficient means of foreclosure provided in the law (such as a *fideicomiso de garantía*, which can be applied by the trustee without judicial process).

⁹⁵ CdProc, Arts. 535(5), 551, 565, 608-611.

⁹⁶ CdProc, Art. 645.

⁹⁷ Under the stewardship of Andrés Bello, jurist, statesman, and man of letters.

⁹⁸ Merchants' legal affairs are consigned to the Commercial Code, which states in Article 1, "Merchants, acts of commerce and all commercial things shall be regulated by the dispositions of this Code and other commercial laws."

⁹⁹ CC, Libro IV (*De las Obligaciones y Contratos*), Título XV (*De la Concurrencia y Prelación de Créditos*), Arts. 2244-2262. The terms *concurso* and *conurrencia* may be translated as a gathering or competition, in this case among creditors in pursuit of debtor's assets.

¹⁰⁰ See CC, Art. 1444, for a list of personal assets exempt from creditors' execution for payment of debts.

¹⁰¹ See CC, Arts. 1440-1450. The bankruptcy estate is defined in Civil Code Article 525 as "all the assets of [the debtor] and all his obligations, even those not due and owing, except those goods and obligations which the law expressly exempts."

¹⁰² CdProc, Arts. 564, ¶ 1; 566-586.

¹⁰³ CdProc, Arts. 564, ¶ 2; 587-607.

¹⁰⁴ CdProc, Arts. 565, 608-611.

¹⁰⁵ CC, Art. 2253.

¹⁰⁶ CC, Art. 524, ¶ 2.

The debtor may avoid the formal *concurso* proceeding and its implications by securing his or her creditors' agreement to a *convenio*, or plan, submitted in satisfaction of the creditors' claims.¹⁰⁷ Essentially, the debtor must convince the creditors that they will collect more against their claims by not taking the debtor's non-exempt assets, but instead allowing the debtor to retain the assets and pay the debts over time. There is incentive for the debtor: upon successful compliance with the terms of an approved *convenio*, a debtor secures a discharge of all debts treated therein. Failing such a plan, or failing the debtor's compliance after the plan's acceptance by the creditors, the debtor's non-exempt assets are liquidated for the benefit of the creditors in a straight *concurrentia* proceeding administered by the court and its appointed *síndico*, or trustee in bankruptcy, who is responsible for marshaling and liquidating the bankruptcy estate.¹⁰⁸

3. Code of Commerce— Bankruptcy (“Quiebra”)

Effective since 1950, the Code of Commerce instituted new and advanced—for their time—bankruptcy rules, exclusively for merchants, consisting of two alternatives that track the alternatives under the Civil Code: (a) straight bankruptcy and liquidation of assets (*quiebra*)¹⁰⁹ and (b) suspension of payments in favor a debtor's plan for payment accepted by the creditors (*suspensión de pagos*).¹¹⁰ As with the *concurrentia* under the Civil Code, completion of the commercial bankruptcy, or *quiebra*, process does not discharge the debtor from his or her responsibility to any creditors who received less than full payment. They may continue to pursue the debtor until their claim is fully satisfied.¹¹¹ The Commercial Code's treatment is more detailed than that of the Civil Code, however.

The Commercial Code does not abandon the basic presumption of the Civil Code: that the debtor is at fault and that bankruptcy should provide procedures that aid creditors in pursuing the debtor who refuses to pay his or her debts.¹¹² A merchant might voluntarily declare bankruptcy,¹¹³ but it is also possible for creditors,¹¹⁴ attorneys general (*ministerio público*),¹¹⁵ and even a court that finds proper grounds while presiding over another civil or criminal proceeding¹¹⁶ to initiate an involuntary *quiebra*.¹¹⁷

¹⁰⁷ CC, Art. 2250.

¹⁰⁸ See CdProc, Arts. 538(1), 539-542, 544(2), 554-562, 566, 568, 575 and 579.

¹⁰⁹ CdCom, Libro V (*Quiebra y Suspensión de Pagos*), Títulos I-V, Arts. 1318-1640.

¹¹⁰ CdCom, Libro V, Título VI, Arts. 1641-1674. This section is shorter because in a suspension of payments the debtor must submit a plan for the creditors' approval, Article 1644, triggering a special proceeding to test whether the creditors will accept the plan in place of a straight bankruptcy and liquidation.

¹¹¹ CdCom, Art. 1543.

¹¹² The Commercial Code begins its provisions on *quiebra* with the threat, “The merchant who ceases to pay his obligations may be declared in a state of bankruptcy.” CdCom, Art. 1318.

¹¹³ CdCom, Art. 1322.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ CdCom, Art. 1326.

¹¹⁷ A summary hearing, held upon 5 days' notice, will determine whether the merchant is truly bankrupt, since creditors might institute the proceeding even when the debtor is not truly insolvent. CdCom, Art. 1327. The court will issue its decision on whether the debtor is in fact and in law bankrupt “as part of the hearing, according to the reasonable presumptions that the judge acquires from the evidence presented.”

Upon declaring the merchant debtor in bankruptcy, the court names a *síndico*, or trustee in bankruptcy,¹¹⁸ who forthwith takes possession of all assets and records of the bankrupt.¹¹⁹ Among the trustee's first duties is to render to the court a "detailed report concerning the causes that gave rise to the bankruptcy [including] the debtor's responsibility for it" and the effective date upon which the debtor ceased to pay its debts.¹²⁰ A limited-liability business entity whose corporate standing lacks validity exposes all of its individual shareholders or partners to unlimited liability.¹²¹ The creditors, at scheduled creditors' meetings, name from one to five *interventores* (interveners) to represent the creditors' interests throughout the bankruptcy proceeding.¹²² In the meantime, the merchant bankrupt not only loses all access to and possession of the bankrupt business¹²³ but also is treated very much like a criminal: deprived of civil rights and positions that require full civil capacity,¹²⁴ held under subpoena power of trustee, intervenors, and creditors;¹²⁵ and prohibited from leaving the venue of the proceeding without the court's permission.¹²⁶

After the *quiebra* administration is properly set up as detailed above, the trustee proceeds under court order to inventory,¹²⁷ administer,¹²⁸ and liquidate the assets of the bankruptcy estate¹²⁹ and pay creditors¹³⁰ their recognized claims¹³¹ according to the priorities established within the bankruptcy proceeding.¹³²

A major portion of the proceedings following a declaration of bankruptcy focuses on determining whether the bankrupt has any degree of criminal responsibility for the cessation of payments to creditors.¹³³ The best that a bankrupt can hope for is a finding that the bankruptcy

¹¹⁸ CdCom, Art. 1332(I). The *síndico* should be a bank, a chamber of commerce or industry, or a merchant local to the court. CdCom, Arts. 1343, 1347.

At the close of the initial hearing, the court also orders that the declaration of bankruptcy be inscribed in all commercial registries, against the bankrupt merchant company itself and against all inscribed rights and obligations of the bankrupt. CdCom, Art. 1332(VII).

¹¹⁹ CdCom, Arts. 1332(II), 1356, 1470.

¹²⁰ CdCom, Art. 1332(VI). The effective date of the bankruptcy takes on significance, since transactions after that date—usually well before the actual judicial declaration of bankruptcy—may be overturned. *See* CdCom, Arts. 1463-1468.

In a voluntary bankruptcy, the merchant must offer at the outset his own "exposition of the reasons for his request." CdCom, Art. 1323.

¹²¹ CdCom, Art. 1321.

¹²² CdCom, Arts. 1367-1381. The court also notices meetings of all creditors as the law requires or the court deems appropriate. CdCom, Arts. 1382-1390.

¹²³ CdCom, Art. 1391.

¹²⁴ CdCom, Art. 1392.

¹²⁵ CdCom, Art. 1394, ¶ 3.

¹²⁶ CdCom, Art. 1394, ¶ 1.

¹²⁷ CdCom, Art. 1356.

¹²⁸ CdCom, Arts. 1356-1366, 1479-1480.

¹²⁹ CdCom, Arts. 1481-1491.

¹³⁰ CdCom, Arts. 1533-1547.

¹³¹ CdCom, Arts. 1492-1519.

¹³² CdCom, Arts. 1520-1532.

¹³³ CdCom, Arts. 1398-1421.

was “fortuitous.”¹³⁴ The least fortunate bankrupt is one found guilty of “fraud”; such a finding makes the debtor subject to criminal penalties, including incarceration and a fine.¹³⁵

Given the serious penalties that a finding of “fraudulent” bankruptcy can entail, it does not take much to create sufficient facts to support such a finding. Robbery and embezzlement obviously constitute fraud,¹³⁶ but failure to keep “all of the account books” or keeping books that are “altered, falsified or destroyed” is also fraud in the eyes of the Honduran bankruptcy law—an exacting standard, given the potential rigors of post hoc auditing and the reality that debtors *in extremis* tend to become sloppy bookkeepers.¹³⁷ However, perhaps the least forgiving criterion for fraud in the law is that which sanctions the bankrupt for, after the effective date of bankruptcy,¹³⁸ making preferential payments to a given creditor or extending “guaranties or preferences” to a creditor who had no right to them.¹³⁹ This standard is particularly harsh given that, in the normal course of managing business accounts, unless all creditors are paid in full at exactly the same time, some creditors always receive preferential payments simply by billing at different times or for other ordinary accounting reasons.

To drive home the criminal thrust of the bankruptcy law, fraudulent bankruptcy is presumed whenever the true situation of the debtor cannot be deduced from his or her books.¹⁴⁰ Further, where the bankrupt is a business entity, the individuals responsible for its administration shall be “responsible for the acts that classify the bankruptcy”¹⁴¹ (*i.e.*, the corporate veil shall be pierced to impose criminal penalties on directors and administrators of the fraudulent bankrupt).

Apart from its preoccupation with assigning blame, its unforgiving standards for doing so, and its failure to provide a total discharge of all debts even for the fortuitous bankrupt, the provisions of the Honduras Commercial Code on *quiebra* are quite modern and serviceable in many of their specifics, with concepts and principles that echo those in more recent insolvency legislation around the world. To name one of many examples, it includes dispositions by which the trustee may accept or reject executory contracts, depending on their benefit to the estate, and subject to a hearing and court approval.¹⁴²

¹³⁴ That is, the merchant was “overcome by misfortunes that, taken as proper cause even presuming a regular and prudent process of good commercial administration, reduced his capital to the extreme that he had to cease payment of his debts.” CdCom, Art. 1399. Even the fortuitous merchant bankrupt cannot regain his or her civil rights and return to doing business after the bankruptcy, unless and until he or she binds himself or herself legally to repay the unpaid creditors “as soon as his [post-bankruptcy] situation permits.” CdCom, Art. 1628. “Guilty” bankrupts must either pay off all debts or wait 3 years for rehabilitation. CdCom, Art. 1629. “Fraudulent” bankrupts must both pay off all debts and wait 3 years after completion of their criminal penalty or forever suffer exclusion from exercise of their civil rights and from doing business. CdCom, Art. 1630. Of course, such sanctions have little effect on a business entity that simply goes out of business. But findings of “guilty” and “fraudulent” *quiebra* virtually always implicate individuals who had administrative charge of the company. See CdCom, Arts. 1401, 1403, 1408 and note 59 *infra* and accompanying text.

¹³⁵ CdCom, Art. 1406.

¹³⁶ CdCom, Art. 1403(I).

¹³⁷ CdCom, Art. 1403(II).

¹³⁸ See note 120 *supra*.

¹³⁹ CdCom, Art. 1403(III).

¹⁴⁰ CdCom, Art. 1405.

¹⁴¹ CdCom, Art. 1408.

¹⁴² CdCom, Arts. 1439-1454.

4. Code of Commerce—Suspension of Payments (“Suspensión de Pagos”)

Again tracking the Civil Code, the Commercial Code provides debtors with a way out of bankruptcy by securing creditors’ agreement to a negotiated settlement, or *convenio*. Such a settlement provides final discharge for the debtor who succeeds in performing all his or her obligations under it.¹⁴³ Although agreement on a *convenio* does not terminate the question of the bankrupt’s degree of responsibility,¹⁴⁴ it might well have a mitigating influence in debtor’s favor.

The statutory *suspensión de pagos* provides breathing space in which the bankruptcy parties can work out a negotiated settlement. In addition to the debtor, the *síndico*, the *interventores*, and the creditors may all present proposed *convenios* to the court.¹⁴⁵ Ultimately, the court must review the approved *convenio* and issue a judicial sentence ratifying it.¹⁴⁶ When the court order becomes final, the *quiebra* terminates, along with the duties of the *quiebra* officers.¹⁴⁷

The statute imposes few requirements on the terms and conditions of the settlement plan. It must “maintain absolute equality in its treatment of creditors without guaranties,” and if it distinguishes among creditors “of the same grade,” all such creditors must approve the distinction.¹⁴⁸ Creditors who enjoy guaranties against property of the debtor and creditors whose claims enjoy privileged status need not participate in the *convenio*, which then has no effect on them and their claim’s status.¹⁴⁹

C. IMPLEMENTING INSTITUTIONS

Honduran insolvency laws would depend on Honduran courts, if they were ever used. Institutional players specified in the laws, such as trustees and intervenors, are left to the appointment and supervision of the court.

Supplemental roles might fall to banks (as trustees), the active Banking and Insurance Commission, the nonexistent Corporation Commission, and the Attorney General according to the law, but these institutions have never played any part in insolvency matters, show no inclination to do so, and should have no call to do so, given the absence of any such proceedings. The reconstituted Banking and Insurance Commission, much fortified in recent years, would be an exception; it is prepared to play a role in the insolvency of banking and insurance entities.

¹⁴³ CdCom, Arts. 1551-1667.

¹⁴⁴ CdCom, Art. 1609.

¹⁴⁵ CdCom, Art. 1560. When confronted with more than one proposal, the court should call the various sponsors together and urge them to collaborate on one common draft. CdCom, Art. 1571. Failing agreement on a common draft, all drafts are submitted to vote to choose one, by “relative majority,” for submission to all the creditors. CdCom, Art. 1572. For acceptance, votes representing more than 50 percent of the participating creditors and more than 60 percent of the outstanding obligations must approve the *convenio*. CdCom, Arts. 1573-1574. The statute provides for extensive notice and careful procedural observance at each step in the process of approval. *See* CdCom, Arts. 1568-1584.

¹⁴⁶ CdCom, Arts. 1585-1586.

¹⁴⁷ CdCom, Art. 1595.

¹⁴⁸ CdCom, Art. 1561.

¹⁴⁹ CdCom, Art. 1565. Or they may elect to participate partially, retaining partially privileged and partially unprivileged status in their claim. CdCom, Art. 1566.

D. SUPPORTING INSTITUTIONS

1. Trustees (Síndicos)

Honduran law does not include extensive provisions regarding the qualifications and activities of bankruptcy trustees. Nonetheless, the duties are clear to a large extent, as detailed above.

2. Intervenors (Interventores)

Rules regarding intervenors are even fewer than those regarding trustees. The intervenors should be chosen from among shareholders for a business entity's bankruptcy. Beyond the need for the intervenor to meet the approval of the court, virtually no other requirements exist.

3. Professional and Business Associations

Professional and business associations are the same as those discussed in the Collateral Law section of this report.

E. SOCIAL DYNAMICS

Although reform of other commercial laws is proceeding, creating much controversy in the process, there is no imperative to reform Honduras's insolvency laws at this time. There is a feeling that there are few insolvency proceedings in the country because of the lack of either a tradition or a "culture" of insolvency. Nonetheless, participants at the roundtable held at the end of this assessment process did discuss insolvency laws and their potential in Honduras, especially if the laws were reformed to provide discharge of debts. As other commercial laws are reformed in Honduras, greater attention should be devoted to the insolvency laws.

F. RECOMMENDATIONS

Honduras has no functioning insolvency laws. Its current laws, while well drafted, are out of date and do not perform the functions and purposes of modern insolvency laws. Nonetheless, the current law, as contained in the Commercial Code, is better than that in other Central American countries and might serve as a viable statute if carefully and extensively modified.

To coordinate its insolvency laws with its other commercial laws, and to reduce risk in its credit market, Honduras should institute the following reforms:

- ♦ An extensively amended law of insolvency, taking into account the concepts, principles, and rules included in modern bankruptcy laws such as those promulgated recently in Eastern Europe and other recent national laws of insolvency. In particular, new laws should provide for a discharge of all debts upon completion of bankruptcy and should do away with the concept of blame for the bankrupt debtor.
- ♦ A new law of civil and commercial procedures and a new law of *garantías reales mobiliarias*, both of which take into account and harmonize with insolvency law reforms. The Honduran Supreme Court currently has before it a draft of a reform Code of Procedures, which should be carefully reviewed with an eye to eliminating the delays and

bottlenecks in current judicial enforcement of commercial laws, including insolvency laws. A draft law of *garantías reales mobiliarias* is circulating in congressional counsels' circles and could soon come forward for consideration, but this needs to be carefully vetted to make sure that it conforms with the principles of the OAS Model Law on Secured Transactions.

- ♦ An overhaul of Honduran courts, beginning with the selection of judges in such a way that ensures that capable jurists can make a career in the judiciary. Only then can any meaningful training take place, making it possible to build judicial competence in applying insolvency laws and other commercial laws.

IX. COMPETITION LAW AND POLICY

A. INTRODUCTION

Recognizing the benefits of a competition law and policy, the Government of Honduras has engaged in significant efforts to adopt a competition law.¹⁵⁰ Substantial initial efforts began in 2001, with renewed interest and activity in 2003. Since the end of 2003, momentum has increased significantly. The well-publicized anticompetitive practices in the cement sector during the past year, combined with pressures created by CAFTA preparations and related internal and external concern about the lack of a competition law, have all driven forward the process of adopting a competition law. In September 2004, a draft competition law was “officiated” and submitted to the Economics Committee of the Legislative Assembly. It is anticipated that this draft law will be voted on before the end of 2004.

B. LEGAL FRAMEWORK

No competition law exists in Honduras; however, certain laws have competition-related provisions, many of which are comprehensive. Article 339 of the Honduran constitution prohibits monopolies and oligopolies. Articles 4 and 5 of the Commercial Code address unfair competition, described as competition undertaken by merchants wherein a merchant unduly attracts the clientele of a competitor. The Consumer Protection Law (and the accompanying implementing regulation of July 25, 1989) has numerous competition-related provisions. Article 5 provides the basis for a competition law, stating that all goods and services offered in the national territory must comply with conditions of just retribution with respect to quality, quantity, and efficiency in the prices paid by the consumer. In Article 29B of the Consumer Protection Law, the executive branch is empowered not only to adopt any measures necessary for preventing or combating unfair competition but also to stop any activities that unfairly restrict or limit the delivery of products or services or affect price. Specific examples within this law include Article 7, which states that a producer cannot condition the sale of one product on the acquisition of another product. In the implementing regulation of the consumer protection law, Article 41 authorizes the executive branch to issue any other measures necessary for controlling

¹⁵⁰ Competition law provides a regulatory framework for maintaining and improving efficiency in markets, promoting competitive pricing practices, and restraining price rises in markets where competition is affected by anticompetitive business practices (including horizontal and vertical restraints [*e.g.*, collusive price-fixing, input/output allocation, bid rigging], abuse of dominant position [*e.g.*, exclusion, discrimination, predation], and certain mergers and acquisitions). Competition law alone does not create competition, but when effectively applied can counteract the dangers of private anticompetitive behavior. For example, cartels may deliberately create artificial shortages, resulting in some consumers’ being able to obtain the product but others’ paying an inflated, or monopoly, price. Dominant firms may abuse their market power by, for example, tying two products without a legitimate business purpose. Firms with market power that erect protectionist barriers may block entry to new participants.

In addition to private conduct, competition law can be used to counteract inefficient government regulation and promote efficiency within the public sector. Competition authorities can use the competition law to perform a comprehensive review of existing and proposed laws and regulations, providing suggestions and advice on government policies and measures that promote anticompetitive practices or inefficiencies. Activities often include the review of possible sources of public restraints on competition in trade policies (tariff and non-tariff barriers, antidumping duties and discriminatory export practices), investment policies (exclusionary lists, ownership restrictions, licensing requirements), and sectoral regulation (power, transportation, telecommunications, natural monopolies).

and prohibiting restrictive practices that impede the free circulation of goods and services. Finally, the consumer protection law allows for the creation of a technical advisory body within the executive branch of government.

None of these competition-related provisions appears to have been enforced; instead, there has been widespread interest in the adoption of a competition law. The first significant effort was to draft and adopt a competition law in 2001, but the law failed to pass. The 2001 draft has been described as one either written or revised in congress to reflect the protection of certain businesses of powerful companies and lobbyists. A new draft, prepared in 2004, incorporates many international norms and practices. A limited number of provisions, however, might benefit from further reflection, as described in the following sections.¹⁵¹

Agreements

The law includes prohibitions of certain types of “restrictive practices” in Articles 8–13.¹⁵² This section is generally sound. In particular, the law differentiates between those practices that are subject to a per se legal standard (Article 8) (e.g., price fixing, bid-rigging) and those that are not. The per se standard, however, is usually reserved for cartels, the types of agreements among competitors that are intended solely to eliminate competition among companies and have no redeeming social or economic benefit.¹⁵³ Article 8(e) opens the provision for application to any agreement between competitors. The inclusion of Article 8(e) would broaden the scope of per se activities beyond what is considered appropriate.

Non-per se agreements, including certain types of horizontal agreements, vertical agreements, and abuses of dominant position, are set forth in Articles 9–13. The law establishes a 40-percent market share test as a prerequisite to finding harm. Because market shares depend on market definition—a subject about which reasonable minds can and often do disagree—it is unlikely that the 40-percent test would provide a functional definition that could be easily applied. It can be expected that there will be many arguments over market definition that will go to the

¹⁵¹ Although there is no one “right” model of competition law, in recent years agreement has emerged as to principles and scope. In the case of Honduras, the government might want to carefully consider promoting regional convergence, if not harmonization, in Central America. Trade and investment would benefit if all countries in the region strove to adopt consistent standards. For guidance, the Government of Honduras could examine the competition law of Panama, which is similar to the Mexican competition law.

¹⁵² The term restrictive practices (“*practices restrictivas*”) might be more appropriately replaced by “anticompetitive practices” because an agreement can be “restrictive” and yet efficiency-enhancing and pro-competitive. For example, if a trademark holder gives an exclusive license to a licensee to exploit the mark, this would be “restrictive” in that no one else would get the license, but the exclusivity would be necessary to give the licensee the incentive to exploit the mark through marketing, etc. The definition also refers to agreements with the “objective or effect” of restricting competition; consideration should be given to referring only to the “effect” of restricting competition, so that subjective intent (which is difficult to prove) does not enter the picture. The concern should be the harmful effect of the agreement, not the intent of the parties; agreements might restrain competition although this was not their principal objective.

¹⁵³ The OECD recommendation defines a cartel as follows: a “hard core cartel” is an anticompetitive agreement, anticompetitive concerted practice, or anticompetitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markets by allocating customers, suppliers, territories, or lines of commerce.

difference between a 39-percent and 41-percent market share, consuming time and resources. In the end, this will only divert attention from whether the agreement in question in fact affected competition. An alternative approach would be to require, as to those sections, proof of injury to competition instead of proof of market shares. One solution would be to use the same threshold Mexico uses, “substantial market power in the relevant market.”¹⁵⁴

Finally, an additional improvement could be made in the list of practices set forth in Article 13. This list appears both under- and over-inclusive, particularly if the 40-percent market share test remains. A preferable list would be one similar to the list of relative monopolistic practices found in the Mexican competition law.¹⁵⁵

Merger Control

The draft law proposes a voluntary merger notification regime. Adoption of a voluntary regime is an important way to limit the burdens of merger review for new competition authorities. Although these provisions are generally sound, two improvements could be made. First, the definition of concentrations (in Article 15) is overly broad.¹⁵⁶ Second, although it is important that the *Instituto para la Promoción de la Competencia* proposed under the law (i.e., the Institute) review the notification within a specified time period, given the complexity of merger review, 30 days might be insufficient for complicated transactions. It is useful to examine the Recommended Practices for merger notifications established by the International Competition Network (ICN).¹⁵⁷ Regarding the timing for review, Recommended Practice IV(D) provides “[i]n non-suspensive jurisdictions, initial merger reviews should be completed within a specified period following notification and any extended reviews should be completed within a determinable time frame.” The comment to the practice explains “[n]on-suspensive jurisdictions should likewise seek convergence of their review periods with time frames typically used by competition agencies internationally to facilitate coordinated reviews and clearances. Thus, initial reviews in non-suspensive jurisdictions should be completed in 6 weeks or fewer, and extended or ‘Phase II’ reviews should be completed or capable of completion within 6 months or

¹⁵⁴ Mexican Federal Competition Law, Chapter II, Article 13.

¹⁵⁵ Mexican Federal Competition Law, Chapter II, Article 10.

¹⁵⁶ Consideration may be given to a common definition that has worked well in a number of countries:

Se considera que existe concentración cuando:

- ♦ Dos o más agentes económicos se fusionen o cuando por medio de cualquier acto dos o más agentes económicos que han sido independientes entre sí, consoliden, integren o combinen sus negocios en todo o en parte;
- ♦ Cuando uno o más agentes económicos que ya controlan por lo menos otro agente económico adquieran por cualquier medio, el control directo o indirecto de todo o de parte de más agentes económicos.

Para los efectos de esta Ley, se entenderá por control, la capacidad de influenciar substancialmente a un agente económico a través de:

- ♦ La propiedad o el derecho de usar todo o parte de los activos del agente económico;
- ♦ Los acuerdos que confieren influencia substancial en la composición, votación, o decisiones de los entes directivos y administrativos del agente económico.

¹⁵⁷ The International Competition Network is a voluntary organization of virtually all of the world’s competition agencies.

less following the submission of the initial notification(s).” With a view to convergence with this Recommended Practice, review periods should be extended.

1. Implementing Institutions

The draft law proposes creation of the *Instituto para la Promoción de la Competencia*, a body [*desconcentrado*] of the President of the Republic, with technical, administrative, and financial autonomy in its internal affairs and independence in the exercise of its functions. A three-member directorate would head the Institute for a 4-year period, with each director appointed by the President of the Republic.¹⁵⁸ The Institute would have exclusive power to initiate and investigate cases and would have authority to impose a variety of remedies and sanctions.

Investigation and Prosecution

Experience has shown that private complaints are an important information source for competition agencies in initiating investigations, but it appears that, under the draft law, private complaints to the Institute are precluded (Article 50). The draft law would benefit from revision in this respect, allowing private complaints, as well as including provisions that ensure that the Institute can decline to take action in cases in which there is no injury to the competitive process or in response to the Institute’s enforcement priorities.

In conducting investigations, experience also makes clear the importance of creating, by statute, investigational powers that enable the Institute to obtain information essential to identifying violations of the law. The information gathering articles in the draft law (Articles 48–49) should be rewritten to provide the Institute with the power to compel the information it needs for completing its investigations, including the right to compel the production of documents, interview witnesses and conduct hearings, and inspect corporate records. It is important, if other provisions of law do not so provide, for these provisions to have sufficient force to create incentives to comply with the law. Experience in other countries has shown that if the only sanction for violating such provisions is the payment of small fines, it might be worthwhile to simply pay the fine as a cost of conducting business rather than to provide the information needed. Consideration might be given to imposing heavy fines and other penalties on firms refusing to comply with legitimate requests for information or destroying records to frustrate a pending investigation.

During the investigation of cases, the Institute will handle a vast amount of confidential information (e.g., business plans and financial information). The way in which confidential information is protected is a difficult subject in every competition law. The challenge is to make the necessary information available to decision-makers and to allow parties to fairly contest a case without compromising the secrecy of confidential business information. The confidentiality provisions in Article 34 are vague and apply only to public functionaries. This article should be

¹⁵⁸ The nomination of the directors should be done in staggered terms, and this should be explicitly stated in the law. For example, the draft Nicaraguan competition law provides: “Para el primer periodo de funcionamiento de La Comisión, se conformará de la siguiente manera: dos comisionados serán nombrados por un periodo de seis años; el otro por un periodo de tres años. Posterior al cumplimiento de este primer período, la renovación de los comisionados se hará parcialmente cada tres años es decir, se nombraran dos y un comisionados sucesivamente.”

made more precise, notably by including protections to keep the confidential information of one competitor from reaching the eyes of others.

Transparency

Transparency is important for achieving consistency, predictability, and ultimately fairness in applying a competition law, thereby enhancing the credibility and effectiveness of law enforcement. Transparency also enables the private sector to better understand and predict the likely response to their business conduct. It might be advisable to rewrite Article 57 in a way that puts more responsibility on the Institute to publish regulations, advisory opinions, and decisions.

Penalties

The penalties for unlawful conduct are clear, designed to correct the competitive injury caused by the offense, and crafted in such a way that they do not appear to deter pro-competitive conduct. The principal weakness is that the fines may not be sufficiently stringent to deter future violations of the law. Experience across countries has shown that deterrence is one of the most important benefits of a competition law. The size of fines should reflect that amount needed to deter firms from engaging in violation of the law. If a fine is too low, it will be considered only as the cost of conducting business. The draft law would benefit from an increase in the maximum allowable fines and the allowance of larger fines for submission of false information and for repeat offenders.

Competition Advocacy

Competition advocacy is the ability of the competition agency to provide advice, influence, and participate in government economic and regulatory policies to promote more competitive industry structure, firm behavior, and market performance. All the competition agencies in Latin America have some role for competition advocacy within the government, and several (e.g., Mexico) can overrule decisions by other government agencies. International best practices suggest that advocacy should be a priority for new agencies; therefore, consideration should be given to making the advocacy provisions more robust.¹⁵⁹ For example, the provisions could allow for compulsory review of new legislation or explicitly give the Commission the power to deliver opinions ex officio. The ICN has prepared a compilation of advocacy provisions that are available on the Internet at:

http://www.cfc.gob.mx/icn_infocenter/files/Model_advocacy_provisions.DOC.

Consideration should be given in particular to the advocacy provisions in the Mexican law or the draft Nicaraguan law.

¹⁵⁹ For more information on advocacy, including its importance for new agencies, see http://www.cfc.gob.mx/icn_infocenter/.

2. Supporting Institutions

The Judiciary

Appeals of the Institute's decisions are made to the courts. Although the judiciary has traditionally been weak, the current president has introduced successful initiatives, such as depoliticizing the judicial selection process. Now a panel composed of lawyers, parliamentarians, and representatives of civil society selects judges. These and other judicial reforms suggest that the capacity of the judicial system will continue to grow in the years to come.

Industry, Business, and Professional Associations

Certain members of the business community, including chambers of commerce and industry and business associations, are among the foremost supporters of the adoption of a competition law. They view competition law as a necessary element of market reform and a key component of attracting investment. The *Cámara de Comercio e Industria de Tegucigalpa* recently offered comments on the draft competition law. The *Consejo Hondureño de la Empresa Privada* also is now preparing comments.

NGOs

Fundación para la Inversión y Desarrollo de Exportaciones (FIDE), the largest and most respected think tank in Honduras, has worked very closely with the private sector and with the executive and legislative branches of government to promote the adoption of a competition law.

Law Faculties

No courses in competition law are offered in the law schools in Honduras.

3. Social Dynamics

Regarding competition policy, the most striking aspect of the Honduran economy is the lack of competition in nearly all sectors, reflected in anecdotal evidence and in global competitiveness indicators. In the Heritage Foundation's Index of Economic Freedom for 2004, for example, Honduras ranks extremely low, and considerably worse than its neighbors (Honduras ranks 121st of 155, compared with 24th for El Salvador, and 67th for Nicaragua).¹⁶⁰ In the World Economic Forum's Growth Competitiveness Index Rankings, Honduras was ranked 94th of 102; and in the World Economic Forum's Business Competitive Index Rankings, 89th of 95.¹⁶¹

Initiatives aimed at improving the competitive environment have met with limited success. Although recent governments have attempted privatization, for example, these efforts have met with little success in the face of opposition in Congress. The 2004 Economist Intelligence Unit

¹⁶⁰ The Index of Economic Freedom is available by country at <http://www.heritage.org/research/features/index/countries.html> (last visited September 14, 2004).

¹⁶¹ The World Economic Forum's Competitiveness rankings are available at http://www.weforum.org/pdf/Gcr/GCR_2003_2004/Competitiveness_Rankings.pdf (last visited September 21, 2004.)

country report states, “Since the mid-1990s, three governments have pledged to accelerate the privatization program, with the partial privatization of the state-owned telecoms company, the *Empresa Hondureña de Telecomunicaciones* (Hondutel), a priority, but the sale has repeatedly stalled. The part-privatization of the generation and billing arms of the state-owned electricity company, the *Empresa Nacional de Energía* (ENEE), went ahead in 2000. Some successful privatizations have occurred in the transport sector, with concessions awarded to manage four international airports and some roads.”¹⁶² The “partial privatization” within the energy sector has been minimal. Only 20 percent of power generation, for example, is privately owned.

There has been progress in improving competitiveness especially since the beginning of 2004. In 2000 the World Bank and the International Monetary Fund (IMF) confirmed that Honduras had qualified for debt relief under the heavily indebted poor countries (HIPC) initiative, contingent on its adherence to an economic adjustment program. In February 2004 the Government of Honduras agreed with the IMF on the specifics of the economic adjustment program and is now working to meet the poverty reduction and growth facility goals to reach the completion point for HIPC. The economic adjustment program includes the introduction of a great number of reforms that will increase the competitiveness of the economy. Specifically, regarding a competition law, World Bank conditions for disbursement of funds require adoption of a competition law.¹⁶³

External pressure is merely one driver of the process of adopting a competition law. Internal pressure has increased enormously since the widely-publicized events in the cement industry. In brief, in 2003 a Japanese cement company, Taiheyo Cement, entered the Honduran market and started a price war, resulting in average prices’ falling from La 80 to La 44 per bag by early 2004. The price war continued until the two dominant cement companies—one operating in the north and one in the south—were able to push the Japanese company out of the market using pricing strategies.. As soon as the Japanese company was forced out of the market, prices began to rise, exceeding pre-2003 levels. The public was outraged at what they considered illegal activities on the part of the cement companies. The government eventually imposed price controls on cement in the summer of 2004. Proponents of a competition law have used the cement example to highlight the need for a law.

Allegations of anticompetitive conduct have also surfaced in the dairy sector and in the sugar and flour industries. For example, in the dairy sector, a dominant dairy producer created a plant to produce powdered milk. Shortly thereafter, a new tax was imposed on imported powdered milk, making the locally produced powdered milk cheaper than the imported product. In the sugar industry allegations have been made that an association of sugar mills conspires to fix prices for the sale of sugar across regions.

Certain members of government, private legal practitioners, and members of FIDE have a solid understanding of competition law policy. FIDE and the executive branch of government appear to be the strongest local drivers of reform.

¹⁶² Economic Intelligence Unit (2004), Country Profile for Honduras at 21.

¹⁶³ In 1993, through the Protocol of Guatemala to the General Treaty on Central American Economic Integration, Honduras and its neighbors committed themselves to adopting a competition law. As noted above, efforts to date have been unsuccessful.

The pressure to adopt a competition law, together with the alleged existence of anticompetitive practices, suggests the need for a competition law, though broad-based public support for such a law is not self-evident. Many members of the public, for example, appear vehemently opposed to market reform (in particular, to privatization). Successes in market reform¹⁶⁴, are frequently discounted, and so-called “failures”¹⁶⁵ are highlighted. Moreover, a limited number of discussions with members of the public suggested a weak understanding of competition law policy.

If the adoption of a competition law and promotion of competition policy are to move forward in Honduras, considerable educational efforts will need to be undertaken, as elaborated further in the conclusions and recommendations section of this chapter.

4. Recommendations

Competition law, together with several microeconomic, industrial, and commercial policies, such as privatization, international trade, and foreign investment, is the main instrument for nurturing market reform. The application and interface between competition law and these related policies can have a significant bearing on industrial structure and the competitive market performance of enterprises in the private and public sectors and on economic development. Competition law and international trade liberalization, for example, complement each other in promoting trade, market access, economic efficiency, and consumer welfare. Promoting the objectives of a liberal trade policy supports the objectives of competition law and vice versa. For example, trade liberalization and competition law together can prevent powerful business interests with monopoly power from creating barriers to trade. Similarly, competition law and privatization interact to ensure that a public monopoly is not merely transferred to a private monopoly. When a sector has been liberalized through introduction of new competitors into the market, competition law and its enforcement can fill the primary role of maintaining competition and avoiding distortions caused by anticompetitive practices.

Honduras has engaged in a variety of these market reforms without introducing and enforcing a competition law; consequently, Honduras has not been able to realize the full benefits of these reforms. Actual and alleged anticompetitive practices cause considerable consumer injury, suggesting that this strategy of market reform without a competition law merits reconsideration. A number of active proponents throughout Honduran society, combined with a number of informed government representatives and private legal practitioners, suggest that the capacity for successful adoption and enforcement of a competition law exists and needs to be supported by education of the members of the Legislative Assembly. Specific recommendations are as follows:

- ♦ With a view toward regional convergence and harmonization, consider carefully the competition laws of Mexico and Panama; consult with the drafting committees in El Salvador, Guatemala, and Nicaragua.

¹⁶⁴ For example in liberalizing local transportation, private companies entered the market, and the government eliminated price controls, leading to a considerable decrease in the price of local transport.

¹⁶⁵ For example, after the issuance of concessions for operation of the international airports, prices increased because the new operators were actually collecting airport fees as opposed to accepting smaller bribes to waive the fees.

- ◆ Consider comments made by private sector representatives, including those by Tegucigalpa's Chamber of Industry and Commerce (Cámara de Comercio e Industria de Tegucigalpa or CCIT) and the Honduras Council for Private Enterprises (Consejo Hondureño de la Empresa Privada or COHEP).
- ◆ Consider comments on the current draft made by international experts, including those by the World Bank and U.S. antitrust authorities.
- ◆ Revise and circulate a new draft based on these comments and on the ongoing experiences of regional efforts.
- ◆ Consider promoting passage and implementation of a competition law through a twofold strategy:
 - Develop a series of seminars to promote private sector support, focusing on recent experiences, for example, in the telecommunications sector, regional initiatives, etc.
 - Develop a series of seminars to educate the Legislative Assembly about competition law.
 - As a first step, prepare an advocacy brochure for the deputies who will vote on the bill, explaining in clear, basic language the principal purposes of a competition law in the Honduran context, drawing on examples from previous studies.
 - Hold a 2-day training seminar for the Legislative Assembly, bringing in foreign experts from the region (including at least one expert from Mexico.)

Following passage of the competition law—

- ◆ Develop a policy strategy to make the law operational, including institutional arrangements (e.g., staffing and training).
- ◆ Develop regional training programs for staff and with universities and bar associations.
- ◆ Continue advocacy initiatives, including reviews of government policies and regulation affecting competition, and prepare studies on key sectors.
- ◆ Develop an enforcement strategy that focuses on investigating anticompetitive conduct in sectors that are important to consumers and that address Honduran market failures.
- ◆ Promote a competition culture through public communication, including preparing communication and media materials; enhance the media capacity in publication of competition-related issues through dialogues and workshops with journalists; and engage in dialogues and workshops with related law enforcement officers, other government regulators, and business and academic communities.

X. INTERNATIONAL TRADE

A. INTRODUCTION

Honduras has basic international trade conventions in place, as well as a regional integration commitment and several free trade agreements. It became a member of the World Trade Organization (WTO) in 1995 and is a charter member of the General Treaty on Central American Economic Integration, now in its fourth decade of application. Honduras is committed to a functional customs union. It has free trade agreements with Mexico, Chile, and the Dominican Republic. Most of its exports enter the United States, Europe, and Japan duty-free under GSPs unilaterally established by those destination markets.

The customs rules and practices of Honduras, including sanitary and phytosanitary controls, and the effectiveness of the Honduran customs agency are reviewed in detail in the “Flow of Goods and Services” section.

In general, Honduras’s laws and practices regarding international trade have not developed to take into account recent events in the area. Thus, the country has not overhauled its laws to incorporate recent rules into an effective, functioning national regime for international trade. The advent of CAFTA could act as an incentive to such reforms.

Honduras’s lack of legal and administrative structures for application of countervailing duties illustrates the country’s current framework for international trade law. The WTO sets standards for appropriate trade in goods, permitting recipient countries to impose tariffs to offset improper competitive advantages that imports may have gained through subsidies in the country of origin or through dumping at prices below those prevailing in their home market. A member nation must implement the WTO standards by establishing a national regime of laws and administrative procedures. Although the WTO sets the standards and provides a review process by which an affected nation can challenge their application by a given country in a given case, it has no original enforcement mechanisms. If a given country does not promulgate laws and institute administrative procedures by which it may impose countervailing duties, imports of goods to that country will never suffer countervailing duties, no matter how obvious a subsidy or dumping may be in the case of a given imported good.

Countervailing duties imposed by national administrative processes frequently provide the basis for negotiations between the exporting country and the importing country, leading to reduced countervailing duties on several products going in both directions and achieving benefits for both countries.

To participate in this negotiating process, however, each country must have its own national system of trade laws, or it will have no countervailing duties from which to negotiate. In such a one-sided situation, exporters from the country without a trade-law system must suffer countervailing duties against their products without any hope for negotiated relief, while subsidized and dumped goods from the other country continue to penetrate their market immune to such tariffs.

Honduras and other Central American countries lack effective systems for applying countervailing duties and other WTO standards to imported goods. A viable system requires administrative staff to conduct economic studies and to resolve requests for countervailing duties by deciding whether a subsidy or dumping exists, whether it significantly injures national production, and if so, what the proper level of any countervailing duty might be. Such systems are expensive but essential to full participation by any country's exporters, importers, and national producers within the international marketplace.

To remedy this situation, the Central American countries, already advanced in their attempts to create a common market and a customs union, could join together to create a regional administration, which might administer requests for countervailing duties from any one of the region's countries.

B. LEGAL FRAMEWORK

1. Domestic Laws

The latest version of the Central American Uniform Customs Code (*Código Aduanero Uniforme de Centroamérica*, referred to as CAUCA III) and its implementing regulations (RECAUCA III) have been in force in Honduras since May 2003. In Honduras, as in other Central American Common Market (CACM) countries (except Costa Rica, where CAUCA III was approved by the Congress), CAUCA III and RECAUCA III were enacted by executive decree, without congressional approval. The domestic Customs Law of 1987 (*Ley de Aduanas de la República de Honduras, Decreto 212-87*) remains in effect and has yet to be amended to make it consistent with CAUCA III.¹⁶⁶ Although CAUCA III, as an international agreement, should take precedence over domestic laws, in practice it appears that Honduras is still in the process of fully implementing many provisions of the code.

Honduras applies regional sanitary and phytosanitary rules through the Regional International Organization for Animal and Plant Health (*Organismo Internacional Regional de Sanidad Agropecuaria or OIRSA*), which includes Mexico, Belize, Panama, and the Dominican Republic in addition to the five CACM countries. In the same way, regional regulations implement rules of origin based on the WTO treaty principles. The WTO principles for applying import duties to countervail dumping or subsidies also find application in regional regulations and bilateral free trade agreements.

Honduras has adopted the Central American Regulations on Unfair Trade Practices and on Safeguard Measures, applying the WTO rules. Nonetheless, while the country theoretically might apply countervailing duties or safeguard clauses when confronted with unfair practices or harmful circumstances from imports, the country has no developed practice in these areas. Attempts to institute such proceedings have been abortive and have never actually resulted in the application of a countervailing duty or a safeguard against entering goods. There are apparently no practicing lawyers in the country with a specialty in such "trade" matters.

¹⁶⁶ The last amendment to the Customs Law was made in 1997. There is no regulation to the Customs Law.

Neither the public nor the private sector in Honduras seems much concerned about the current state of affairs, however. International and regional rules provide a sketchy framework for existing circumstances in which Honduran exports enjoy duty-free entry to major markets while Honduras may tax nonregional imports as it wishes. As free trade agreements expose the internal Honduran market to increased competition from exports, demand for more developed laws and procedures for applying countervailing duties and safeguard measures may emerge. For the time being, however, most Hondurans seem content that gaps and inconsistencies in national legislation will be filled when it becomes necessary to do so.

Honduras has laws that support its substantial *maquila*, or assembly plant, operations. Honduran businesspersons and merchants, like other Central Americans, feel that in recent years China has gained *maquila* operations by diverting them from established local interests and that it will continue to present stiff competition in the future.

C. TARIFF REGIME

Honduras applies the Central American Tariff System (*Sistema Arancelaria Centroamericano*, or SAC), a harmonized classification and duty system for the region that implements a common external tariff, applied *ad valorem*. Tariff impositions give rise to disputes, which begin within the administrative offices of the customs authority and may be appealed in stages up to the Supreme Court.

D. IMPLEMENTING INSTITUTIONS

The Honduran Ministry of Commerce and Industry has principal administrative authority for applying tariff laws and duties and other trade laws.

E. SUPPORTING INSTITUTIONS

Cooperation between the public and private sectors in Honduras is lacking, and there is a paucity of institutions supporting the foreign trade sector. However, the Government of Honduras has taken a first step toward improving this situation by establishing a private-public sector commission, *Comisión Especial Interinstitucional para la Modernización del Servicio Aduanero* (CEIMSA), similar to the trade facilitation commissions in Guatemala and El Salvador. CEIMSA's aim is to address modernization of the Customs Service in Honduras. According to newspaper reports and interviews with representatives from the Federation of Customs Brokers (*Federación Nacional de Agentes Aduaneros de Honduras*, or FENADUANA), which is participating in CEIMSA, the initial focus of the commission will be combating corruption and undervaluation. CEIMSA has been working on a strategic plan to address these issues.¹⁶⁷ To address undervaluation, the draft strategic plan contemplates that information about all importations into the country, including the declared value, will be published on the Web site of the DEI. The plan also proposes that corruption, as well as inefficiency in Customs, be tackled by depoliticizing the Customs Service, beginning with an evaluation of all customs personnel and the dismissal of those who are not properly qualified for their positions. It is also recognized that modernization of the Customs Service, including improvements to infrastructure, is

¹⁶⁷ El Heraldo, *Buscan despolitización de las aduanas Hondureñas* (August 21, 2004) at <http://www.elheraldo.hn/detalle.php?sec=9&fecha=2004-08-21>.

necessary to meet the country's obligations as a member of the CACM to complete the Customs Union, as well as to comply with those obligations Honduras has assumed under CAFTA.¹⁶⁸

F. SOCIAL DYNAMICS

Many steps remain before Honduras will have a complete legal and administrative structure for its international trade. Within the region, the country lags behind its CACM partners in its general commitment to regional and global free trade and in its general awareness of and response to international trade issues. In addition, Honduras's foreign trade concerns have focused on promoting and facilitating export operations to the relative exclusion of import controls other than simple tariffs; Honduras has enjoyed GSP privileges in industrialized markets for which it did not have to reciprocate by opening its borders. This flow may change.

Both the public and the private sectors may not yet fully realize the extent of the legal and administrative changes that must take place in the foreign trade sector. Honduras has not yet demonstrated the will and capacity to maintain laws, regulations, procedures, infrastructure, controls against corruption and inefficiency, and other elements that define operations in the sector at levels that support the country's foreign trade. Such changes should become even more necessary as CAFTA takes effect. The legal and institutional and infrastructural frameworks for foreign trade in Honduras generated virtually no concern from government or private sector participants, despite their obvious weakness.

G. RECOMMENDATIONS

In matters concerning international trade, particularly its laws and its administrative infrastructure, the only appropriate recommendations are quite general:

- ◆ Encourage the growth of cooperation between the private and the public sectors
- ◆ Encourage and support reform and increased efficiency and transparency in customs administration and operations
- ◆ Begin to address the lack of a national legal framework for international trade, taking into consideration that the day will come when significant reforms become necessary, perhaps first in the internal administration and procedures for applying countervailing duties
- ◆ Consider the possibility of further regionalization to rationalize the administration of international trade laws that depend on economic investigations and judgments by administrative agencies.

¹⁶⁸ *Id.*

XI. FLOW OF GOODS AND SERVICES

Recently, Honduras has taken some strides in facilitating trade. Indications are that a number of aspects of the trading system have improved, including (a) development of a stronger customs agency; (b) development of open markets nationally, regionally, and internationally; (c) improved relationships between the public and the private sectors; (d) efficient trade-related visa and immigration processes; and (e) adequate basic infrastructure for current trade volumes.

Nevertheless, the trade-related institutions still encumber traders with trade transaction costs in the form of delays and administrative burdens. By eliminating the unwarranted and onerous constraints embodied in laws, regulations, and procedures, Honduras can capture greater savings and efficiencies. In fact, improving the trade facilitation environment can reduce trade costs by as much as 15 percent of the value of traded goods. Even in Honduras's relatively small market, where somewhat over \$6 billion in goods and services were exchanged in 2003¹⁶⁹, improved trade facilitation can lead to *significant* savings. In turn, these savings can improve Honduran economic development in a number of ways: (a) making Honduran exports more competitive, resulting in more exports; (b) lowering prices for Honduran consumers; and (c) enhancing Honduras's overall attractiveness as an investment opportunity.

The United States is the dominant trade partner of Honduras. In 2003, 53 percent of its import trade and 69 percent of its export trade was with the United States.¹⁷⁰ Honduras has based much of its economic stability and future on the *maquila* textile apparel industry, which represents the majority of the country's U.S. exports.

The following discussion evaluates Honduras's current status of trade facilitation and identifies areas where Honduras can reduce trade transaction costs. The assessment looks at the efficiency and security of cross-border flows of goods, services, people, and money and the infrastructure that supports these flows. Currently, trade-related people and money flows pose few problems. Major areas in which improvement could lead to significant results include (a) the development of a professional civil service, especially among key trade-related agencies; (b) professionalizing relevant agencies and implementing strong integrity measures; (c) better integrating and simplifying processes among all trade-related agencies; (d) implementing and updating key functions, such as risk assessment; (e) improving the security environment; and (f) enhancing infrastructure.

A. INTRODUCTION

In 2003 flows of goods amounted to more than \$6 billion. Of these goods flows, \$1.37 billion was exported while \$2.80 billion was imported. Services include \$1.09 billion in exports, and \$687 million in imports. Free zones accounted for \$560 million of service exports (51 percent), which are included because they are a value-added category. Tourism makes up another \$291 million in service exports (27 percent).¹⁷¹

¹⁶⁹ Economic Intelligence Unit (2004), Country Profile for Honduras.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

Honduras's top five trading partners include the United States, Venezuela, Costa Rica, Guatemala, and Mexico, with the United States accounting for approximately 50 percent of exports and 40 percent of imports and other traders accounting for approximately 10 percent or less. Major products flowing out of the country include textiles, apparel, coffee, bananas, and seafood. Major products flowing into the country include consumer goods, automobiles, machinery, transport equipment, and food.¹⁷²

These flows of goods and services are needlessly encumbered by a trading system troubled by weak institutions and corruption. Although there has been some recent progress, serious obstacles hinder the efficient and secure movement of trade across Honduran borders. Major challenges facing Honduras include (a) professionalizing relevant public agencies (Customs, National Police, Ministry of Agriculture, Ministry of Health, and the export agency *Centro de Trámites de Exportación* (CENTREX)); (b) stamping out corruption; (c) improving the security environment; (d) further streamlining trade processes, including the import and export processes handled by Customs, the Ministry of Health, and CENTREX; (e) increasing the integration of border institutions; and (f) fostering greater cooperation among the public and private sectors.

To further facilitate goods and services flows, Honduras must improve the laws, institutions, and operations of its trade-related institutions, including its customs agency. It must also develop modern institutions that are managed, staffed, and equipped to achieve the appropriate balance between facilitation and control and to provide reduced trade transaction costs. Honduras's trade-related institutions are making progress in developing more modern and reliable public services through numerous and significant changes to its regulations, organization, and operations.

The following subsections provide an analysis of the legal, institutional, and operational constraints that impede trade expansion and recommend ways to minimize those constraints. The analysis focuses on legal framework for the primary border institution, Customs; the institutional issues regarding Customs management, organizational capacity, and operations; and the other key public institutions involved in trade facilitation, including the Ministries of Agriculture and Health and the National Police, and their role in trade facilitation. Finally, major recommendations for improving trade facilitation in Honduras are also provided.

B. LEGAL FRAMEWORK

The state of the law is a problematic area for trade facilitation in Honduras. To provide such facilitation, it is most important that the legal and regulatory framework provide (a) an adequate and coherent authority structure for the essential trade-related institutions and (b) clearly stated regulations and procedures for implementing these authorities that strike a balance between facilitation and necessary control.

The basic legal framework is in place, because Honduras, like other CAFTA members, has adopted the Central American regional code (CAUCA) and its implementing regulations (RECAUCA). Honduras also has national legislation that covers other basic Customs procedures. Those sections are found within the Honduran Revenue Code and involve Customs processes and penalty provisions. (The Customs Service is an integral part of the Revenue

¹⁷² *Id.*

Authority created in 1994.) The positive aspects of the legal framework include clearly stated authorities that provide a balance between facilitation and control. There is adequate authority for Customs and its supporting institutions, particularly the Ministries of Agriculture, Health, and Industry and Commerce, and the National Police, to carry out their functions in an efficient manner. Although most law enforcement functions reside with the police, Honduran law provides some authority for Customs to conduct joint investigations with the police when there is belief that an infraction is criminal in nature.

Nevertheless the existing legal framework is not sufficient to ensure an orderly and well-functioning trading system. Despite the adequate basic authority for Customs and its supporting institutions to perform their functions in facilitating efficient, secure flow of goods and services, this authority is undermined by a civil service regime that is far from achieving the foundation of well-functioning public services—personnel and integrity—and key authorities, such as risk management for Customs.

1. Legal Authority Supporting Trade Facilitation

- ◆ There is adequate support for Customs management, operations, and procedures. CAUCA and RECAUCA and supporting national laws provide a generally good legal framework for Customs authority in Honduras.
- ◆ The Honduran constitution provides that all laws are to be published in official government Gazette, and Customs laws and regulations are also made available on the Customs Web site.
- ◆ CAUCA and RECAUCA provide a legal foundation for efficient processing of goods. CAUCA requires that all declarations be electronically transmitted. There is authority for the electronic transmission to be the legal declaration. Procedures are standardized and written and also are available on the Customs Web site. The procedures are in general conformity with Kyoto Convention Guidelines.
- ◆ Honduras is not a contracting party to the Harmonized Commodity Description and Coding System but has been a user of the system at the eight-digit level since 1993.
- ◆ The General Agreement on Tariffs and Trade (GATT) valuation agreement was implemented in January 2000, with some reservations allowing minimum values on used goods, which have now expired. Honduras has been a WTO member since 1995.
- ◆ The law provides for proper monitoring of prohibited and restricted goods. Such goods are identified by directive and provided to officers in the form of written directives and electronic notifications.
- ◆ RECAUCA regulations adequately cover the brokerage community, requiring either a written test or a university degree in Customs matters to gain a license.
- ◆ There is a process for administrative and criminal penalties within the law. CAUCA provides that the importer has a right to both administrative and judicial review of Customs decisions.

- ◆ There is adequate authority within CAUCA and RECAUCA for expedited processing of express shipments.
- ◆ There is a process that allows the importer to request tariff classification rulings that are binding.

a. Trade Facilitation Legal Issues to Address

Honduras can take a number of legal steps to improve the Customs process, including the following:

- ◆ Customs' parent agency, the Executive Directorate for Revenue (*Dirección Ejecutiva de Ingresos*), has its own regulations on recruitment, hiring, retention, and conduct that apply to Customs. These personnel laws and regulations must be reviewed and standardized within the framework of current or revised laws. Currently, Customs' hiring practices are based more on political patronage than on merit. These authorities, or authorities covering the civil service as a whole, must be revised to limit political appointments and build professional public services.
- ◆ Although a new integrity law is before the legislature and Customs management anticipates that it will be approved by the end of 2004, there is skepticism as to its passage and implementation. Prompt passage and strong enforcement are both essential to ensuring that all participants who knowingly promote noncompliance or fraudulent practices in an attempt to circumvent the law can be penalized.
- ◆ CAUCA should be revised throughout the region to provide an advanced binding ruling process that covers not only classification but also value, origin, quota, drawback, and other Customs processes. Currently, the ruling process is limited to classification opinions.
- ◆ CAUCA laws should be revised to give Customs additional authority to detain shipments that are suspected of being in violation of intellectual property rights (IPR). Honduran IPR laws provide that Customs can only detain goods by specific directive. Customs officers do not have the authority to detain shipments based on their suspicion that the shipment is in violation. This component must be instituted.
- ◆ Honduras also has penalty provisions that include penalties for clerical errors; that area should be revised to penalize only repeat errors where there is substantial information that the declarer has not exercised reasonable care.

C. IMPLEMENTING INSTITUTIONS

In all countries, Customs is a primary institution for facilitation of trade and must be properly managed, staffed, and equipped to perform this function effectively. Key components of modern Customs include (a) professional management, (b) up-to-date and sufficient equipment, (c) a well-trained and professional workforce, (d) a well-developed risk management system, (e) transparent and simple procedures, (f) a strong automation system, (g) a robust public private cooperation and consultation, and (h) in the case of Central America, movement toward regional integration.

Honduran Customs has made limited progress in some of these areas, but there is still much work to be done in the areas of personnel recruitment, training, and equipment. Most facilities are in need of refurbishing, and additional management and technical training would benefit the organization and promote greater understanding of the significance of Customs in the process of economic growth. Customs management also must institute a well-developed risk system to reduce the number of nonproductive, costly, and time-consuming physical examinations and the development of a compliance program to reward compliant traders. Also, the noncompliant portion of the trade community must be appropriately sanctioned.

Honduran Customs is an integral part of the revenue authority, *Dirección Ejecutiva de Ingresos* (DEI), which was created in 1994. The director general of DEI is also the head of Customs, with a sub-director having operational responsibility for the agency. The Customs Service now has 725 permanent, full-time employees and more than 200 additional contract-reimbursable employees stationed at the free zones and warehouses. The main commercial processing sites are La Mesa International Airport (San Pedro Sula), Puerto Cortez, Toncontin (Customs inland facility), El Amatillo (Guatemala), El Poy (El Salvador), and Las Manos (Nicaragua). Secondary sites include Guasale, La Ceiba, San Lorenzo, Trujillo, and La Fraternidad.

Although there are plans to modernize the agency and integrate with the Central American Common Market, there are still many issues to be addressed. Customs officers believe that the customs agency is improving and moving toward modernization, but this is not necessarily the prevailing view of the users. Users have indicated that the technical capacity in Customs is very low and that there is neither a career path for officers nor any incentive for officers to upgrade their knowledge. Donor training has little sustained benefit because the Customs workforce is replaced after each change in administration. There is no incentive to effect a change in procedures because there is no continuity within the organization.

1. Customs Management and Operations That Support Trade Facilitation

a. Customs Management

- ♦ Customs has a reasonable organizational structure that incorporates several modern customs practices, such as post audit, post verification, and automation. Automated processes include electronic manifest, statistical gathering, analysis, a risk management system, and a valuation database facility.
- ♦ Customs is working with the Secretariat for Economic Integration for Central America, *Secretaría de Integración Económica Centroamericana* (SIECA), on integration measures. Honduras expresses great interest in fully implementing the union. However, it appears as of the time of this assessment that Honduras will not have achieved much progress toward this end by the January 2005 deadline.

b. Customs Procedures

- ♦ There is a network for electronic declarations. The network is provided by a contract owned and operated by the Customs brokers association FENADUANA (Federación Nacional de Agentes Aduaneros de Honduras). The association charges \$8 per transaction.

- ◆ Management is seeking to create a new risk management system. Canadian Customs has provided training over the past 2 years with onsite visits and a 2-week course in Canada. Four analysts are currently assigned to the risk group and are performing some functions. However, Customs is still without official authority authorizing a risk management process.
- ◆ Post verification is well developed, with a staff of eight dedicated to Customs audits. This staff verifies approximately 3,600 transactions referred from field locations monthly and finds errors in classification, value and some nonrevenue issues. Many of the discrepant declarations are referred for penalty. There is still a high broker/trader error rate, and the post verification group has collected more than \$500,000 in additional revenue in the first 8 months of this year. The Revenue Enforcement office performs customs and tax audits on company premises.
- ◆ Customs is developing adequate capacity in valuation. It has received some value training, including training from the WTO in 2003 and has a value database of approximately 40,000 records that provide values for reference purposes. The Value branch is staffed by a group of seven analysts, who are responsible for updating the database and providing expertise to the field and for post verification.
- ◆ There is a system for handling restricted goods. Prohibited and restricted goods are identified in directives sent to field personnel indicating what permits and licenses are required to process such goods. The directives appear to be extensive and are also provided via electronic mail.
- ◆ Automation efforts are improving. Puerto Cortez electronically receives more than 60 percent of goods by value, and within the past month Customs has started a pilot program to electronically receive vessel manifests. Other sites are manually inputting bill data into the automated system and matching and verifying bill of lading data with the declaration.
- ◆ A ruling process is applied for handling classification issues. Four analysts are assigned to the classification function, including the ruling process. The ruling process is only for classification issues but is said to be binding on all sites.

c. Customs Processing Sites: Toncontin, Las Manos, and Puerto Cortez

- ◆ The Toncontin inland facility in Tegucigalpa provides an efficient operation with adequate hours, staff, systems, and security. The facility processes about 35,000 declarations annually for air and inward cargo arriving from Puerto Cortez and land borders. The offices are small, but the cargo examination facility is sufficient, with good security, including cameras, guards, and cold storage facilities. All shipments are weighted and filmed on arrival. The operator of the facility, Swissport, indicated that there is little pilferage of goods, because of secure controls. All personnel working for Swissport are screened and wear identification badges that specifically authorize them to work in certain areas. The office operates from 8:30 a.m. to 4:30 p.m. and also processes some courier shipments. Officials stated that 60 percent to 80 percent of shipments are released without examination, while 20 percent to 40 percent undergo physical examinations. Most goods are released within 2–4 hours of the filing of the declaration,

with 80 percent of the goods released the day of arrival. There are banks onsite, and payments are made directly to the bank, which notifies Customs electronically of receipt.

- ♦ Cooperation among trade-related agencies appears to be fair. A site administrator indicated that he frequently meets with other co-located agencies and with representatives of private sector parties.
- ♦ Las Manos, the border port with Nicaragua, has operating hours that facilitate trade. It is open 24 hours a day/7 days a week, with the main staff onsite from 6 a.m. to –10 p.m. and one officer on duty between 10 p.m. and –6 a.m. Officials clear about 150 trucks a day, working in groups, with one group working 1 week and the second group working the following week. A total staff of 20 officers is assigned to the site.

2. Customs Management and Operational Issues to Address

The following issues cover major challenges and impediments that Customs must address in order to improve the flow of goods and provide efficient service to the trade community.

a. Customs Management

- ♦ The Customs agency does not have a professionalized workforce and is extraordinarily politicized, particularly at field locations. There is no apparent career path because officers are often assigned for the duration of an administration and, in any case, do not have sufficient training or Customs expertise required to work in today's complex trade environment. Customs personnel practices must be reviewed to provide a career path that creates incentives for development of personnel. In addition, decision-making within the government is too centralized, and more authority should be delegated to field offices. Because much of the business community is centered outside the capital, centralized decision-making slows the movement of goods. It is anticipated that pressure from the Committee on Customs Modernization will promote this process.
- ♦ The current institutional system for handling integrity is inadequate, and Customs is widely viewed as the most corrupt agency in a public system troubled by corruption. The consensus within the trade community is that Customs officers are often promoting vested interests and self-enrichment. Customs officials must improve the agency's integrity. It is crucial that Customs be seen as working in the interest of the government and the trade community, not for themselves or for private or public parties to whom they owe their position. The integrity law (*Código de Ética y Conducta*), produced in consultation with the Inter-American Development Bank, should be passed by the legislature and firmly implemented as soon as possible.
- ♦ Poor funding is another major issue. Employee salaries are very low. Currently officers receive around US \$300 a month and managers around US \$600. There is little incentive to do a good job when salaries are the lowest in the region. Modern customs agencies require modern equipment both in terms of automation and examination. Less intrusive examination tools would give customs personnel the confidence they need to ensure that goods are not smuggled and would also expedite shipments by allowing examination without intrusive and time-consuming removal of goods from containers. Customs

facilities also need to be upgraded. Currently, Customs does not receive the funding it is entitled to by law. It now receives somewhat over 2 percent of the revenue collected for Customs operations. According to Customs officials, the law provides for 3 percent, but because of national budget problems, Customs does not receive the full amount. An additional source of funding (beyond what the agency receives from the national budget) is revenues received from auctions of seized and abandoned goods. However, there needs to be outside funding identified for Customs, in the form of WTO-compliant user fees, that would be dedicated to Customs modernization, equipment purchase, upgrade of facilities, increase of employee salaries, and incentive awards for excellent service.

- ◆ Customs officials' cooperation with the private sector needs improvement. This function is essential for improved trade facilitation. Customs should have regular meetings with the private sector to address areas of mutual concern and should work with the private sector to reduce documentary requirements and cumbersome procedures. Currently, it appears that meetings occur only when problems arise.
- ◆ Training efforts also need improvement. Customs has a training facility, which currently trains new recruits and outside personnel in Customs functions. The facility also provides training to brokers and shippers in Customs procedures. This capacity is important for any customs agency; however, its utility is undermined by the lack of a professional customs staff. In addition, training of Customs personnel is wasted because of the regular turnover. Currently, employees provide all instruction and create the materials for the training. There is a full-time staff of six, including the director, but there are no full-time trainers. Technical training in classification, valuation, fraud detection, computer training, and CAFTA requirements is necessary. Improvement in this area is critical. The European Union (EU) will provide support for a regional training academy in Honduras beginning next year. The EU will provide equipment and expertise for train-the-trainer courses.
- ◆ Honduras does not have reliable trade statistics that business can use to make critical decisions. Statistical data is not readily available and is not available in sufficient detail for credible market analysis.

b. Customs Operations and Procedures

- ◆ Automation of vessel manifests is necessary. Currently, no vessel manifests are downloaded to either the port authority or the Customs automated operating system. Instead, print copies are given to the port authority, and the carriers manually input manifest data into the Customs system. This manual process leads to input errors, which can delay cargo.
- ◆ Examination rates have been reduced, as have the number of discrepancies. However, conversations held during this assessment indicate that the examination rate is still too high. (The current rate is approximately 40 percent.) In addition, although discrepancies are falling, there is no indication whether this is due to increased compliance, lack of expertise in identifying discrepancies, or nonproductive examination criteria. Cargo release procedures also are unsatisfactory. Cargo is generally released on the same day the declaration is filed, with a maximum 2-day processing time if physical examination is

required. If physical examinations are not providing adequate results, the risk management parameters for generating examinations should be adjusted or reduced. Through post audit, post verification, and physical examination, Customs has concluded that approximately 80 percent of its shipments are compliant.

- ◆ There is concern in Honduras and the region that goods sold in Panama are imported with undervalued invoices. This problem must be addressed on a regional level, and those parties participating in undervaluation should be penalized and criminally prosecuted for flagrant violations of customs law.
- ◆ The trade community is concerned that goods are entering without Customs clearance. Supporting this concern, the number of commercial declarations generated by the Customs automated system for 2003 appears low. All commercial imports over \$500 are to be transmitted electronically and should be logged in the system.
- ◆ The Customs laboratory is understaffed and under-equipped. In fact, there is only one employee at the Customs laboratory and that person is responsible not only for customs analysis, but also for quality control. Laboratory issues requiring complex analysis are sent to Mexico, which is expensive and time-consuming.
- ◆ Although it may be sufficient for current processes, the existing level of automation does not provide the capabilities required to incorporate a sophisticated risk management process. In addition, the current automated system, ASYCUDA/SIDUNEA ++ 1.17d, is difficult to modify. The automated system is now available at 14 sites, and communications are said to be stable for use of both microwave and satellite linkage. The network, ADUANETT, is provided by a private association, and users pay for the network, charging their clients approximately \$8 per transaction. The contract with Customs states that ADUANETT is to provide some equipment, including workstations, servers, and printers. Inspectors are selected at random to perform examinations, and examination findings are input into the system to provide an electronic history of the results. The automated system provides manifest, selectivity, declaration processing, accounting, and transit modules. Some in-house programs have also been developed, and work is under way to provide linkage with other countries. It is anticipated that, for Central American goods, the export country's declaration will become the import declaration. Honduras is seeking, as it should, to move to another system, because of the current system's limitations.
- ◆ Customs procedures are now too complex and cumbersome. All of these procedures require review to identify those that are redundant or unnecessary. Many neighboring countries have taken the initiative on this issue and reduced procedures as well as documentary requirements.
- ◆ Customs' risk management system is not fully utilized. There are still many unnecessary, unproductive examinations resulting from overly broad criteria. The analysts should take into account the training received and input targeted criteria on the basis of extensive analysis to define risk and develop a methodology for updating examination criteria. A better understanding of risk management and the development of a mechanism to provide managers with performance feedback are both needed.

- ♦ The relationship between Customs and the National Police should be improved. The police do not have opportunities to use their authority at the border because of lack of cooperation and coordination between themselves and Customs and Immigration. The distrust among these agencies impairs the country's ability to combat smuggling. Customs views the police as using its enforcement authority to check on the actions of Customs officers and generally interfering with Customs responsibilities. Police view some Customs officers as nonprofessional. Currently, the agencies do not share information. No police officers are assigned within Customs units such as Risk Management, as is the case in other countries. A clear definition of the roles of each organization and the joint development of a strategy, with specific goals, to combat smuggling and undervaluation would do much to improve this relationship.
- ♦ Courier facilities and procedures need review and upgrading. According to Customs officials, courier shipments over \$500 require formal entry procedures with the use of a broker; dutiable commercial shipments under \$500 are processed by Customs with the courier paying duty prior to release. Although courier shipments are segregated, they are processed at the same site without any added security. There are four couriers, FedEx, UPS, DHL and TACA. FedEx and DHL have their own facilities to clear shipments and have Customs officers onsite. The Customs officer at the site is a reimbursable service for which a fee is paid monthly to the government. A best practice courier module, such as that used by Nicaragua, should be studied and copied to allow full electronic transmission of data before arrival and release of those goods not subject to duty on arrival. Dutiable goods should be processed in a secure environment. Honduran representatives should visit and review Nicaragua's up-to-date facility in Managua and consider implementing a similar process. Courier processing is a passable operation, with express consignments being processed with minimal delay.
- ♦ Customs lacks the authority to ascertain and detain goods in possible IPR violations. More authority and greater training should be provided to help Customs work in this area. Also Rules of Origin training in verification of origin should be provided and consideration given to moving the process from the Ministry of Trade and Industry to Customs.
- ♦ The Las Manos facility is small, with officers from Nicaragua onsite. The cargo lot, which is in an open area, is large and not congested, although outside the gate there is congestion as many truckers take care of personal business, such as eating, resting, and cleaning their rigs. Little attention has been paid to upgrading this site because it is anticipated that once the Customs Union becomes a reality these border sites will no longer be required except for agricultural work.
- ♦ Relations with Customs should be improved and processes facilitated at Puerto Cortez. Although Cortez Customs is making some improvements in integrity, bribes are often required to gain approvals. Burdensome policies, such as the requirement to clear 30 percent of all incoming cargo and all Panamanian goods, increase costs because of higher handling charges within the port.
- ♦ Overall, Customs communications systems are not reliable. Communications are often down, which causes significant delays.

- ♦ Customs does not have a set tariff for overtime services. The method of establishing such tariffs is not transparent, reasonable, or predictable. As a result, Customs officials admit that when the agency is short-staffed, as it is during holidays, carriers are told they must pay more to secure Customs services.

D. SUPPORTING INSTITUTIONS

1. Public Institutions

Although Customs is the main implementing institution for the movement of goods, an efficient trading system relies on an interdependent process that includes other trade-related public sector institutions and the users of the system. Their combined capacities and performance can result in significant costs (or savings) within the trading system, and optimized trade facilitation depends on their active involvement. These agencies also need sound management, well-trained staff, modern equipment, modern facilitative procedures, and active dialogue with the trade community to respond predictably, and in a timely manner, to issues while guarding the public safety and security of the country. The effectiveness of the enforcement efforts of these agencies, particularly in the area of IPR and activities against smuggling and introduction of contraband, directly affects the investment and business environment of Honduras.

Major public institutions involved in trade facilitation include the National Center for Exports Transactions (Centro Nacional de Tramite par alas Exportaciones or CENTREX), which is the Honduran export agency, Ministry of Agriculture, Ministry of Health, Ministry of Industry and Commerce, the Organismo Internacional Regional de Sanidad Agropecuaria (OIRSA; the regional agricultural standards body), and the National Police. Each of these organizations plays a role in the trading system, and each has a significant impact on trade transaction costs. The Ministries of Health and Agriculture and OIRSA work with sanitary and phytosanitary issues. The National Police provides general security for the country, as well as enforcement in the detection and investigation of smuggling and misdeclared goods. The Ministry of Industry and Commerce serves as the focal point for IPR registry and enforcement, and the export process.

Major issues involving Honduran supporting public sector institutions include (a) providing security in the country; (b) maintaining professionalism throughout the ranks of public agencies; (c) eliminating cumbersome, unnecessary bureaucratic demands and procedures within the import/export process and providing better security, faster delivery, and reduced costs for the trader; (d) adopting a pro-business, client-oriented approach; (e) maintaining a consistent policy of disseminating information concerning procedures and requirements to the business community; and (f) encouraging public-private cooperation to resolve issues or develop streamlined procedures.

a. CENTREX

CENTREX, Honduras's export agency, is a "one-stop shop" for facilitating all required export documentation. There are four CENTREX sites: Tegucigalpa, San Pedro Sula, La Ceiba, and Puerto Cortez. In addition to CENTREX staff, representatives from Customs, the National Plant and Animal Health Service *Servicio Nacional de Sanidad Agropecuario* (SENASA), Central Bank, and the Trade Ministry are co-located at these offices, and exporters are required to visit

each representative independently. CENTREX staff ensures that all required processes have been completed. Exporters are required to provide completed declarations to Customs at the point of export. There are no fees for this service.

1) CENTREX Operations That Support Trade Facilitation

CENTREX has been a positive governmental initiative for facilitating the export process, as demonstrated by the following highlights:

- ◆ CENTREX has streamlined the export process without adding additional fees and costs. Exporters can now secure required documentation in 30 minutes for a process that formerly took 2–3 days.
- ◆ Co-location of the regulatory authorities has increased dialogue among the agencies and between agencies and their users.

2) CENTREX Issues to Address

CENTREX could achieve a more facilitative process through the following initiatives:

- ◆ An automated electronic system should be implemented to link agencies and the exporter electronically. The exporter should be able to transmit his or her documents electronically to the system, with the agencies then completing their required steps and transmitting the file to Customs for action. The current CENTREX concept merely gathers at one location the officials involved in export documentation. Although the Customs Brokers association has petitioned CENTREX to have a representative onsite for electronic submission through its proprietary communications system ADUANETT, this proposal would only be a slight improvement.
- ◆ CENTREX should consider relocating to the Chamber of Commerce and Industry in San Pedro Sula to improve access for the trade community. This step would expand use of the center as an information point for exporters in starting and conducting their business.
- ◆ The officers assigned to CENTREX should have more decision-making authority and access to information required for issue resolution. For example, currently, if a problem occurs with the SENASA representative, the issue is forwarded to the headquarters office for resolution. This delays processing significantly. Many of the products on hold are perishables, for which speed to market is critical. If increased authority is not possible, a special desk should be established within SENASA to expedite resolution of such issues.

b. Ministry of Health

The Ministry of Health, through its Directorate of Sanitary Regulation, is responsible for the registration of imported and exported processed food products, cosmetics, and pharmaceuticals. The regulatory requirements, which apply to both national and imported products, are restrictive to provide public health protections. Food products, cosmetics and pharmaceuticals represent a major share of imported products, and the impact of regulations is far-reaching.

Registration has several required steps. The first requires obtaining a health safety certificate from the food safety agency in the exporting country. In the United States, the Food and Drug

Administration (FDA) issues these certificates, at a cost of \$10 per certificate. Certificates must be authenticated three times through notary actions, twice in the exporting country and once by the Honduran Ministry of Foreign Trade. As a result, according to Ministry of Health officials, securing a certificate usually takes about 4 to 8 weeks, at a cost of \$80 to \$100. The second step involves filing the certificate with the registration at the Ministry of Health. For processed food registration, which can be submitted and approved at four locations throughout the country, approval takes about 20–30 working days, at a fee of \$11. For pharmaceuticals and cosmetics, the process is more lengthy, costly, and centralized (in Tegucigalpa). Fees range from \$20 to \$30 for administrative processing with a flat \$350 for required laboratory analysis. The laboratory at the Honduran Pharmaceutical College is used for this purpose. Although current regulations state that this process must be completed within 40 working days, this deadline is often missed, and Ministry of Health officials acknowledged that the process can take as long as 6 to 8 months.

A staff of 12–14 members, who manually administer all steps in the process, handles registrations. Collected fees, with the exception of those for laboratory analysis, are dedicated to Health Ministry operations. The agency is now rewriting the current law to increase administrative fees by 50–100 percent, which they say will more accurately reflect true costs.

1) Ministry of Health Operations That Support Trade Facilitation

The agency has taken or is now taking steps to modernize and improve its procedures through the following actions:

- ◆ The agency has established a customer service window at Tegucigalpa where the trade community can obtain registration status information. Another such window will soon be established in San Pedro Sula. Unfortunately, this service will not shorten the time it takes for agency personnel to actually determine registration status, which is now approximately 2 days because of a lack of automated tracking systems. Nevertheless, the service will enable traders to get status updates.
- ◆ The agency, through World Bank funding, is developing an automated operating system within the registration offices to track and control submissions and authorizations. Although this will take at least 1 year to complete, and even more to implement, the modernization process has begun.
- ◆ Facilitative procedures for regional products were initiated in August 2004. National registration of some food and beverage products is now accepted as valid within four Central American countries, though Costa Rica is not participating. Under this mutual recognition policy, products can be imported from one country to the next with a certificate of “free sale” from a third country. A dialogue is now under way with the Dominican Republic to establish the same reciprocal procedures.
- ◆ Full accreditation of the laboratory at the Pharmaceutical College is under way. The improvements needed to achieve this accreditation will expedite and improve the quality of laboratory results.
- ◆ Laboratory fees will soon be based on the product rather than being a flat fee. This fee structure should reduce laboratory fees for routine products.

2) Ministry of Health Issues to Address

Sanitary Phytosanitary regulations are a major factor in improving trade facilitation because of the high percentage of such products traded within the Honduran international trade environment. Aggressive pursuit of further modernization efforts to streamline requirements could have significant cost and other benefits. Recommended modernization efforts include the following:

- ♦ The registration process should be reengineered to better balance safety and facilitation. Representatives from the private sector claim that the current system adds 6–8 percent to the cost of imported food products, and even more to the cost of pharmaceuticals and cosmetics. Emphasis should be placed on adopting the new Central American procedures for elimination of registration requirements on low- and medium-risk commodities to international goods. Because of the current lengthy delays and high costs, many traders circumvent the system through smuggling and false declarations. Some industry representatives state that up to 50 percent of food items at the retail level are unregulated. This puts the legitimate trader at a severe competitive disadvantage and can force the smaller importer out of business or into the black market. Also, the length of the registration process (a minimum of 2–8 months) restricts the range of goods that can be imported. Specifically, the long process prevents seasonal or closeout items from being offered to the consumer through legitimate channels.
- ♦ The World Bank project to automate the registration operation should do more than automate the current system. A working group of trade and agency staff should review each step of the process and determine the cost of that step and whether it could be eliminated or streamlined. The goal should be a significant reduction in registration cost and time. The design of the automated system should accommodate this reengineered process.
- ♦ Quality controls measures should be instituted to check the work of laboratory and procedural personnel. Currently, favoritism and politics influence the process. It is necessary to implement a system based on professionalism and integrity.
- ♦ A special waiver or procedures should be considered for retail outlets/importers who import products directly from wholesalers rather than directly from manufacturers. The current process makes it difficult to secure the required documents for registration. Because the products will be analyzed and tested by national authorities, such procedures would have no negative implications for public health.
- ♦ Resistance to change should be overcome among many staff members. The agency should push more aggressively to modernize its procedures.
- ♦ Clear, uniform, and predictable import regulations should be made available to the trade community on a timely basis. The SPS process itself is not well defined, making it subject to interpretation, which increases the opportunity for favoritism. In addition, there is no system for communicating procedural changes to the trade community; thus, the importer often becomes aware of a new requirement only when his or her registration papers are rejected.

- ◆ Greater transparency and predictability are important. The agency should follow the scientifically based principles outlined in the Codex Alimentarius¹⁷³ in adopting requirements and determining whether to approve a registration request.

c. Ministry of Agriculture

The Ministry of Agriculture regulates products from the agricultural sector, including raw and processed plants and livestock, from a health and safety perspective. In this task, the agency faces numerous challenges. For many years, Honduras's only exports were bananas, coffee, and wood, all of which are subject to few SPS requirements for entering the global market. However, with the recent growth of the seafood industry and diversification into nontraditional products (such as okra, eggplant, and snow peas), demands on the food safety inspection, certification and approval system have increased. As this transition occurs, the ministry will have to increase its technical capacity to ensure that new products meet SPS standards.

Because of their limited technical capacity and resources, small economies, particularly developing ones such as Honduras, have difficulty meeting constantly increasing, rigorous international food safety requirements, such as those established by the new bio-terrorism law of the United States. When large players in the global economy, such as the United States, impose new requirements, these ripple throughout the world, eventually becoming part of international recognized standards for the product. As a result, products from smaller, less developed countries are often denied access to the global market for long periods of time while their regulatory agencies and growers attempt to implement and certify production to meet the new requirements.

Within the Ministry of Agriculture and Livestock, the National Plant and Animal Health Service (SENASA), develops and implements the procedures governing SPS certification for exports and import permits for processed and raw plant and animal products. As noted, export certifications are completed at the four CENTREX offices with a staff of eight technicians. A fee of \$8.25 per SENASA certificate is charged for each of the approximately 9,000 certificates in 2004 through September. At CENTREX, this process takes less than 10 minutes to complete.

SENASA has four divisions that issue the import permits required to secure release of each shipment of raw or processed vegetable or animal product. SENASA maintains a register of all companies permitted to import these products. Import permits are issued only by the headquarters office in Tegucigalpa and normally take 2 days to review and approve. In 2004, through September, 18,000 import permits were issued, at a cost of \$8.25 each, by a staff of 10 people.

1) Ministry of Agriculture Operations That Support Trade Facilitation

The Ministry of Agriculture has taken several steps to improve the quality of its operations and its level of service, including the following:

- ◆ Importers can secure the required certifications with few serious delays.

¹⁷³ The Codex Alimentarius standards are available online at the Codex Alimentarius Commission's website, available at http://www.codexalimentarius.net/web/index_en.jsp.

- ◆ In 2000 the ministry signed an agreement with OIRSA, which entrusted OIRSA with the full range of *Servicio de Proteccion Agropecuaria* (SEPA) import activities, including collection of all fees, performance of all inspections, fumigation, laboratory analysis, and quarantine services at the borders. This arrangement has produced a process with increased integrity and professionalism. Honduras and Guatemala have SEPA.
- ◆ The ministry has an internal automated operating system that tracks actions, permits, and the importer/exporter registry and provides quality statistical data. Using an Inter-American Development Bank loan, SENASA is updating the system so that the traders' permits can be submitted and approved through Internet application. The target completion date is January 2005.
- ◆ There is an excellent working relationship between OIRSA and SENASA, which work together to upgrade public safety. Jointly, the two agencies provide training to upgrade professionalism.
- ◆ OIRSA funds are used to eradicate and control pests and to maintain pest-free zones so that producers in these areas can export their commodities.

2) Ministry of Agriculture Issues to Address

Improvements in the following areas would expedite and enhance the ministry's efforts to modernize and improve performance:

- ◆ SENASA should improve its relations with the trade community. To do so, it should promote a customer service approach to its work and involve the trade community more in streamlining and modernizing procedures. Active dialogue and working groups should be established for this purpose.
- ◆ A quality control program should be established so that management can determine how well it is fulfilling its responsibilities. Currently, the only reports are quantitative.
- ◆ A modern public information system should be implemented so that changes in procedures and policies are sent to the trade community on a timely basis. Because of constantly changing SPS requirements, importers and exporters do not benefit from predictability.
- ◆ The agency's risk management system should be improved. Currently, the system is rudimentary, and technicians need training in qualitative and quantitative analysis. Increased risk management will lead to better resource allocation, better detection of problems, and fewer, shorter delays for low-risk items that can forgo inspection.
- ◆ Honduras should improve the maintenance of pest-free zones. Although SENASA works effectively with OIRSA on programs to eradicate pests and disease (it has successfully eradicated four poultry diseases), it is having difficulty in maintaining these efforts.
- ◆ Agriculture and livestock producers often look at the food safety process as compartmentalized into production, processing, and packaging. This hinders effective oversight and often prevents a product grown under a properly controlled environment from entering the export market because of problems in subsequent steps.

d. OIRSA (*Organismo Internacional Regional de Sanidad Agropecuaria*)

In 2002 the Government of Honduras designated OIRSA the provider of SEPA services at all border locations. SEPA services include complete responsibility for inspection, fumigation, quarantine, laboratory analysis, and fee collection. (Guatemala has this same arrangement, whereas the other Central American countries use OIRSA's "SIC" services, which cover only fumigation and quarantine functions.) OIRSA inspectors work under requirements, laws, and policies established by SENASA. Problems that arise in the field, are resolved by SENASA. Both agencies participate in the recruitment and hiring of inspectors. Fees are established by Honduran law, and are currently the third highest in the region, behind Costa Rica and Guatemala. OIRSA collects all fees derived from inspection and import/export permits.

OIRSA collects funds from two processes: inspectional collections and import/export certifications. It retains approximately 60 percent of OIRSA inspectional collections for operating expenses. The remaining 40 percent is used by SENASA to fund programs for the eradication or control of pests or for training. In addition, OIRSA collects the \$8.25 fees for SENASA import/export certifications. OIRSA receives an 8 percent processing fee for this service, with the remaining amount left to SENASA.

OIRSA maintains a staff of 89 employees, 73 of whom are in the field. About 300,000 inspections per year are conducted at Puerto Cortez, which has a staff of 25 inspectors. This is the largest operation in the country. OIRSA currently operates three laboratories in the country and uses an additional one in Guatemala. An inspection is performed on every shipment to verify contents against the import permit. If laboratory analysis is not required, release usually occurs within 1–2 hours. Laboratory analysis requires a 1–2 day delay in release.

1) OIRSA Operations That Support Trade Facilitation

OIRSA's presence in Honduras has upgraded the quality of the country's SPS services, as evidenced by the following:

- ◆ OIRSA inspection personnel are more technically proficient than other inspectors in the region because OIRSA requires higher qualifications. OIRSA inspectors are also less susceptible to bribes because they receive higher pay.
- ◆ Regional inspection provides a less politicized environment than do national inspection agencies.
- ◆ OIRSA uses sophisticated automated systems to control and record the process and to provide updated information to field offices. This increases speed, transparency, and accuracy.
- ◆ Since OIRSA assumed inspection responsibilities, the number of pests and plaques identified has risen to 3,000, up from 11 identified by national inspectors in the preceding years.
- ◆ OIRSA laboratories are modern, well equipped, and well staffed.

- ◆ Fieldwork is conducted thoroughly and efficiently. Pre-identification of pests is performed onsite. Fieldwork is automated and tracked, and inspectors have online research capability. Reports on the quantity and quality of work are prepared weekly, monthly, and yearly; these are forwarded to SENASA so that it can maintain effective oversight.
- ◆ The collection of export/import certification fees by OIRSA has generated an increase in the funds available to SENASA. The government used to charge 17 percent for fee collection, and getting these funds back was difficult. OIRSA charges only an 8 percent administrative fee, which goes directly to SENASA.
- ◆ OIRSA fund management has also streamlined SENASA's procurement process because it eliminated many of the bureaucratic obstacles that government imposed in these areas.

2) OIRSA Issues to Address

The partnership between OIRSA and Honduras should be expanded and improved by the following measures:

- ◆ OIRSA's SEPA services should be used in all Central American countries as a first step toward harmonization of the SPS process. SPS issues were not considered in developing the Customs Union, which was primarily designed to promote the simplification and harmonization of Customs procedures. OIRSA is now conducting a study sponsored by the Inter-American Development Bank to define the various SPS requirements of the five CAFTA countries and to recommend ways of harmonizing requirements and operations, where presently there are wide disparities. Harmonization is difficult to achieve because of legitimate concerns for public safety and a lack of political will. As a public safety issue, pests present in some countries are not present in others. As a political issue, countries are hesitant to relinquish sovereignty, and there are vested political interests in some bureaucracies. A first step would designate OIRSA to conduct full SEPA services in all countries. OIRSA inspectors could perform their services at any site in accordance with multiple countries regulations, depending on the destination of the product. Also, as a regional office, its services would be accepted and deemed of good quality in all countries. This approach would eliminate the need for countries to post inspectors in other countries as the Customs Union progresses. The national Ministries of Agriculture have neither the resources nor the funds for these relocations.
- ◆ At Puerto Cortez, OIRSA's system should be linked with the Customs operating system so that inspectors can access pre-arrival manifest data and make advance plans to examine cargo and research new products to minimize delays.

e. National Police

The National Police force, created in 1998 when the military gave up its role in civil society, comprises five major divisions. The one related to customs fraud, smuggling, and border enforcement is the General Office for Special Investigative Services. This unit has higher recruitment standards, with the recruits carefully selected and subject to random drug testing and polygraphs. The 300 officers in this unit are divided into separate departments that deal with

narcotics interdiction; contraband; and fiscal fraud, including IPR, border patrol, and money laundering. Salaries are higher for this department but are still relatively low at \$300 per month.

Protection of the border, particularly the blind spots, is extremely challenging in Honduras. The country has major land borders with three countries; two sea borders; and the largest Central American port on the Atlantic, Puerto Cortez, which is heavily used by Honduras's neighbors. About 200 officers are assigned to the borders, including the blind spots.

In addition to patrolling the blind spots and reviewing shipments at the border posts for possible fraud and undervaluation, police conduct road stops. They will pull trucks aside to review the declaration, and if, in the officer's opinion, the cargo has not been properly declared to Customs, the truck must proceed to the importer's warehouse, police headquarters, or the Customs warehouse for further review. Customs is then notified, because the examination must be conducted in the presence of a Customs officer. Such inspections are conducted even when Customs has previously examined the shipment.

Smuggling and undervaluation are major issues. Private sector representatives interviewed for this assessment estimate that up to 80 percent of imported merchandise is either undeclared or falsely declared. The threat is greatest at the point where the borders of Honduras, Guatemala, and El Salvador meet. Smuggled commodities including coffee, livestock, and potatoes, head to El Salvador and Guatemala where growers can get higher prices, and Nicaraguan cheese is smuggled into Honduras. In addition, fuel smuggling, related to the tax on fuel in Honduras, is a serious problem. Estimates are that up to 50 fuel trucks from Guatemala and El Salvador enter Honduras illegally *every day* through official border points.

Last year about 8,000 road stops were conducted, with about 10 percent proceeding to further inspection. These, in addition to detections at the borders, resulted in the collection of approximately \$500,000 in additional revenue. Approximately, 30–35 cases were referred to Customs for appropriate action.

Customs is the final authority on whether a case warrants a civil penalty or criminal action. If a transgression constitutes a crime, the matter is forwarded to the Revenue Transparency Department of DEI, which prepares the case for prosecution, making recommendations to the court as to dispositions. Since 2002 only five cases have been referred to this office for criminal action. The current Customs administration has not forwarded any cases during its 2 years in office. The National Police is aware of the situation and is displeased with Customs' failure to forward criminal cases.

1) National Police Operations That Support Trade Facilitation

This agency plays a significant role in security by combating fraud and smuggling; these efforts encourage and facilitate legitimate trade. Actions of the agency that support this function are as follows:

- ◆ Border police activities have strengthened trade security on Honduran roads. Two years ago, as many as 2–3 containers were stolen per month. In 2004 there have been no container thefts. (Some question the police's role in this improvement, believing that

security has improved mainly due to private efforts, i.e., additional private security for transporters.)

- ◆ Recently, an agreement was implemented at Puerto Cortes between the police and port authority that allows police access to the port facilities. Now police are entering facilities and doing a good job of inspecting and seizing illegal goods and narcotics.
- ◆ The division devoted to combating fraud and detecting IPR violations is recognized as an important force for economic growth and has been rewarded with higher pay. The division's special recruitment and selection process, along with the higher salaries, has resulted in greater integrity and higher performance for this division. In addition to being specially recruited and carefully selected, the police in this division are well trained and are required to take random drug tests and polygraphs.
- ◆ The IPR unit has been active recently and has seized and destroyed infringing articles. The police can only initiate action upon receipt of a judicial order, issued as the result of a complaint filed by the owner. The police have been effective in following up on about 30 such orders in the past 6 months and are now involved in an ongoing project with the Business Software Association to combat illegal use of software products, based on complaints from Microsoft.

2) National Police Issues to Address

To improve the actions of the National Police in interdicting the flow of illegal goods across the borders, the following issues deserve attention:

- ◆ Corruption within the police is still perceived as a major problem. Although some steps have been taken to address this issue, more efforts must be made to demonstrate that the agency is serious about addressing it. In 2003 an internal affairs unit was created in the police. This has produced some positive results, but the unit's actions have been circumscribed by legal restraints. As a result, criminals have been able to penetrate public institutions to bribe officers to allow their illegal activities to go undetected.
- ◆ The police lack personnel; equipment, especially in the area of communications systems; and training in investigative, examination, and surveillance techniques. Although the United States has assisted in upgrading National Police capabilities to combat the flow of narcotics, money laundering, and illegal immigration, the criminals still appear to be better equipped, organized, and funded.
- ◆ Although smuggling and false declarations are recognized by all parties as major threats to the economy, discovery of such transgressions and effective punishment that would act as a deterrent are lacking. Customs claims that it cannot rely on the courts to administer fair justice, and thus settles such cases administratively. A recommendation to establish a special court for resolution of fiscal/Customs crimes is now being considered by Congress. Customs has no authority to disregard the criminal code that clearly defines what constitutes a criminal action in regard to smuggling and contraband. The issuance of administrative penalties and settlement of cases with payment of loss of revenue create an environment that encourages smugglers to continue and expand their activities.

- ◆ Although transportation security has improved recently, security issues remain a major concern and significantly affect trade transaction costs because many trucks must travel in convoys, some with armed guards, and limit travel to the hours from 6 a.m. to 6 p.m. Increased costs related to security are estimated to range from \$50 to \$70 per container, including the cost of a guard for each vehicle and monitoring personnel to track the movement of each dray. Outside of the special unit dedicated to security, the police thus far have been unsuccessful in addressing this issue.

f. Intellectual Property Rights

The Director General of Intellectual Property within the Ministry of Industry and Commerce administers and oversees IPR requirements for Honduras. With the passage of the new Property Law (*Ley de Propiedad* or LdP), the Registry office will be incorporated into a new *Instituto de Propiedad*, an autonomous office independent of any ministry. According to officials involved in protecting intellectual property rights (IPR), in 2003 the office's current staff of 21 employees processed 186 patents, 5,638 trademarks, and 230 copyrights. Three alternatives exist for dealing with infringing articles—administrative, civil, and criminal.

1) IPR Operations That Support Quality Enforcement

- ◆ IPR officials report that Honduran law includes protection for all categories of IPR merchandise and meets the minimum standards of the WTO TRIPS agreement.
- ◆ Steps have been taken to make the IPR regulatory body an autonomous department outside of any ministry. This should increase the profile and priority of the work performed, provide an increase in budget to improve technical capacity, and improve the quality of the review of initial decisions by the office (since the first level of review will be by qualified staff within the department rather than by Ministry of Trade officials who have no training in IPR issues).
- ◆ Communications between the Registry office, judges, police, and prosecutors are conducted on an as-needed basis, and the sharing of information is without barriers.
- ◆ Honduras has a unique provision within its copyright laws, whereby administrative penalties can be assessed. In 2003–2004 nine penalties, totaling \$53,000, were imposed on cable companies for unauthorized broadcasts.
- ◆ Honduras has completed its assessment of the changes required to meet its IPR obligations under CAFTA. This includes 14 modifications to existing IPR laws and becoming a signatory to five existing IPR international agreements. The government anticipates being able to complete these actions by the required deadlines.
- ◆ Political influence is minimal within the Registry office, with only the director, not the staff, rotated with each new administration. In addition, the current director was well qualified for the appointment, having an extensive background in IPR issues and law.

2) IPR Issues to Address

- ◆ The IPR Registry staff is inadequate to handle the workload and insufficiently qualified to handle the complexities involved. Excessive workload hampers training efforts.

- ◆ The current automated system is outdated, inefficient, and unreliable. Requests to the World Intellectual Property Organization (WIPO) for assistance have not been met. A modern system with linkages to the other Honduran agencies and offices involved in enforcing IPR requirements would improve service to the filers and increase enforcement capabilities.
- ◆ The government must initiate a campaign to raise awareness of IPR protection as a critical function of the state and a necessity for protecting national innovation and artistic development. IPR protection cannot be viewed as the sole responsibility of the Registry office.
- ◆ Honduras has a poor record of IPR enforcement because of a lack of technical capacity and a serious government mandate to address the problem.

3) Private Institutions

Private sector entities also contribute to trade facilitation. The costs and speed of delivery to market for the international trader are directly affected by the strength of the trading community and its level of cooperation with the public sector. This community includes exporters, importers, customs brokers, the trucking community, vessel carriers and agents, freight forwarders, free zone operators, couriers, and bonded warehouse proprietors.

Private sector priorities include improving trade facilitation and preparing for the opportunities and challenges of CAFTA. Many private institutions are leaders in the campaign to simplify procedures and increase public agency professionalism. With few exceptions, the transport industry and the other service sectors, such as the free zones, warehouse operators, and customs brokers, provide the trade community with competent and efficient service. However, there are some areas of concern, such as the poor condition of the transport fleet and the poor quality of many customs brokers.

g. Importers and Exporters

With more than \$6 billion in goods and services traded per year¹⁷⁴, and as a major Central American port, Honduras has a significant import-export community. Key issues for the trade community include quality standards and establishing a stronger export community.

1) Importer-Exporter Operations That Facilitate Trade

- ◆ Private organizations representing the business community are working to improve trade facilitation and prepare for CAFTA. The *Asociación Nacional de Industriales* (ANDI), the national manufacturers association, is helping industries, principally small- and medium-sized enterprises, compete internationally and working to improve the business climate. The Honduran Association of Maquiladores (*Asociación Hondureña de Maquiladores*, or AHM) promotes trade facilitation activities. Various associations support the development of the Customs Union to reduce fees through simplification and automation.

¹⁷⁴ Economic Intelligence Unit (2004), Country Profile for Honduras.

- ♦ ANDI is working to establish industrial estates, where human resources, technical training, and facilities can be co-located for collective use. Co-location in one industrial park will allow producers to gain economies of scale in raw material purchases, tooling to modernize styles, and quality control implementation. The initial project will be for shoe manufacturers, many of whom are small.
- ♦ The Honduran Association of Private Enterprise, *Consejo Hondureño de la Empresa Privada* (COHEP) represents 51 major business organizations and seeks to make private enterprise more competitive by initiating sectoral training on CAFTA challenges and opportunities.

2) Importer-Exporter Issues to Address

- ♦ As an overall constituency, exporters are not well organized. The export community is splintered and polarized into various organizations. The lack of a single, representative organization inhibits the presentation of an effective collective voice on policy and procedures affecting the export community, particularly because there is little communication between the groups. For example, *Asociación Nacional de Exportadores de Honduras* (ANEXHON), the National Association of Exporters, has limited membership and represents mainly industrial producers. The *maquila* industry has its own association, as do agricultural producers of nontraditional products. Other associations represent coffee and banana growers.
- ♦ One major export-related problem is the lack of information and knowledge within the agricultural sector about Sanitary and Phytosanitary Standards (SPS) requirements for exporting products to the United States. As a result, there is a general perception that such standards are too high and can never be successfully met. Private efforts could significantly improve this knowledge gap.
- ♦ Honduras lacks a designated organization for quality control standards to educate manufacturers and producers in international industry requirements and assist them with implementation. This is a basic requirement for global competitiveness, and assistance will be needed in this area, particularly by SMEs.

h. Customs Brokers

Honduras has an adequate supply of brokers, including 212 licensed individual brokers. Although some brokers provide professional service at a reasonable rate, the quality of service within the profession is reported to be generally poor. Approximately 75 percent of brokers meet CAUCA broker requirements, including a university degree and an exam-certified or customs-specialized degree. Brokers must be bonded (\$1,400 per year per customs processing site). The standard tariff for fees throughout the industry ranges from 2.5 percent to .40 percent of CIF value, well within the regional fee range for these services.

1) Customs Broker Operations That Support Trade Facilitation

- ♦ Brokers must pass a rigorous examination, which sets high standards for knowledge. In 2004 only 7 of 80 applicants passed the examination.
- ♦ Brokers are required to be electronically connected to Customs.

- ◆ Because of training and the need to meet CAUCA standards, corruption within the broker community appears to have decreased recently.
- ◆ The Honduran National Federation of Customs Brokers, FENADUANAHA, is an active advocate for trade facilitation. The organization represents most brokers (197 of 212 licensed brokers).
- ◆ FENADUANAHA is making concerted efforts to improve the quality of services provided by its members. It recently hosted a 7-month course at two locations, holding classes on Friday evenings and all day Saturday. Of the 212 licensed brokers, 205 attended and 145 received a diploma for successful completion.
- ◆ FENADUANAHA took the initiative to establish working groups between public agencies and the private sector to reform customs procedures. (This work is now under the umbrella of CIEMSA, the recently established private-public trade facilitation committee.)
- ◆ Relations with Customs are generally good. The federation receives advance notification of changes in procedures but is not sought for input into policy-making. Monthly meetings are conducted with Customs to resolve problems.

2) Customs Brokers Issues to Address

- ◆ The professional quality of a large number of Honduran brokers is poor, and Customs is a weak regulator. Private sector representatives interviewed for this assessment estimate that 40 percent of the sector is still considered to be incompetent or corrupt. Customs currently suspends 2–3 licenses every 6 months for a period of 59 days. However, suspension is ineffective in dealing with the problem, and FENADUANAHA and Customs should join efforts to improve the quality of the sector and take actions to *revoke* licenses.
- ◆ The partnership between Customs and the broker community needs to be strengthened. Brokers must be more active in the development of policies and procedures. At a minimum, Customs and brokers should share draft Customs procedures.

i. Free Zones

Customs officials mentioned that in 1976 Honduras granted the government the authority to establish free zones that included significant tax incentives for manufacturers. In 1987 Honduras approved privately operated free zones, which could be established anywhere within the country. The *maquila* industry operates mainly in these private zones. Eighty percent of all zones are located in the north coast, between San Pedro Sula and Puerto Cortez. Altogether Honduras has 25–30 operating zones, providing service to about 225 companies. Approximately 10–12 zones house about 50 percent of the users, with the others being relatively small operations. The larger zones offer a wide range of services, including banking, employee training, personnel services, and infrastructure.

Currently, the tax benefits and incentives granted to these operations are secure until 2007, with extension possible until 2009 if granted by the WTO under the procedures applicable to

developing countries within the Agreement on Subsidies and Countervailing Measures (SCM Agreement).

Customs officers specially trained to perform only zone oversight functions are onsite at each zone location. These officers, who number between 80 and 100, work from 8 a.m. to 4 p.m. and are available for overtime services at extra pay, performing physical verification of all loading operations and selecting imports to oversee discharge.. The zone operator reimburses Customs for all costs associated with these positions.

1) Zone Operations That Support Trade Facilitation

- ◆ Private sector involvement in the operation of the free zones has resulted in competitive regional facilities, offering high-quality service and modern infrastructure. The operators of the zones aggressively market their services to potential users and receive good support from the government that recognizes the importance of zone activity to the national economy.
- ◆ Costs are competitive, when the full range of services is taken into account. Cogeneration of electricity that will reduce energy costs by 40 percent is being developed within the major zones.
- ◆ Zone operations are continuing to expand, and space is available to meet the needs of the users. Between 50 percent and 60 percent of current national construction efforts involve expansion of these sites and development of the required infrastructure.
- ◆ Diversification into areas other than textile apparel has recently started; currently, the main additional area is parts for the automotive industry.
- ◆ Zone operators are attempting to provide a full service package to the users by identifying users' needs for raw material and producing those products within the zone. If an item such as a type of woven fabric or button is needed in the production of a finished product, the operator will attempt to locate a local firm to manufacture it within the zone. Currently, U.S. inputs constitute about 67 percent of the finished exported product.
- ◆ Zones are well secured, with little or no leakage. At the largest facilities, there have only been 1–2 cases in the past 10–15 years of stolen merchandise.
- ◆ The Ministry of Finance and the Central Bank audit zones. These audits occur less than once a year. Operators and users must file monthly and bimonthly reports to each of the institutions. This function improves security and control.
- ◆ The Honduran Free Zone Association, *Asociación de Zonas Francas de Honduras* (AZAFRANCA), is an active advocate for trade facilitation. AZAFRANCA represents 12 of the largest operators and is active in promoting the services and growth of the sector.

2) Zone Issues to Address

- ◆ The zones are not linked to the Customs automated operating system. This disconnect delays shipments. Although the operators have been promised this linkage by the end of 2004, such deadlines have not been met as of the date of this assessment.

j. Bonded Warehouses

Bonded warehouses are privately operated facilities where importers can store merchandise for up to 1 year and defer the payment of duties and taxes until withdrawal. These warehouses provide essential services to the trade community, especially to SMEs, by allowing importers to postpone payment until merchandise is needed or sold.

Honduras has six public bonded warehouse operators, most of whom have a minimum of two facilities. Total available space is about 100,000 square meters, of which 60 percent is in use. There are also 50–60 private bonded warehouses established by importers to store their own merchandise. Although there are very few restrictions on the types of merchandise that can be stored, raw materials, machinery, vehicles, and alcohol constitute most of the stored goods.

Various public agencies provide administration and enforcement. The Ministry of Finance approves licenses and the Superintendent of Banking provides oversight and has the power to revoke licenses. The Ministry of Finance, the Superintendent of Banking, Customs officials, and warehouse operators conduct reviews and audits. Each operator posts an annual guarantee, which is set according to the value of goods in storage. A minimum of one Customs official, called a “fiscal delegate,” is posted at each site (with about 75 officers total). The operator reimburses Customs for all costs associated with these positions, including office space, equipment, salary, and benefits.

1) Bonded Warehouse Operations That Support Trade Facilitation and Security

- ◆ Losses and pilfering are minimal because of tight security measures, which include 24-hour guard service, limited use of cameras, and modern inventory control systems.
- ◆ Costs are low in comparison to similar operations throughout Central America.
- ◆ The public warehouse operators are well organized. All operators belong to the Association of Fiscal Public Warehouses of Honduras, and are active in the regional warehouse organization as well.

2) Bonded Warehouse Issues to Address

- ◆ The arbitrary nature of Customs procedures limits the cargo available for warehousing. For example, Puerto Cortez Customs demands that all goods from Panama be cleared on arrival, even if the client wishes to place them in a bonded warehouse. In addition, as an informal policy, this Customs office demands that 30–40 percent of *all* cargo arriving at the port must be cleared there. The stated rationale for these policies is to reduce fraud, but the result is to limit the quantity of cargo available for warehousing.
- ◆ Long delays are encountered in transferring cargo to the warehouse. For example, a transfer of a container from Puerto Cortez to a bonded warehouse should take 1–2 days. It currently takes about 1 week, requiring multiple telephone calls to check on status, initiation of two transfer documents, and three Customs reviews.
- ◆ Warehouse operators are not linked to the Customs automated operating system to file transfers and withdrawals although they have been promised this service for 2–3 years.

Automation would expedite acceptance and release of merchandise, and would decrease the need for an onsite Customs presence.

- ◆ Operators must employ full-time Customs officers, even though Customs staff are occupied only 20–50 percent of the time.
- ◆ All told, the costs and delays associated with Customs processing have severely affected warehouse businesses. For the past 6 years, warehouse profits have been declining because Customs restrictions have been driving business away. Despite having the lowest costs in the region, Honduran warehouse operators can no longer compete. Efforts to lobby for the required reforms within the Ministry of Finance and the Central Bank have failed. The industry is still operating within the confines of an unchanged 1967 law. As a result, this critical private supporting institution is in danger of disappearing.

k. Transport Industry—Vessel Carriers and Truckers

The transportation industry generally provides an adequate service at a reasonable rate for the Honduran trading community.

According to transportation officials, the focal point for sea transportation is Puerto Cortez, which handles 90 percent of Honduran vessel traffic. Approximately 30 carrier lines, including 10–12 major international containerized carriers and small bulk carrier lines, call at the port. In total, about 150 calls per month are made through this facility, with a minimum of one call per day to and from the southeast coast of the United States. The major carriers all have terminals within the port limits. Although security is good within these areas, theft has occurred when containers are drayed outside these areas for examinations. As a result, carriers now demand a letter of transfer with receipt. If the cargo is not returned within 24 hours, the carrier checks on its status. In addition, containers are left off wheels at night to make theft more difficult.

The trucking industry falls into two distinct groups: five major operators handle about 40 percent of the trade, with the remainder covered by small owner-operators. The *Cámara de Transporte de Carga de Honduras* (CATRACHO) is Honduras's major trucking association, representing 70 percent of the industry through its 1,700 company members. Each carrier has its own arrangement with the trucking companies. Some run their own operations, others use the major trucking companies, and some deal exclusively with the small owner-operator businesses. Most require that the vehicles be in good condition and no older than 6 to 10 years.

1) Transport Industry Operations That Support Trade Facilitation

- ◆ High-quality, sufficient service is available to the trade through the vessel carriers calling at Puerto Cortez. These international carriers meet industry standards regarding security and operate efficiently within their private terminals at the port.
- ◆ An excellent partnership exists between the carriers and the trucking community. Most carriers compensate partially for rising fuel costs. Carriers dealing with small companies will finance the maintenance of a fleet, secure fuel at reduced costs, and provide insurance, deducting small amounts from each payment to cover these expenses. No interest is charged for these services.

- ◆ Drivers are subject to screening to decrease theft and corruption, which increases security. The Center of Criminal Investigation within the Ministry of Security performs background investigations on all candidates for an operator's license. Thirty candidates were denied licenses last year as a result of these checks. One carrier requires truckers to take a polygraph every 4 months. This carrier reports no loss of merchandise since this program was initiated 4 years ago.

2) Transport Industry Issues to Address

- ◆ Security of transport is a major issue and adds significantly to the cost of moving merchandise. Approximately 80 percent of cargo moves involve additional security measures, including armed guards (which cost \$45–50 per load) and continual monitoring of each shipment in transit (at a cost of \$10–20 per move). These fees are now routinely incorporated into the general tariff of the carrier. Cargo does not move by road after 6 p.m. As a result of these private initiatives, security is improving, but at significant cost to the trader.
- ◆ Rising fuel costs are a major problem for the trucking companies. Honduras has high prices, at \$2.25 per gallon at the time of this report. Diesel fuel is \$.56 cheaper in Guatemala and \$.43 cheaper in El Salvador.
- ◆ The Honduran trucking fleet is in poor condition. Only 20 percent of the fleet is rated as very good, while 50 percent is merely acceptable and 30 percent is in poor condition. The number of “poor” trucks continues to increase because of various factors, which include prohibitively high interest rates (between 26 percent and 36 percent) for financing new purchases, a low profit margin (between 7 percent and 10 percent) due to oversupply in the market, and rising fuel costs.
- ◆ Intentional overloading of containers and open trucks have caused damage to the highways. There is no fear of penalty—if these activities are detected, bribes will permit loads to proceed.
- ◆ Carriers and truckers have a poor working relationship with the port authority, a public agency. Improvements in operations or resolution of problems are achieved slowly. Most port authority management personnel are political appointees who lack experience in and knowledge of port operations.

E. SOCIAL DYNAMICS

The working relationship between the executive branch and private industry is currently good, in fact, the best it has been in a long time. President Maduro is generally pro-business and a free trade advocate. The executive maintains a dialogue with the private sector for input into policies. One of the successes resulting from this cooperation was the institution of a reformed, more transparent government procurement program 2 years ago. To date, this effort has resulted in a savings of more than \$7 million within one agency.

Despite these initiatives, the government is viewed by the private sector as not active enough in modernizing and pursuing reforms that would make Honduras more competitive. Although there seems to be a political will to change, not enough urgency is attached to reform. As a result,

Honduras continues to fall behind its neighbors in trade facilitation measures. More dynamic initiatives to decrease bureaucratic procedures and decentralize decision-making are required.

Honduras is generally perceived to lag behind the rest of Central America in preparing its business and agricultural sector for CAFTA implementation. The private sector is attempting to fill this gap. Some of the most active of the private institutions are the 32 chambers of commerce and industry spread throughout the country. Their membership consists principally of small to medium-sized commercial enterprises representing all sectors of the economy. Although most are not involved in international trade today, they would like to enter the global market. The major chambers have established help desks to assist in establishing a business and act as intermediaries between the business and the government. They urge the adoption of streamlined procedures, decentralization of decision-making, and more technically competent public officials to decrease costs and make Honduran business more competitive. The chambers also host technical training with emphasis on quality control measures and are planning workshops by sector on the challenges and opportunities presented by CAFTA. Most of the private sector, and even the public sector, has no clear idea of CAFTA is and what it will require of them.

Honduras has excellent laws for commercial practices but lacks adequate enforcement and implementation. Governmental officials either ignore or are unaware of the legal requirements, making it impossible for the trader to predict the cost or time it will take to complete a required procedure. Simplified procedures that are correctly and expeditiously followed would significantly reduce transaction costs.

Problems are still encountered within the Customs Union, with individual countries imposing regulations and procedures that contradict regional policy. This indicates a lack of respect for the agreement and weakens the advancement and validity of the union. All of the member countries are implicated in this problem, because when one implements such an action, the affected party retaliates with its own policy. Countries must be encouraged to address such issues through the regional organizations for resolution.

The Customs Union lacks private sector participation in policy and procedural development, leading to problems when new procedures are implemented. Although the regional brokers association has requested more participation in the development of the Customs Union, the association has not been invited to participate.

Political influence is pervasive within the government, decreasing transparency in decision-making because of collusion and political pressure. This undue influence in the governmental process, including influence in the selection of personnel for key technical positions, has resulted in a low quality of governance. In part because democratic procedures are still developing, the public does not demand reforms and improvements.

CIEMSA, the recently established committee of private and public sector representatives to modernize Customs and facilitate trade, is attempting to deal with some of the problems within that agency. The committee is headed by the Minister of Finance and is the process of establishing working groups to deal with specific areas of concern. CIEMSA will address corruption by looking at ways to simplify Customs processes, reduce excessive documentation, promote automation, and thereby limit opportunities for this behavior.

CEIMSA will first seek to depoliticize the selection and promotion of Customs officers to increase professionalism throughout the ranks. CIEMSA will develop qualification standards to be used in each of these personnel actions and recommend continued private involvement in these processes. This approach, if successful, could then be used as a standard for other government agencies. Although there appears to be presidential support for this initiative, the required legal changes will be difficult to achieve because of the strength of the beneficiaries of the current system.

To remain competitive, Honduras should consider revising its labor and environmental laws. The current legislation was adopted many years ago for the banana industry and was designed to protect workers. The restrictions it places on the employer in regard to such issues as termination and productivity need to be balanced with the needs of the industry to be competitive within the region and internationally. The strongest labor union is at Puerto Cortez, where the average cost to the port authority for each employee on its rolls is currently \$3,900 per month, including all benefits.

Customs Union Issues. Part of the effort to achieve regional harmonization and integration has been the development of a regional Customs Union. The evolution of the Central American Customs Union is now at a critical stage. The primary benefits of the union thus far accrue to Central American merchandise, making the union relatively less beneficial to Honduras than the other members because Honduras has the lowest trade volume with its neighbors. However, a customs union could result in significant benefits to Honduras through increased trade flows through its port, and enhanced economic power through the union as a result of economies of scale, compared with the economic fragmentation of the individual countries.

To achieve the 2005 goal of implementing a real Customs Union in regard to international goods arriving from or exported to countries outside Central America, the following crucial and complicated issues must be addressed:

- ◆ Lack of a uniform international trade policy among the Central American countries. Free trade agreements (FTA) are negotiated on an individual country basis. Some of the five CAFTA countries have FTAs with Panama, Chile, Canada, and Taiwan. Although the agreements with the same country have identical Rules of Origin, not all of the countries in the region have such agreements. This lack of uniformity in tariff treatments complicates the integration process.
- ◆ Tariffs and taxes are not harmonized within Central America for goods imported from outside the CACM. For example, medicines are free of duty in some countries while subject to 5 percent duty in others. The duty on dairy products in Costa Rica is 65 percent, in Honduras 35 percent. Value-added taxes also vary.
- ◆ The organization of Customs within the Customs Union has not been defined. Will Customs be a regional organization? Will officers at the outer borders continue to work for their national administrations? Will officers at the inner borders be eliminated?
- ◆ When movement towards the Customs Union was reactivated and implemented several years ago, SPS issues were not addressed. SPS requirements vary significantly between countries, and pests and plagues present in some countries have been eradicated in others.

There is no regional food or agricultural agency, so harmonization is difficult. For Central American goods, three levels of risk have been identified. By the end of the year, the need for import country registration of the 440 products identified as low risk should be eliminated.

F. RECOMMENDATIONS

The following major recommendations must be addressed to lower trade transaction costs and increase Honduran competitiveness. (Some of these may repeat recommendations presented in previous sections.)

- ♦ **Professionalize trade-related public agencies.** The Customs authority must become a professional organization and develop a personnel policy that provides for a professional workforce. Customs officers should be hired with an expectation that this will be a long-term career, not a short-term job (i.e., for the duration of the current administration). Customs must be perceived to be professional, employing skilled personnel who are well trained in the complexities of Customs laws and procedures. A workforce where political patronage exists will not be as competitive as a merit-based workforce. As the gatekeeper for international commerce, the quality of the Customs employees will have a direct impact on trade, thus Customs reform should be a top priority.
- ♦ **Implement the Customs Union.** This will increase private sector involvement in the decision-making process through establishment of a private sector group that will be involved in planning future modifications. This group could then act as a vehicle for notifying its sector of upcoming changes and training. A common Web site should be established for this purpose.
- ♦ **Improve security.** Because of the efforts of a special unit handling kidnapping, such incidents are down sharply. The unit handling these crimes was specially formed, recruited, and trained (by the U.S. FBI) to handle kidnapping cases. The unit has been very effective, resulting in dramatic improvements in personal security. Three years ago, there were as many as 40 kidnappings per year, mainly targeting businesspersons near San Pedro Sula. In 2003, the number of kidnappings dropped sharply down to three, and there have been none in 2004, as of October.
- ♦ **Streamline trade-related processes.** It is necessary to review all Customs procedures and begin the process of benchmarking to identify redundancies, unnecessary review, and unnecessary steps and start to remove these from the process. Currently, procedural change is very slow. If required, the Committee on Customs Modernization can oversee and review the process.
- ♦ **Crack down on trade-related smuggling and fraud.** Develop and provide for support within the trade community for criminal prosecution of major customs violations. Currently, there appears to be no political will to prosecute parties involved in defrauding the government through improper goods declaration or for failing to declare goods to Customs.

Honduras also should establish a special anti-smuggling and fraud unit, using a

combination of officers from Customs and the Special Investigations Unit of the National Police. The staff would be carefully selected and subject to random drug testing and polygraphs. This unit would develop a threat assessment and a corresponding action plan to combat smuggling and set specific priorities and goals. Training in examination and interview techniques and the legal requirements for building a criminal case would be required. In addition, the team would have to be equipped with contraband detection kits with fiber-optic scopes and density meters and be trained in their proper use. A vital link and partnership with the trade community would also have to be established to develop sources of information.

- ♦ **Implement the risk management system.** Risk management is the foundation of a modern Customs agency. Honduran Customs has undergone some training by Canadian Customs, but additional training is required, particularly in the analysis of risk commodities and high-risk traders or filers, so that appropriate profiles and criteria can be created and monitored. It makes little sense to rely on nonproductive, costly physical examinations. Honduran Customs should also perform analyses to ensure that all goods destined for national use are properly declared and are not entering Honduras without Customs clearance. A well-developed risk system would identify areas of concern that could easily be developed into specific enforcement actions with the National Police. In addition, a risk management system should identify areas of continued noncompliance or error rates and provide a methodology to take corrective action through specific seminars.
- ♦ **Modernize export process/CENTREX.** The government should expand the functions of CENTREX, automate the export process, and allow more private industry participation in CENTREX operation. It should also consider implementing the Chamber of Commerce's proposal to assume oversight of CENTREX and expand its service beyond export processing. There have been proven successes when private industry has increased control of processes involving business and international trade. Honduras also should consider adopting the "best practice" from CENTREX in El Salvador, which has completely automated the export process, with links to the pertinent public agencies and the trade community, and is expanding this effort to imports.
- ♦ **Upgrade the express consignment system.** Honduras should review, with a view toward adopting an express consignment process. When fully implemented in 2004, that process may provide an express consignment best practice to be reviewed and possibly adopted in neighboring countries. The Inter-American Development Bank has funded software development and renovation in Honduras to promote an efficient model based on WCO Express Consignment guidelines.
- ♦ **Improve laboratory facilities and analysis.** The Customs authority needs to upgrade such facilities and capabilities as the Customs laboratory, examination equipment, personnel skills, and resources. To provide the capability to build a modern Customs service there must also be a stable source of funding. It is recommended that Customs receive the revenue due by law and also initiate a WTO-compliant service fee for declaration processing that would be used specifically for upgrades.
- ♦ **Streamline customs processing and costs in free trade zones and bonded warehouses.** According to Customs officials, there are now approximately 200 Customs

officers stationed at these locations, and zone and warehouse now fully reimburse Customs for their services. However, most of these personnel are not fully utilized. All users of the zones and the warehouse operators have automated inventory control systems that are audited frequently by the public agencies assigned oversight responsibilities. Once the warehouses and zones are directly linked to the Customs operational system, which is anticipated by the end of the year, onsite Customs supervision should be eliminated and Customs should adopt a post audit approach to oversight. This is particularly pertinent to zone operations that have little or no revenue impact. The operator should have the appropriate guarantees on file and be designated as responsible for controlling movements into and out of the facility. Once the operator's inventory control systems are certified as able to competently perform this function, Customs should be withdrawn from the site. Adoption of this approach would produce significant cost savings. In addition, the certification of inventory control procedures and the resulting post audit approach would improve Customs control over the operations.

- ♦ **Facilitate the movement of products requiring SPS or food safety regulation and harmonize procedures within the region.** All CAFTA countries should make OIRSA SEPA services the standard throughout Central America. The most modern procedures, the best equipped and staffed laboratories, and the highest quality of inspection services are in those countries, Honduras and Guatemala, where such services are provided. Moreover, regional personnel are less subject to corruption and collusion with the local trade community. Reliance on OIRSA has improved the national Agricultural Ministry's access to collected user fees for modernization of its operations and would eliminate the need for each country to station its inspectors at posts throughout the region where its cargo arrives, as contemplated by the Customs Union. OIRSA personnel, representing a regional body, could perform inspections for all regional goods in accordance with each country's requirements even if not standardized.

CAFTA countries should establish a regional coordination and information center where all exporters and public SPS agencies could obtain information about U.S. import requirements and what technical assistance is necessary to help public agencies meet these standards. It has been suggested that OIRSA assume responsibility for this center. The center would have to have a contact in the United States who could achieve a speedy resolution to issues that it could not respond to competently. A Web site could be established by the regional entity to disseminate information regionally about U.S. SPS requirements as updated criteria are received. This would be supplemented by seminars held throughout Central America by representatives by agencies such as USDA, AHPHIS, FSIS, FDA, and EPA, as well as U.S. import groups such as the grocers associations.

SPS and food safety procedures must be simplified to reduce the cost and time of compliance while maintaining sufficient controls to safeguard public health. Under current procedures, private sector sources project that a minimum of 6 percent to 8 percent of a product's cost is attributable to compliance; this percentage must be reduced. The simplification process should include all agencies involved in regulation of the industry, as well as the private sector. Much progress has been made in this sector with respect to Central American products, and this same process must now be extended to

international goods. At a minimum, the process must decrease or eliminate authentication of SPS documents by notaries, establish a simplified process for low-risk goods, and decentralize the registration and import permit process.

- ♦ **Participate in the Container Security Initiative at the Puerto Cortes.** Once scanning equipment is operational, the presence of a U.S. Customs officer, who would review outbound manifests to the United States before export and cooperate with local Customs officials to examine any suspicious shipments before loading, would expedite release of shipments on arrival in the United States and serve as a major selling point in the port's marketing strategy. Regional support for this initiative should be secured from at least Honduras and El Salvador, significant users of the port.
- ♦ **Eliminate Customs requirements that increase the time and cost of delivery of goods to a bonded warehouse.** Customs should implement procedures that require filing only a transfer document at point of arrival, under which the cargo could proceed directly to a warehouse. In addition, the informal policy requiring 30 percent of all goods arriving at Puerto Cortez to be cleared there negatively impacts the business opportunities of the bonded warehouse operator, as does the Customs requirement that all Panamanian goods be cleared at point of arrival. Both of these procedures should be reviewed to identify alternative measures to control the widespread undervaluation of Panamanian goods. The current policies inhibit the importers' right to designate clearance location and on the margin, have a negative impact on trade..
- ♦ **Identify an organization to serve as the national authority for quality control standards.** This body would assume the role of identifying and codifying industry international standards and would help producers or sectors implement and perform certification of company processes and laboratories. The organization's role would be similar to that of *Consejo Nacional de Ciencia y Tecnología (CONACYT)*, the National Council for Science and Technology, in El Salvador. Such an organization is needed because Honduran light industry, such as leather manufacturing, shoe production, and agro-business, must upgrade its quality to compete internationally.
- ♦ **Upgrade enforcement efforts related to IPR.** Upgraded enforcement should include cooperation of the business community in identification of IPR infringements, for example, working through the International Anti-Counterfeiting Coalition to train personnel involved in registration, detection, and prosecution of IPR-related violations. No Central American country has a modern automated system for registration and tracking with communication links to its enforcement entities. A model for this should be developed as a regional project and then implemented in all countries of the region. Advice could be drawn from international organizations, such as the World Intellectual Property Organization (WIPO), as to design and funding. The WIPO might have recommendations concerning current operational systems within small, developing countries that could serve as a model.

XII. FLOW OF PEOPLE

A. INTRODUCTION

After Costa Rica, Honduras has the greatest flow of people across its borders in the region. Annual visitors to the country numbered more than 886,000 in 2003, up from 672,000 in 2001, a 32 percent rise. According to officials, a great number of these visitors (i.e., 276,000, or approximately one-third of travelers) are on single-day excursions from cruise ships. The greatest share of cross-border traffic (58 percent) comes from residents of other Central American countries. North American visitors account for 30 percent of total visitors; Europeans, 7 percent; and others, the remaining 5 percent.

In total, arrival by air constitutes the largest portion of cross-border traffic, with Honduras's two airports receiving roughly 44 percent of Honduras's arrivals (29 percent arriving at San Pedro Sula and 20 percent arriving in Tegucigalpa), according to immigration agency sources. Approximately 34 percent of travelers cross the land borders; 2 percent travel by sea. Among land crossings, El Amatillo (El Salvador) and Guasule mark the major entry points, with 21 percent each of crossings. Las Manos ranks third, with 15 percent of overall traffic. As noted previously, tourism is one of Honduras's largest "exports" (the highest export after *maquilas*), and significant money flow results from the flow of people. Revenue from tourism provided \$373 million in 2003, up from \$274 million in 2001 (a 36 percent rise).

Overall, Honduran laws and public and private institutions facilitate the flows of trade-related people. Honduras is streamlining processes at land border crossings, upgrading its automation, and amending its laws. However, as with other Honduran public institutions, Honduran people-flow institutions are not professional and are overly politicized. Also, Honduras could do more to simplify its system for handling highly skilled visitors seeking longer stays. Work permits require more than 12 pieces of paperwork and involve five or more government agencies. Further, Honduras can do more to address illegitimate people flows, which remain a significant problem. Honduras's borders with Guatemala, El Salvador, and Nicaragua are long and porous, and Honduras now serves as a key origin and transit country for illegal immigration to the United States.

B. LEGAL FRAMEWORK

The legal framework generally supports core trade facilitation intraregional movements of trade-related persons such as business travelers and transporters. There are no undue restrictions. However, the law presents a legal maze for highly skilled workers seeking longer stays.

1. Laws and Regulations That Support Trade Facilitation

Laws and regulations further trade facilitation through the following measures:

- ♦ The law does not require a visa for visitors from the United States, the EU, Canada, Mexico, and the CAFTA countries.
- ♦ With regard to regional harmonization, the CA-4 requirements provide a model in the immigration area. These new requirements allow CA-4 members to travel freely without

a passport, and will eventually allow the non-CA-4 international traveler to move within the CA-4 with only one immigration review at the point of entry.

2. Legal and Regulatory Issues to Address

Honduras can further support trade facilitation and its development through the following measures:

- ◆ There are frequent changes in legal and regulatory requirements for immigration. Users, understandably, are seeking predictability and clarity.
- ◆ Further support and encouragement are needed for the CA-4 process regarding immigration. Although the CA-4 countries wish to facilitate movement of people within the union, the goal is not near realization. Harmonizing laws and regulations regarding visa requirements, and especially issues regarding criminal activity must be addressed.
- ◆ Laws and enforcement of human trafficking should be supported and improved.

C. IMPLEMENTING INSTITUTION

Overall, the major implementing institution for people flows, the *Dirección General de Población y Política Migratoria* (hereinafter “Immigration Agency”) has a clear mission, and active leadership that has made numerous changes in the past year. However, the lack of a professionalized service, common to many public agencies, and funding problems have led to serious staffing and equipment shortfalls.

1. Immigration Operations That Support Trade Facilitation

The Immigration Agency aids trade facilitation through the following measures:

- ◆ Border crossings with Guatemala and El Salvador have been streamlined, with the countries sharing offices on one side of the border so that travelers are processed at a single point. Currently, travelers into Honduras are handled on the Salvadoran side of the border, whereas travelers exiting are handled on the Honduran side. In 2004 the Honduran-Salvadoran sites were further streamlined with establishment of a single office on one side of the border.
- ◆ Officials posted at border crossings, ports, and airport have basic computer equipment for documenting persons. Before this computerization, files were handled manually, and researching a single file could take 1–6 months.
- ◆ Documents and fee requirements for those entering the country are not overly burdensome. Regulations require no visa for U.S. travelers and travelers from many other nations on arrival. For those departing by air, there is an airport tax on departure. However, the fee is nominal (\$29).
- ◆ Honduran immigration officials use watch lists from the INTERPOL, the United Nations (UN), the United States, and other sources to check for entry and exit of dangerous persons. This procedure is executed electronically.

- ◆ Corruption is said to have decreased at Immigration. Payments for immigration services are now made directly to banks, which have eliminated opportunities for corruption.
- ◆ The Immigration Agency seeks to better facilitate trade by training and deploying more English speakers.
- ◆ Honduras is implementing a biometric identification system for visitors. However, this was not in use at any of the border crossings, airports, or seaports the assessment covered and is therefore difficult to assess. The system may have the potential to streamline the entry process and secure the border.

a. Immigration Issues to Address

Honduras can further support trade facilitation through the following measures:

- ◆ Like other public agencies, Immigration suffers from a lack of a professionalized service attributable to politicization of the bureaucracy. This situation leads to corruption and delays, which seriously hamper immediate at-the-border trade facilitation and impact Honduras's attractiveness for FDI. As with other agencies, it is critical to provide civil service reform that creates an agency that is intelligently recruited, well trained, and honest.
- ◆ Although measures such as mandatory bank payments strengthen integrity, the result of such a system is an added step to the process. Creating a transparent, professional, and trusted institution is critical. Honduras should seek to make the public agencies part of a strong civil service with as little political influence as possible. Key functions, including recruiting, hiring, retention, training, integrity, and automation, should all be part of this effort.
- ◆ Although Immigration does have computers at the borders, it lacks modern systems for using the computers. The border posts are not linked to headquarters via e-mail or intranet. Further, no border crossings have technology capable of reading passports.
- ◆ At border exits, Honduras (and other Central American countries) requires citizens and visitors to check out of the country. This adds another unnecessary step to the people-flow process. Strong entry controls, risk management, and proper enforcement should allow governments to reallocate resources and remove the requirement for checking all those who exit.
- ◆ At airport exits, Honduras collects three fees from three different windows from exiting travelers. Although the overall fee is not that significant (\$29), it is a cumbersome bureaucratic process and a poor use of resources (three collectors where one or none would do). The most efficient and transparent system would involve collections by the airlines with electronic disbursements to the appropriate agencies.
- ◆ With respect to illegal immigration, Honduras's institutions are improving, but they are still inadequate for safeguarding the country's borders. Immigration officers need further training in identifying false documentation, including training in investigations and procedures.

- ♦ Like other Central American countries, Honduras has a cumbersome system for processing those seeking longer trade-related stays. International visitors who seek an extended stay and a work permit would benefit from a new facilitated process. The Immigration Agency is perceived to be responsive to inquiries, the fees are reasonable, and the most recent law is viewed as an improvement. However, the documentary requirements are complex (involving more than 12 pieces of paperwork and five or more government agencies) and are not seen as fairly and transparently executed. Processing times vary greatly and can extend to months because of bureaucratic hassles and multiple visits to the Immigration Agency. Moreover, additional steps can be added by the Immigration Agency without notice and without regulatory basis. Honduras should implement a system that is predictable, transparent, and timely.

D. SUPPORTING INSTITUTIONS

In Honduras, as in other Central American countries, the Immigration Agency administers the laws, while the police execute law enforcement functions, such as detentions and arrests. The police force is considered by some to be a constructive partner, but others consider Immigration, the National Police, and Customs to all be part of a corrupt and inefficient system.

The Honduran Institute for Tourism is a strong partner in trade-related people flows. The organization receives significant support from the government. It has a focused mission and is well organized.

The legal profession provides support to the trade community by acting as an intermediary in transactions between trade-related people seeking longer stays in Honduras (i.e., a plant manager at a free zone in San Pedro Sula). Unfortunately, in Honduras, numerous interviewees identified poor legal assistance. Although good quality attorneys do exist and provide service to traders, there is a segment of the Honduran law profession that has a reputation for providing poor and inadequate service, in some cases resulting in paying clients' being charged for services never rendered or poorly performed.

Infrastructure and services regarding people flows, as described later in this report, are adequate. Honduras has two major international airports in Tegucigalpa and San Pedro Sula, where there are daily direct flights from many cities in the region, and North and South America. Intraregional road travel along the Pan-American Highway is adequate because of decent infrastructure.

E. SOCIAL DYNAMICS

Trade-related people flows receive little consistent support in Honduras. There is some support in the business community for a more efficient immigration processing system for business travelers seeking longer stays, but people flows, particularly in the form of tourism, are widely supported and encouraged at all levels, executive branch, legislature, private institution, and general public.

F. RECOMMENDATIONS

- ◆ **Upgrade the professionalism and modernization of the Immigration Agency.** The agency should focus on the following key areas:
 - Assist government in implementing an integrity program, including strengthened independent internal affairs.
 - Develop a comprehensive personnel system to upgrade candidate qualifications, improve recruitment procedures, and establish job-specific performance and evaluation standards.
 - Provide training in document examination and investigative and interviewing techniques.
- ◆ **Harmonize and implement a CA-4 immigration visa** so that trade-related visitors may enter one country in the region and visit all with appropriate security.
- ◆ **Amend laws to create a streamlined entry process for highly skilled individuals (engineers, doctors, attorneys, etc.).** Simplify this process by implementing a one-stop processing center at the most appropriate ministry. This process should include, at a minimum, filing of applications and payments through one agency with a transparent, predictable process for review and determination. Also, eliminate the review requirement for all exiting parties by strengthening risk assessment and enforcement. It should be mandatory for citizens and visitors to “check in,” but departure procedures should be unencumbered and lead to less delays at borders.
- ◆ **Modernize and upgrade automation for people processing at the border.** This includes passport readers and networked computers so that borders can—
 - Electronically exchange people information among border sites and headquarters
 - Electronically exchange people information with other CAFTA countries
 - Enhance the risk analysis system and automate risk processes.
- ◆ **Provide training to increase the capacity of Customs officers,** especially in the following areas:
 - Documentation of fraud detection techniques
 - Customer service
 - Risk management.

XIII. FINANCIAL CRIMES

A. INTRODUCTION

Corruption generates various kinds of financial crimes, including bribery, theft, and money laundering. The money laundering in Honduras, according to the U.S. Drug Enforcement Administration (DEA) country report of 2000, results from a variety of crimes, including drug-trafficking, auto theft, kidnapping, bank fraud, prostitution, and corruption. Enforcement efforts since 2000 against auto theft, kidnapping, and bank fraud may have altered that mix.

The DEA's country report of 2000 states, "Honduras is neither a major money laundering center, nor a major offshore financial center." Operating of offshore financial institutions is prohibited.

The report identifies banks, currency exchange houses, and front companies as the locus of money laundering in Honduras. Casinos are also possible avenues for money laundering. Although not a major money laundering location, Honduras has an increasing level of crime—much of which is drug-related—which produces a greater volume of money laundering.

The banking sector, which has until recently been largely unregulated, has been one focus for money laundering. Although the economy is weak and the country is not a regional financial center, the banks appear to be prospering. The banking sector, however, has a history of bankruptcies resulting from questionable loans.

The Associated Press has recently reported the possibility of terrorist financing of crime in Honduras, something that has not surfaced in our previous reports on financial crimes. The Honduran government, as confirmed by the President and Security Minister, is investigating reports that Al Qaeda is financing gangs that control the trafficking in narcotics and arms between Central America and the United States. The network of gangs includes as many as 600,000 persons, compared with a combined total of 200,000 troops in the armed forces of the entire region.

1. Legal Framework

The Honduran Constitution, adopted in 1982, was amended in 1999 to establish civilian control over the armed forces. In 1998 the country also established a national police force; previously, the military had provided internal security.

With Decree No. 202-97, dated December 17, 1997, Honduras first adopted a money and asset laundering law. In 2002 the National Congress reformed this law through Decree No. 45-2002. The new law is tied in to all international conventions ratified by Honduras, specifically the Vienna Convention on Illegal Traffic of Narcotics and Psychotropic Substances and the Panama Convention on Money and Asset Laundering.

Decree No. 45-2002 covers all financial institutions and creates an obligation for all to comply with reporting requirements. If financial institutions do not comply, they can be sanctioned. All financial institutions have an officer specifically tasked with meeting reporting requirements.

The former law on money laundering reached only the proceeds from drug-trafficking and certain listed crimes. Under the new law, “money and asset laundering” have been extended to “income or assets resulting from illegal activities or which lack economic foundation or legal support for possession.” (Article 2 (9)).

The new law creates the National Bank and Insurance Company Commission (“the Commission”). The Commission supervises state and private banks, financing partnerships, savings and loan associations, general deposit warehouses, stock markets, insurance companies, and public and private pension funds. The law also creates the Unidad de Información Financiera (UIF), or Honduran Financial Information Unit (“FIU”). Banks and other financial institutions are required to report to the FIU, which in turn is responsible for forwarding suspicious transactions to prosecutors and police for investigation.

2. Implementing Institutions

The Ministry of Security:

The Minister of Security oversees the National Police, which took over internal security from the military. When the police and the military were separated, some members of the military joined the police force. Not only does Honduras have relatively little experience in operating a police force but also that experience has been influenced by a military mind-set. Moreover, it is well known that members of both the police and the military are involved in perpetration and protection of criminal operations.

The current Ministry of Security, appointed by the President, appears to be dedicated to attacking corruption. He is apparently aware that, of the four departments under his authority, several are riddled with corruption. The Special Services Unit, however, is apparently reliable and well trained, including in matters of money laundering. The minister supports the Special Services Unit, which works in cooperation with the Organized Crime Unit of the Public Ministry.

The Public Ministry:

The Public Ministry is headed by the Fiscal (Attorney) General, who is appointed by the President of the National Congress. The ministry has responsibility for prosecution of crimes. The Director of the Organized Crime Unit within the ministry prosecutes money laundering and related crimes.

By all accounts, the current director of this unit has been extremely aggressive and very successful in prosecuting corruption. She has prosecuted police, customs officials, military, and public officials. Although prosecutions have encountered difficulties in the courts, and the numbers are still relatively small, the situation is a vast improvement over 2000, when the DEA report noted that there had not been even one successful prosecution. According to current information supplied by the Honduran Embassy, there have been six convictions and 300 seized automobiles.

The Director of the Organized Crime Unit has been very visible in the media. While this is a common tendency among prosecutors everywhere, in Honduras the practice may put pressure on

the courts, which might otherwise obstruct a prosecution. That this strategy should be considered necessary and effective reflects the weakness of the rule of law in Honduras.

The Courts:

The role of, and problems associated with, the Honduran courts has been discussed throughout this document. As indicated in the section on the Public Ministry, the prosecution of money laundering has encountered difficulties in the courts. Although one does not expect the courts to be rubber-stamps for the prosecution, the well-known corruption within the judiciary would seem to play a part in the difficulty of prosecuting money laundering.

The National Bank and Insurance Company Commission:

The National Bank Insurance Company Commission's supervisory role concerning financial institutions is detailed under the financial crimes law, as quoted in the next paragraph. Apparently, the commission is considering new legislation to reform the existing reform legislation. It is said that the proposed changes would give the commission more independence; however, the Superintendent of the Commission seems concerned that the details of regulating financial institutions should not be mixed in with criminal matters, but should be placed in the statutes on criminal law and procedure.

The current financial crimes law places the following requirements and restrictions on financial institutions:

- ♦ They cannot open deposit accounts with false names, or coded names, or of any other modality that conceals the identity of the holder.
- ♦ They will fully identify all depositors, and customers in general, maintaining updated registries of personal documents and information on each of them.
- ♦ When there is doubt as to whether a customer is or is not acting on his or her own behalf, they will adopt reasonable measures to obtain and conserve information on the identity of the persons for whom the account is opened, an international transfer is made, or a transaction is carried out. Special vigilance will be exercised in cases involving organizations that do not carry out commercial, financial, or industrial operations within the national territory.
- ♦ They will maintain during any operation, and for at least 5 years after finalization of the transaction, registries of the information and documentation required.
- ♦ For at least 5 years after the transaction is concluded, they will maintain registries that allow reconstruction of any financial transaction that exceeds the amounts established by the Central Bank of Honduras.
- ♦ They will submit to the remaining regulations imposed on them by the financial crimes law and the regulations established by the Central Bank of Honduras and the National Bank and Insurance Company Commission.

The Financial Intelligence Unit:

Currently, the FIU is an independent body. However, apparently, the banks seek to have the FIU placed under the Public Ministry, which would compromise its independence. In addition, the banks have been slow to cooperate with the new regime of regulation. Given Honduras's history of little banking regulation, it should not be surprising that the banks have not been enthusiastic about the new regulatory climate. Beyond the normal resistance to regulation and change, however, the banks surely understand that enforcement of the new regulations will likely result in a loss of deposits.

The enforcement of Honduras's money laundering prohibitions and other financial crime laws presents a mixed picture. Institutional corruption is widespread among the police and the courts. Banks are resisting new regulation. Meanwhile, a few employees in the Ministry of Security and, especially, in the Organized Crime Unit of the Public Ministry continue to address corruption. .

3. Supporting Institutions

The Banks:

Historically, Honduran banks have engaged in practices that have led to many of them to bankruptcy. Apparently, it was common practice for banks to make "loans" to the family members of those operating the banks. When these loans were not repaid, which was often the case, the defaults threatened the stability of the banks and ultimately forced the closure of a number of them. Until recent years, no particular law punished such conduct. The one, and generally unsuccessful, option for prosecution was for monetary fraud ("*estafa*").

A new law regulates a number of aspects of banking and includes strict guidelines for making loans. In addition, a newly created *Comisión Nacional de Banca y Seguros* has broad powers to regulate banks. When a bank's capitalization falls below a certain level and does not increase above that level by a specified date, the *Comisión* has the power to remove the administrators of the bank and appoint new ones.

Operations at the Port, Airports, and Borders:

As discussed more fully in the Trade section, until recently, police were not able to engage in enforcement efforts against narcotics and smuggled goods at Puerto Cortez. However, currently, as a result of an agreement between the port and the police, police can seize illegal goods and narcotics. Such seizures should provide information that could expose money laundering.

Police have no authority at the airport. If they wish to investigate a plane or a passenger, they must provide 24-hour notice to airport officials. Police also have little authority at the borders.

4. Social Dynamics

In Honduras, as in several other Central American countries, high levels of corruption, together with narcotics traffic, facilitates undetected money laundering. More of this money laundering might be detected if police followed through on drug arrests and looked for the money laundering connections.

In the short term, the prospects for increased enforcement against money laundering and other financial crimes depend on a combination of continued technical assistance from donor agencies and cooperation from those dedicated, non-corrupt Honduran law enforcement officials.

B. RECOMMENDATIONS

- ◆ Improve compliance by banks with requirement to report suspicious money transactions.
- ◆ Continue investigation and prosecution of corruption among police and Customs officials and target smuggling and undervaluation/taxation of imported goods.

XIV. FLOW OF MONEY

A. INTRODUCTION

A significant amount of monetary exchange is involved in cross-border goods and services transactions—more than \$6 billion in goods and services in 2003. Of this amount, exported goods accounted for \$1.37 billion, while imported goods accounted for \$2.80 billion. Exported services accounted for \$1.09 billion; and imported services, for \$687 million. Free zones accounted for \$560 million (51 percent) of the services exports, which are included because they are a value-added category. Tourism constitutes another \$291 million (27 percent) of the services exports. Remittances also represent a major trade-related financial flow. In 2003 an estimated \$600 million to \$800 million poured into Honduras through the remittances of Honduras workers and families abroad.¹⁷⁵

Overall, Honduran laws, public institutions, and private institutions support these trade-related money flows. Basic trade finance products are available to all traders. Foreign currency is widely available and easily exchanged for all traders. However, anything but the shortest term credit can be very difficult to obtain because of high-risk premiums that reflect serious structural issues, such as the recovery from the recent bank crisis, little real competition in the financial services market, a poor judicial system, and little private production capacity.

As are other CAFTA members, Honduras is challenged by illegal money flows. However, recently, the country has succeeded in pursuing and prosecuting money launderers.

B. LEGAL FRAMEWORK

In Honduras, the basic legal framework related to efficiency and security of basic trade-related financial flows (i.e., letters of credit, currency exchange) is generally sufficient. However, the legal framework for credit to assist importing and exporting is inadequate.

1. Legal Operations That Support Trade Facilitation

- ◆ The Trade Finance Guidelines of the International Chamber of Commerce (ICC) are generally applied, and the laws are in conformity with the Uniform Customs and practice for documentary credits.
- ◆ The legal structure for trade-related finance allows for payment through wire transfers, foreign checks, commercial letters of credit, standby letters of credit, documentary collections, and open accounts.
- ◆ Importers and exporters do not find the legal framework for exchanging payments to be overly cumbersome or complicated. There are no government restrictions on the exchange of lempira (Honduras's official currency).
- ◆ The legal framework for currency exchange also provides suitable flexibility for traders. Under the law, traders have the freedom to exchange currency at financial institutions and non-bank institutions alike.

¹⁷⁵ Economic Intelligence Unit (2004), Country Profile for Honduras.

- ♦ There are no restrictions on repatriation of profits by foreign businesspeople.
- ♦ Laws are in place to address illegitimate financial flows. Honduras has enacted and implemented a law criminalizing the laundering of proceeds of crime.

a. Trade Facilitation Legal Issues to Address

Credit, beyond short-term credit, can be difficult for traders to access, and the legal system is part of this problem. Credit is scarce for multiple reasons, among which are the banking legal framework, high reserve requirements, and a judicial system where enforcement has a level of uncertainty.

C. IMPLEMENTING INSTITUTIONS

1. Banks

Honduras has a good-sized banking sector that includes six foreign banks. Domestic private banks operate throughout the country. Among the largest are Banco Atlántida, Bancahsa, Banco de Occidente, and Ficensa. Foreign banks, which operate primarily in Tegucigalpa and San Pedro Sula, include Citibank (U.S.), Credomatic (Costa Rica), Banco del Istmo (El Salvador), Banco Agrícola Comercial (El Salvador), Banco America Central (Costa Rica), and Banco Cuscatlan (El Salvador).

a. Bank Operations That Support Trade Facilitation

- ♦ Although basic trade finance products are available at almost all banks, five banks are primarily responsible for financing trade. The banks maintain correspondent relations with U.S. and other international banks.
- ♦ Trade finance offerings include basic letters of credit and foreign exchange.
- ♦ A second-tier institution, the Central American Bank for Economic Integration (BCIE), has created special programs for export financing through local banks.
- ♦ The U.S. Export-Import Bank provides short- and medium-term guarantees for sales to the private sector, and Honduras participates in the U.S. Department of Agriculture's programs for import credit guarantees of U.S.-origin agricultural products.

b. Bank Trade Facilitation Issues to Address

- ♦ Although financial institutions offer short-term trade finance payment methods, such as letters of credit, to domestic importers and exporters, qualifying for credit beyond short-term payment is extremely difficult for small and medium-sized traders. Most credit in Honduras currently goes to home mortgages, cars, and credit cards.
- ♦ New methods of expanding credit are essential. There are few alternative facilities in place to assist would-be traders (e.g., export finance lines of credit). High interest rates that lead to poor credit access are attributable to a number of factors, including those cited in the legal framework section, the legacy of bank problems in the wake of Hurricane Mitch, lack of credit information (i.e., few traders with firm credit history), and

private sector companies that operate without employ modern standards of corporate governance. That said, recent policy reforms, including the strengthening of the financial regulator, have lowered risk premium.

2. Central Bank

The Central Bank of Honduras manages exchange rate policy and regulation. Its operations impose no real encumbrances on trade.

a. Central Bank Operations That Support Trade Facilitation

- ◆ The institution has sufficient capacity to administer the exchange rate function.
- ◆ Currency exchange occurs at numerous institutions, including banks, currency exchanges, and hotels.
- ◆ Currency exchange operates at rates that are highly competitive, and fees for wiring money abroad are less than 10 percent of the amount of money to be wired.
- ◆ The dollar is fairly tradable in the market, although not as widely used as in Nicaragua or Guatemala.

D. SUPPORTING INSTITUTIONS

The national supporting institutions that facilitate trade-related finance are relatively weak. Honduras has no government-sponsored export credit agency. As noted, Hondurans do receive benefits from the Central American Bank for Economic Integration. One BCIE program involves awarding credits to traders for circulating and fixed capital. BCIE targets economically viable projects and exporting companies to upgrade regional export capacity.

The main supporting institution for securing money flows, the Financial Crimes Enforcement Unit, is working to more effectively address money laundering. It is early in the development of this capacity, but it appears that the institution is working hard on this critical issue. In 2004 a number of cases were brought and won against money launderers. The other institutions that address illegitimate financial flows, i.e., banks, regulator, and prosecutors, are perceived as cooperative.

E. SOCIAL DYNAMICS

The social dynamics of trade-related money flows are relatively poor. Lack of access to trade finance credit is a serious issue in Honduras and receives a good deal of attention at all levels. The government, banks, smaller exporters, and potential traders are all interested in and focused on the need for change. However, the solutions are difficult and structural, and the dynamics do not appear to favor real change in the near term.

The issue of money laundering also receives attention at many levels. The government has been working to improve its capacity to deal with the problem through passage of legislation and establishment of appropriate institutions and processes. The private sector, in turn, has been responsive in implementing its responsibilities, such as know-your-customer regulations.

F. RECOMMENDATIONS

- ♦ **Improve access to credit for SMEs seeking to do business as importers and exporters.** Although there are basic tools for conducting exchange of payment for trade (i.e., letters of credit), trade and financial institutions should develop strategies to more effectively extend credit to reliable small and medium-sized traders. A robust trading system gives SMEs the ability to finance their export and import activities, but the current system often requires smaller traders to self-finance their activities. This reality imposes serious costs on importers and exporters, making them less competitive. Strategies to pursue include such activities as:
 - Establishing guarantee funds that offer credit to exporters for fewer guarantees than are currently demanded
 - Developing associations/cooperatives among producers for pooling resources and risks to enable acquisition of lower cost credit
 - Increasing importers' and exporters' understanding of existing bank instruments through seminars and training.

XV. SUPPORTING INFRASTRUCTURE

A. INTRODUCTION

Infrastructure is an important component of a well-developed trading community. Without it, a region would find it impossible to participate in the world of international trade. Thus, implementation of a highly efficient, user-friendly infrastructure system, offering cost-effective and reliable services, is easily recognized as a competitive advantage. In a broader context, there is a direct link between economic growth and infrastructure quality. Implementation and administration of a high-quality infrastructure system reduces costs, expands market reach, and induces demand for increased services. Within the context of CAFTA and its participating countries, regional competitiveness is an emerging theme, with infrastructure playing an important role.

Honduras's stock of trade infrastructure presents two pictures, depending on one's perspective within the country. Honduras enjoys two primary production/consumption zones: one located within the nation's capital, Tegucigalpa; the other along the nation's Atlantic coast at Puerto Cortez/San Pedro Sula. These locations present a stark contrast to each other with regard to installed capacity, infrastructure quality, and overall effectiveness. Installed infrastructure in the Tegucigalpa consumption/production zone suffers from capacity constraints and poor service quality, ultimately hurting the nation's overall competitiveness. In contrast, installed infrastructure within the Puerto Cortez/San Pedro Sula consumption/production zone benefits from relatively thoughtful planning and targeted investment, providing a comparatively solid competitive environment. That said, it is important to note that the nation's overall stock of trade infrastructure suffers from organizational issues that prevail across the nation. These issues include a high level of direct government involvement in implementing and operating many of the nation's key infrastructure components.

Road differences in capabilities and service levels exist between the various infrastructure components and within individual sectors. Exhibit 1 presents a summary assessment and key findings for Honduras's individual infrastructure components.

Exhibit 1. Summary Infrastructure Assessment Findings

Infrastructure Component	Overall Assessment	Key Positive Aspects	Key Negative Aspects
Roadways	Less Competitive	<ul style="list-style-type: none"> User fee-based maintenance program Strategic planning initiatives for key transportation corridors Pavement systems in generally good condition High capacity corridor at San Pedro Sula Increasing incorporation of safety considerations within cross-section design Ability to secure foreign financing for major projects 	<ul style="list-style-type: none"> Incomplete allocation of maintenance funds Under capacity along key corridors Dense traffic conditions within city limits Under capacity overpasses and bridge structures Incomplete network upgrades

Infrastructure Component	Overall Assessment	Key Positive Aspects	Key Negative Aspects
Seaports	Competitive	<ul style="list-style-type: none"> Dedicated facilities by cargo type Availability of moderate modern handling equipment Recent ISPS certification—strict access control Broad capacity expansion capability 	<ul style="list-style-type: none"> Agility of implementing institution hampered by government organization and fiscal control Incomplete capital projects Just-in-time departure demands of industry
Airports	Competitive ¹ / Less Competitive ²	<ul style="list-style-type: none"> Recent privatization of airport operations High-quality passenger and cargo terminals at San Pedro Sula (SPS) SPS—Significant growth potential 	<ul style="list-style-type: none"> Quality/Capacity of airport infrastructure mixed Teguc—very limited growth potential
Railroads	Unavailable	<ul style="list-style-type: none"> No railway service is currently provided 	<ul style="list-style-type: none"> No railway service is currently provided
Border Crossings	Competitive	<ul style="list-style-type: none"> Existing dedicated facilities Future removal of border crossing requirements 	<ul style="list-style-type: none"> Customs Union initiatives have precluded investment Limited information technology (IT) coordination Off-property traffic congestion
Electricity	Less Competitive	<ul style="list-style-type: none"> Private sector cogeneration plants Government consideration of privatization of electric company 	<ul style="list-style-type: none"> Government-run monopoly entity High technical/nontechnical distribution losses High dependence on fossil fuel thermal generation plants Lack of recent investment in maintenance and expansion
Telecom/IT	Less Competitive	<ul style="list-style-type: none"> Recent initiatives to expand fixed-line services through private sector participation Future expiry of national telecommunications company exclusivity clauses Private sector mobile communications market 	<ul style="list-style-type: none"> Government-run monopoly entity Low historical investment in infrastructure High government dependence on revenues from telecommunications company High cost of international calls Low teledensity High subsidy rate for local/national calls from international rates. Poor service quality
Assessment Scale			
Highly Competitive	Deployed systems exhibit high quality in both fixed assets and operations, are uniformly deployed nationally, and have significant opportunities for growth		
Competitive	Deployed systems adequately meet market demands, may exhibit potential inconsistencies nationally, and have opportunities to maintain service levels over time through thoughtful capital planning and implementation		
Less Competitive	Deployed systems currently suffer from problems inhibiting efficient trade		
Developing	Systems have only recently been deployed providing very limited existing service capabilities, and consequently are immeasurable		
Unavailable	Systems are not deployed		
¹ San Pedro Sula International Airport ² Tegucigalpa International Airport			

Observations and interview results indicate that Honduras has consistently experienced marginal success in implementing its infrastructure investment programs. This pattern of marginal success can be attributed to frequently shifting national priorities, resulting from the turnover of the central government administration during election years. Interviews also indicated that a large number of the public positions responsible for implementing many of the nation's trade infrastructure components are also rotated when the administration changes. This practice has produced an environment in which priorities shift frequently, resulting in little momentum behind infrastructure improvement projects with durations spanning multiple administrations.

A key to realizing significant infrastructure improvement within Honduras is the reduction of direct central government involvement in infrastructure implementation. It is recommended that concerted efforts be made to decentralize many of the existing infrastructure components and to involve the private sector in their implementation as appropriate. Priority areas include electricity, telecommunications, and seaport operations. The nation has recently privatized the operations of its airport facilities; however, interviews indicated mixed success in this area. Consequently, the nation has exhibited trepidation concerning continued privatization of its national assets. It is highly recommended that efforts be made to build public awareness of the benefits of privatization.

In terms of infrastructure capacity and service improvements, Honduras should focus on the following areas.

1. Roadways

Honduras's roadway infrastructure requires significant upgrades along its primary north-south corridor connecting the nation's Caribbean coastal communities of San Pedro Sula and Puerto Cortez to its major consumption zone at Tegucigalpa. Current improvement plans include upgrades to this corridor, with a fair amount of funding already secured. In addition, the nation requires development of bypass corridors around major population centers. This need is particularly pronounced at Tegucigalpa. Plans are under way to develop a strategic logistics corridor from Comayagua to the El Salvador frontier. This 100-kilometer corridor should be considered a national priority, considering the port development initiatives under way at Port Cutuco in El Salvador.

a. Seaports

Honduras's seaport infrastructure is critical to the nation, as well as to the overall region. The facility has not seen significant investment over recent years, despite the level of economic activity near it. To grow, the facility will require an infusion of capital to complete ongoing projects and execute its capacity-building master plan. To allow flexibility in the plan's implementation, Honduras must minimize central government involvement in port operations. Port privatization has been an ongoing subject of discussion; however, successful execution has not occurred. Support is required to develop a port privatization program, enabling the implementing institution to develop the port into a highly efficient facility.

b. Airports

Honduras's airport infrastructure is mixed in capacity and service levels. Although San Pedro Sula is considered a solid facility, the nation's primary international terminal at Tegucigalpa is considered old and inadequate to facilitate trade going forward. Efforts should be made to develop a new international airport facility to serve the Tegucigalpa population zone. Technical support in transportation economics and facility planning will be required going forward.

c. Railroad

Currently, Honduras has no operating rail network.

d. Border Crossings

Honduras's border crossing facilities are considered serviceable; however, experience shows bottlenecks at approach points outside the immediate jurisdiction of the implementing institution. Honduras should consider enacting and enforcing policy to prevent vehicle parking along highways approaching the nation's border crossings. Because regional initiatives include removal of border crossing facilities, in Honduras, as in other Central American countries, little to no investment is currently contemplated for the country's borders.

e. Electricity

Honduras's electricity sector suffers from comparatively high electricity costs and organizational inefficiency. The nation's power generation capacity is highly dependent on fossil fuel thermal generating plants, resulting in highly variable input costs. Promotion of new generation facilities based on renewable energy sources, such as hydroelectric power, is recommended going forward. Honduras's energy sector also suffers from significant cost impacts from technical and non-technical distribution losses, currently estimated at 27 percent. Finally, the nation's electricity service provider is a government-run entity with monopolistic control over power transmission and distribution. This entity is considered highly inefficient in executing its services. It is now widely thought that privatization of portions of the energy sector is required to improve services. Support of privatization of the nation's electric company is recommended.

f. Telecommunications

Honduras's telecommunications sector currently operates within a monopolistic environment for fixed lines and international calls. There is a significant disparity between Honduras and other countries in the region with respect to the costs associated with local and international calls. Going forward, Honduras will face significant challenges in rebalancing rates while building teledensity within the nation. Significant support will be required to involve the private sector in the nation's telecommunications market.

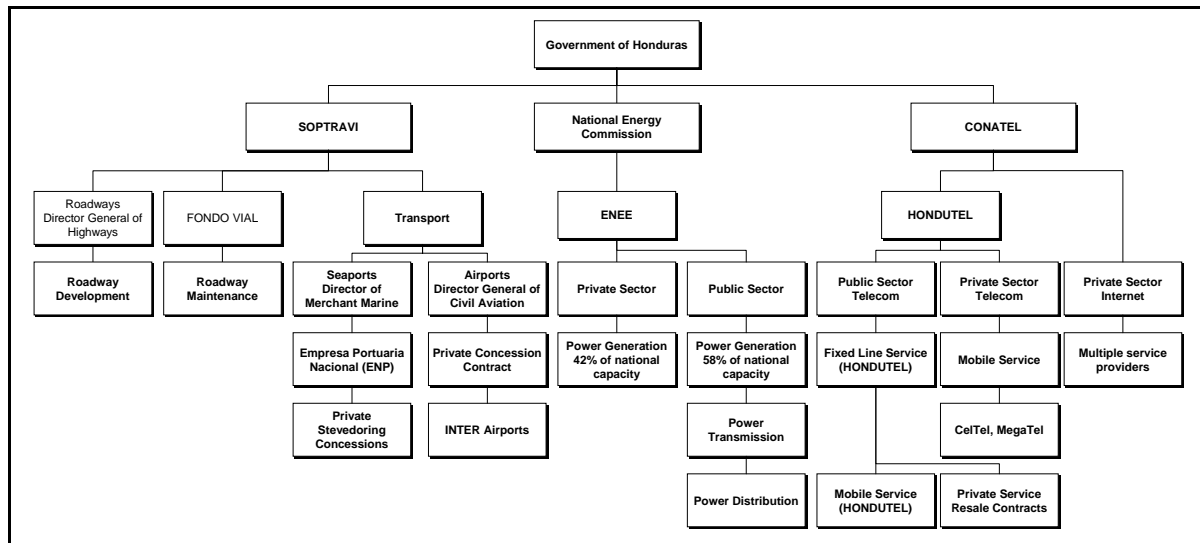
B. LEGAL FRAMEWORK

Honduras maintains a highly centralized government infrastructure implementation structure. Consequently, most of the implementing institutions for the nation's trade infrastructure exhibit the characteristics of inefficient government-run agencies and lack the flexibility and agility to meet the demands of the nation's constituents. Reform is currently being explored through the

Comision Presidencial de Modernización del Estado (The Presidential Commission for Modernization). Key focus areas of this commission include organizational reform and privatization of the nation’s major infrastructure components, with particular emphasis on the electricity and telecommunications sectors.

Exhibit 2 provides an organization chart outlining Honduras’s institutional relationships.

Exhibit 2. Honduras Infrastructure Organizational Chart



Transportation infrastructure planning, coordination, supervision, implementation, and maintenance are the primary responsibilities of the *Secretaría de Obras Públicas, Transporte y Vivienda* (SOPTRAVI), the Secretary of Public Works, Transportation, and Housing. This secretariat consists of multiple subdirectorates, which are responsible for roadway development and maintenance, airport administration, and seaport administration. These subdirectorates are discussed further in the following paragraphs.

Roadway network development and maintenance are the responsibilities of SOPTRAVI under two distinct implementing institutions. The Director General of Highways is responsible for implementing roadway development and expansion projects, while the *Fondo Vial* is responsible for maintenance. Development projects are funded either through the central government or through donor agencies. Roadway maintenance is funded through a recently enacted user fee collected through gasoline taxes. However, fees are collected by the central government and reallocated to *Fondo Vial*; thus, currently, according to knowledgeable officials, less than 50 percent of the fees collected for roadway maintenance are ultimately allocated to *Fondo Vial*.

Honduras’s seaport infrastructure is administered through the *Empresa Nacional Portuaria* (EPN), a semi-autonomous port authority, responding to a board of directors consisting of both public and private representatives. The port authority is under the jurisdiction of SOPTRAVI and has limited authority to approve major investments and acquire long-term debt, which must be approved by the central government. Consequently, the port authority is effectively limited to maintaining operating budgets and administration of the tariff.

Honduras's airport infrastructure is currently operated through a private sector concession agreement with Inter Airports, a private joint venture. This contract is administered through the Director General of Civil Aviation (DGAC), a department of SOPTRAVI. The current concession contract includes a 20-year operating agreement for each of the nation's four airport facilities.

Electrical power is implemented by the *Empresa Nacional de Energia Electrica* (ENEE) and regulated by the National Energy Commission, with leadership appointed by the President. ENEE is responsible for production of the majority of the nation's power, all transmission, and all distribution. ENEE is a government-run monopoly. Although the National Energy Commission regulates operations, reports indicate that little regulatory control actually exists.

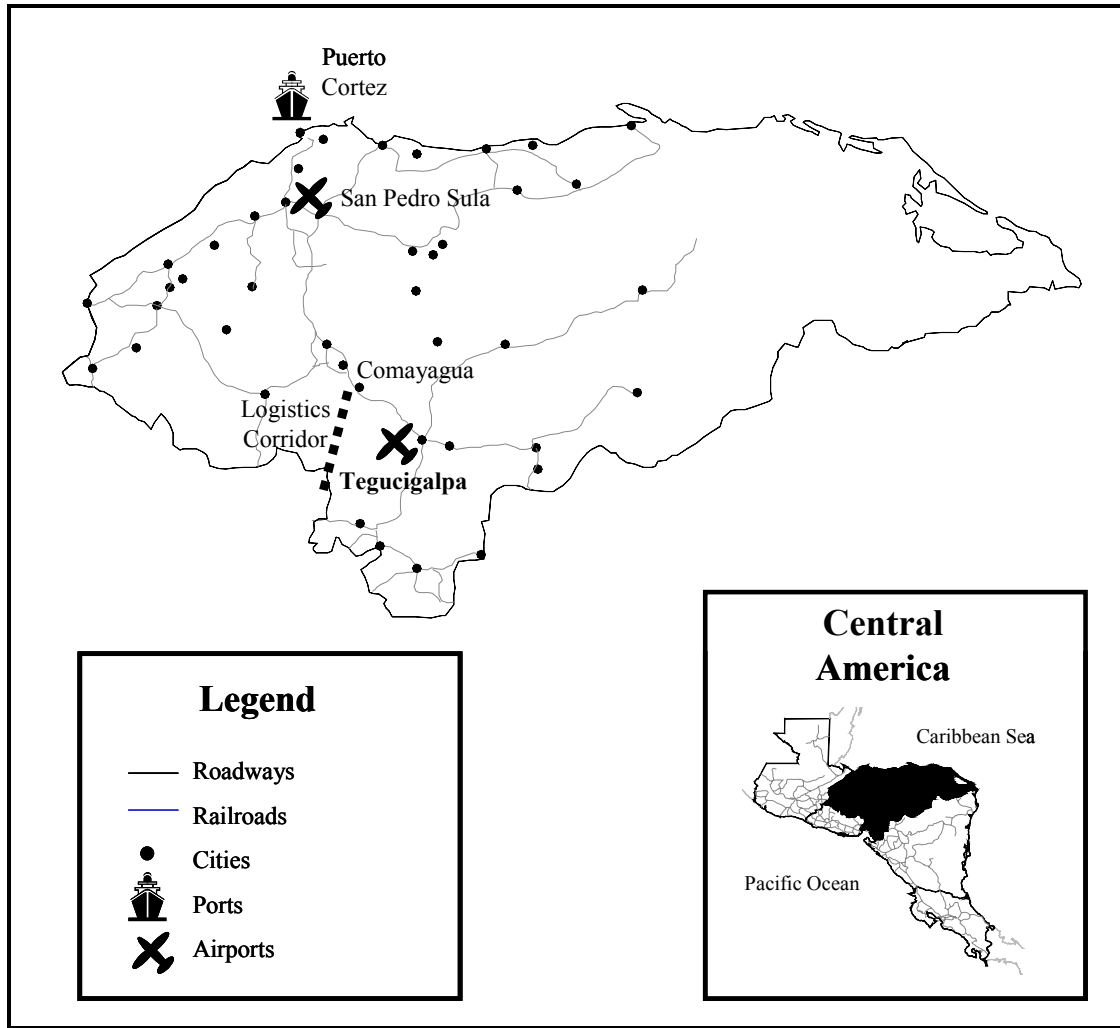
Telecommunications service is provided by Hondutel, a government-owned provider. The regulatory body is CONATEL. Hondutel currently maintains monopoly control of all fixed-line and international calls; however, exclusivity clauses within its contract will expire in December 2005. Efforts are under way to include private sector involvement in extension of Hondutel's fixed-line services, through franchise contracts issued through Hondutel. After December 2005, private sector participants will have the option to renew their contracts or to compete in an open and competitive environment. It is unclear whether Hondutel will be privatized or maintained as a government-owned service provider.

CONATEL maintains licensing authority for Internet service providers. Internet service is currently provided through Hondutel and a number of private service providers. The sector is largely unregulated at this time.

C. IMPLEMENTING INSTITUTIONS

The following sections provide an overview of each of Honduras's major trade infrastructure components. This overview provides a brief description of major facilities and overall operations. Recommendations for improvement are also provided as appropriate. Exhibit 3 provides a regional map of Honduras for reference.

Exhibit 3. Honduras Country Map (N.T.S.)



1. Roadway Networks

Honduras maintains an official road network of approximately 13,600 kilometers. Of this total, according to knowledgeable officials, approximately 3,260 kilometers are designated as primary roads and approximately 76 percent are paved. Roadways are generally two lanes, with higher capacity four- and six-lane corridors as required within major consumption zones. Two corridors represent the nation’s key routes supporting international trade: the Pan America Highway, bearing east-west and connecting Guatemala with Nicaragua, and the principal north-south route linking Tegucigalpa to Puerto Cortez, the nation’s principal seaport facility. Overall, the nation’s primary roadway network is in serviceable condition but lacks capacity along discrete stretches.

To facilitate trade, Honduras’s roadway network will require key capacity upgrades along its principal routes. Many of these upgrades have already been identified by SOPTRAVI, and funding is the primary hurdle to completing the projects.

a. Trade Facilitation Issues to Address

Honduras should make the following improvements to its roadway system:

- ◆ Expand roadway capacity and improve levels of service between Tegucigalpa and Puerto Cortez. This two-lane corridor provides Honduran, El Salvadoran, and Nicaraguan traders with vehicular access to the region's most strategically important port facility along the Caribbean coast. Therefore, it is a critical link and must be designed and maintained to accommodate high traffic counts on a consistent basis. Today, this corridor provides marginal service, is inconsistent in its cross-sectional design, and lacks sufficient capacity in more densely populated areas. In addition, mountainous stretches of this corridor lack passing-lane capacity along upgrades. Although significant upgrades of this key corridor are planned, funding for the entire project has not been fully secured. Full realization of this important project must be made a high priority.
- ◆ Fully fund the nation's roadway maintenance program, as identified by law. The nation's new roadway maintenance program, *Fondo Vial*, is funded by user fees collected through a tax on fuel. Similar maintenance programs within the region have proved to be highly successful in maintaining a high-quality roadway network. However, Honduras's user fee collection mechanism funnels all funds through the central government, with funds reallocated to *Fondo Vial* at the discretion of the Ministry of Finance. As a result, to date, *Fondo Vial* has been funded at approximately 50 percent of its planned funding level. Consequently, maintenance programs are not fully funded, resulting in continued deterioration of the roadway network. Either the user fee collection mechanism must be changed to allow *Fondo Vial* to collect directly or guarantees must be provided at the Ministry of Finance level.
- ◆ Develop bypass corridors around major population centers. Honduras's existing roadway network provides point-to-point services between municipalities and production/consumption zones. Consequently, truck traffic must transit local roads en route to its ultimate destination. This circumstance is most prevalent within the city limits of Tegucigalpa and, to a lesser extent, in San Pedro Sula. Plans to address this issue include development of a Tegucigalpa bypass corridor from Comayagua to the proposed El Salvador Canal Seco project. This contemplated 100-kilometer stretch of highway will be a strategically important corridor for Honduras and should be identified as a national priority. Realization of this project will provide a critical link for Honduras to the Pacific coast while rerouting major truck through-traffic around the nation's densely populated areas.
- ◆ Implement safety measures in the nation's roadway design and operations. Currently, users include motorized vehicles (trucks, buses, and automobiles), human- and animal-powered vehicles, and pedestrians. Current roadway cross-section design provides limited clearance for the passage of the non-motorized-vehicle users, producing an overall safety hazard. This is both a societal awareness issue and a corridor design issue. It is recommended that a national campaign to improve highway safety awareness be implemented. At the same time, future corridor designs should incorporate dedicated nonmotorized vehicle lanes (i.e., bicycle lanes) in densely populated areas. Action on

both of these recommendations will improve overall highway safety, resulting in reduced accidents and impedances to free flow.

- ♦ Implement bridge and overpass upgrades and improvements along principal freight corridors. Many of Honduras’s existing highway bridges, like those in other countries in the region, are under capacity with regard to existing highway loads. Many of the bridges were designed and constructed with loading limits of approximately 25 tonnes. Today, load limits are typically over 40 tonnes. Although funding to improve the entire portfolio of Honduras’s bridges would be difficult to acquire, targeted improvements along major freight corridors are highly recommended. Improvements would enable the nation to realize the benefits of high-capacity truckloads, reducing both traffic congestion and labor costs.

1) Seaports

Honduras’s primary seaport facility is Puerto Cortez on the Caribbean coast. This port is a multipurpose facility handling general cargo, containers, and liquid and dry bulk cargoes. The facility operates as a semi-autonomous port authority (EPN), with limited discretionary authority over facility upgrades and investments. The EPN operates Puerto Cortez as an operating port authority utilizing private sector concession contracts for stevedoring operations. Port authority responsibilities exclude customs, immigration, and agricultural inspection services. Puerto Cortez was recently certified under ISPS codes and is in the midst of executing its security plan. Observations indicate that landside access security procedures may be considered high.

Exhibit 4 provides a breakdown of the key infrastructure elements at Puerto Cortez.

Exhibit 4. Puerto Cortez Infrastructure Summary

Component	Puerto Cortez
Port Location	Caribbean coast
Operation	Public operating port authority—private sector service concessions
Main Wharf	1,000 meter marginal wharf (476 meters equipped with container gantry cranes) 1 liquid bulk pier 1 dry bulk pier 1 cabotage wharf
Water Depth	Varies (8 m – 12 m)
Number of Berths	7 (+ cabotage wharf)
Cargoes Handled	<ul style="list-style-type: none"> • Containers • Liquid bulk • Dry bulk • General cargo/Cabotage
Dedicated Wharf Equipment	<ul style="list-style-type: none"> • Liquid bulk discharge systems • Dry bulk evacuators • Conveyance systems • Refrigerated warehouse on dock • Dedicated reefer storage area
Container Yard Layout	Straddle carrier
Expansion Potential	Medium to high
Comments	Good access, both landside and waterside.
Overall Assessment	Competitive

Puerto Cortez is considered one of the most important seaports serving Central America. But the facility has not seen significant investment over the past 7–10 years and requires an infusion of capital to meet the future demands of the trading community.

2. Trade Facilitation Issues to Address

To facilitate trade, Honduras should make the following improvements to its seaport system:

- ♦ Decentralize government control over the nation’s major port facility. Although Puerto Cortez operates as a semi-autonomous port authority, the facility has limited control over investment and capital improvements. As a result, the facility has not seen significant improvement in recent years. In addition, revenues are often reallocated to other government programs, resulting in further lack of fiscal control. Efforts should be made to enable the port authority to operate as a private company to meet the demands of its customers. Technical assistance will be required to support this effort.
- ♦ Implement the port’s capacity building master plan. Puerto Cortez has developed a solid capacity building conceptual master plan. Execution of this plan would make Puerto Cortez the leader in port services to the Caribbean coast. Considering the level of manufacturing activity located near the port and its dependence on maritime services, investment in the port’s infrastructure is of paramount importance.
- ♦ Establish priorities for completion of ongoing operations improvement projects. Puerto Cortez has invested in traffic improvement projects within its terminals. However, funding is not available to acquire land and complete the projects. Completion of these projects should be made a priority.

a. Airports

Honduras’s airport infrastructure is currently operated under a 20-year concession agreement with Inter Airports, a private sector joint venture. Inter Airports’ concession agreement is limited to airport operations, maintenance, development, and passenger security. Customs, immigration, and air traffic control functions are not within the scope of the concession agreement. Inter Airports operates four international airports: Tegucigalpa, San Pedro Sula, La Ceiba, and Roatan. Of these four, two airports, Tegucigalpa and San Pedro Sula, account for the majority of the international passenger and commercial freight traffic served by the nation’s airport infrastructure. These two facilities contrast sharply in their capability, installed infrastructure, and growth opportunities.

San Pedro Sula International Airport, located near the city of San Pedro Sula, is the nation’s most modern facility, according to knowledgeable officials, handles approximately 527,000 passengers annually. The airport operates as both an international and a domestic airport, but approximately 85 percent of its total passenger volume is classified as international traffic. The airport is equipped with a single 2,800-meter runway accommodating approximately 60 air operations per day. Space is available for a second parallel runway. The passenger terminal encompasses approximately 12,000 square meters of enclosed passenger processing areas and is equipped with three jetways. Master plans include expansion of the terminal to accommodate four additional jetways. The airport facility is also equipped with a 2,500-square-meter air cargo

facility, located some distance from the passenger terminal. San Pedro Sula International Airport is in excellent condition and has significant capability to accommodate potential growth resulting from CAFTA. There are no specific recommendations with regard to this facility.

Aeropuerto Internacional de Toncontin (Tegucigalpa International Airport), in contrast to San Pedro Sula, is an older facility reaching the limits of its operational capacity. The airport is located within the urbanized area of Tegucigalpa and is consequently land-locked. The facility is equipped with a single 1,860-meter runway, nestled between a series of mountain ranges. Because of the airport's geographic and aircraft approach conditions, pilots flying into or out of the airport require special certifications. In addition, the geometric conditions of the runway and its approaches put significant limitations on aircraft size and loading characteristics, limiting the facility's overall capacity. The airport passenger terminal is considered unable to sustain growth in international and domestic passenger traffic. The facility is of insufficient size and is ill equipped to efficiently meet the expectations of passengers and air carriers.

b. Trade Facilitation Issues to Address

To facilitate trade, Honduras should invest in airport infrastructure at Tegucigalpa. Key improvements include the following:

- ◆ Consider developing a new airport facility outside of the urbanized area of Tegucigalpa. As noted above, Tegucigalpa International Airport is a mature facility with limited growth opportunities. Further investment in this facility as the primary gateway for international traffic destined for Tegucigalpa would be ill advised. The existing facility could be used as a general aviation facility or a domestic terminal going forward; however, its prospects as a major international facility are limited. Consequently, it is highly recommended that Honduras consider developing a modern international airport facility located near, but not in, the urbanized area of Tegucigalpa. Efforts should be made to identify areas with the potential for good landside access, limited air obstructions, and substantial opportunities for growth. Technical assistance will be required in transportation economics, strategic planning, and airport master planning.
- ◆ Work closely with Immigration and Customs officials to provide appropriate staffing levels during peak operating hours. The airport operator indicates that there are frequent occasions when air arrivals do not coincide with appropriate staffing by government officials. Consequently, passengers arriving during off-peak periods can experience significant delays. Efforts should be made to identify appropriate staffing levels and work schedules to accommodate aircraft arrival patterns.
- ◆ In the absence of a long-term development plan for Tegucigalpa's airport infrastructure, it is important to improve the existing terminal's landside access capability. Tegucigalpa's existing international airport suffers from serious overland vehicle access constraints. Efforts should be made to identify solutions and build capacity to accommodate passenger vehicles during peak operating periods.
- ◆ Tegucigalpa International Airport's passenger terminal requires significant upgrades to expedite passenger processing. Although the terminal is small and requires extensive capital improvements, which should be addressed through development of a new airport

facility, existing operations can be improved through thoughtful planning and implementation of internal processing improvements. For example, outbound passengers are required to undergo three fee collection transactions before passing through airport security. This fee collection process should be conducted at the passenger ticket counter or in advance of the passenger's arrival at the terminal, when tickets are initially booked. Technical assistance in efficient passenger processing operations will be required to eliminate the inefficiencies at Honduras's international airports.

1) Railways

Railway service is currently unavailable within Honduras. Considering the economics of rail transportation, and given Honduras's geography and landmass, a Central American regional approach would be necessary to justify investment in rail service to the nation.

c. Trade Facilitation Issues to Address

Trade facilitation in Honduras would benefit from evaluation of rail service alternatives. The following action should be considered:

- ◆ Develop a regional rail service for cargo to capture the economic benefits of rail service through length of haul and consolidated cargo. Rail services have economic value for transportation across long distances, typically 500 miles or more. Over such long distances, rail services provide a competitive edge over trucking services. Considering the available lengths of haul within Honduras, it would appear that rail service would not provide competitive cost benefits. However, such benefits might be realized through a regional approach. Honduras should therefore work with its neighboring countries and the United States to develop a regional intermodal rail strategic plan in order realize the potential benefits of rail service.

1) Border Crossings

Honduras provides fixed administration at the majority of its international border crossings. These facilities are designed to house Customs, Immigration, and Agriculture officials while providing vehicle and pedestrian travel ways. The study team sampled one facility for inspection. The subject facility was considered adequate to facilitate trade; however, traffic conditions outside the boundaries of the border crossing impeded efficient traffic flow. However, as noted previously, regional initiatives include removal of border crossing facilities; consequently, little to no investment is currently contemplated for Honduras's borders.

d. Trade Facilitation Issues to Address

Although the intent is to remove formal border crossings in the future, near-term improvements should still be undertaken to facilitate trade. The following interim improvement is recommended:

- ◆ Enact policy and enforce clearance of rights-of-way near border crossing facilities. Although the existing border crossing facilities are simple in design and provide serviceable operations within the limits of the facility footprints, outside the boundaries of the facilities, vehicles stopped along the shoulders impede efficient traffic flow. These

areas are not within the jurisdiction of the border crossing operating personnel. Honduras should consider enacting and enforcing a policy prohibiting parking on the shoulder of the roadways to eliminate the bottlenecks at the nation's border crossings.

1) Electricity

Deficiencies in Honduras's electricity sector present a major obstacle to improving the nation's competitiveness. The country's electricity network suffers from high costs associated with production, as well as from significant technical and non-technical losses in distribution. Honduras's government-run electricity company, ENEE, has monopoly control over the nation's transmission and distribution networks. In addition, ENEE is responsible for approximately 58 percent of the nation's electricity production, with the balance provided by the private sector. Power generation is primarily by fossil fuel thermal generation plants, which provide approximately 70 percent of the nation's power generation capacity.¹⁷⁶ A mix of geothermal and hydroelectric facilities make up the balance of the nation's generation capacity. Honduras's heavy reliance on fossil fuel generation facilities is a competitive disadvantage because of high market prices for fuel and seasonal variability.

e. Trade Facilitation Issues to Address

To facilitate trade, Honduras will require significant assistance to develop a competitive electricity system. The following improvements are recommended:

- ◆ Pursue and develop a low-cost power generation capacity. Honduras is currently highly dependent on fossil fuel power generation plants, resulting from emergency responses to production requirements over recent years. Consequently, the costs associated with power generation are comparatively high for the region. These costs are particularly high when viewed as a percentage of average incomes for the majority of the population. Going forward, Honduras should focus on developing power generation facilities that are based on renewable energy sources, as available. Technical assistance in analysis and implementation is required to realize these potential future cost savings.
- ◆ Reduce distribution losses to acceptable levels. Although Honduras has historically experienced some success in reducing distribution losses, the efforts have not been sustainable. Today, estimated distribution losses are at approximately 27 percent, representing approximately \$35 million per year.¹⁷⁷ Along with the administrative costs associated with the government-run electric company, system inefficiency and illegal connections are responsible for these losses. These financial losses diminish the nation's ability to invest in distribution infrastructure improvements to reduce technical losses. Technical assistance will be required to help provide a full breakdown of non-technical and technical losses. After the causes of the losses are identified, a formal strategic loss reduction plan can be formulated and implemented.
- ◆ Seek opportunities to privatize segments of the nation's electric company. As noted above, ENEE is responsible for the majority of the nation's power generation and has monopoly control over transmission and distribution. Honduras is considering further

¹⁷⁶ Based upon interviews with the ENEE, and the *Comision Presidencial de Modernizacion del Estado*.

¹⁷⁷ Based upon interviews with the *Comision Presidencial de Modernizacion del Estado*.

privatization of power generation, as well as privatization of the nation's distribution network. This effort is currently being studied by the Presidential Commission on Modernization and should be supported. As with many of the nation's government-run implementing institutions, ENEE experiences high labor turnover rates following changes in government leadership. Consequently, the company suffers from loss of technical leadership and skilled labor. Successful privatization will enable Honduras's electricity infrastructure to achieve consistency in talent despite administration changes and enable focused investment in infrastructure improvement.

- ♦ Continue to eliminate complicated subsidy programs. Honduras's electricity sector places significant emphasis on providing low-cost electricity to low-income, low-volume users. To meet this objective, the nation employs a complex subsidy program that places higher user costs on commercial users and requires government subsidies from the general fund. Before privatization, efforts will be required to simplify electricity cost structures. Technical support will be required to achieve this goal.
- ♦ Vigorously support ongoing upgrades in regional transmission capacity. An important regional project, "SIEPAC," currently supported by the Inter-American Development Bank, involves establishing inter-country connectivity and improvement of transmission capability within the region. On an annual basis, Honduras requires importation of electricity to meet its peak operating requirements. However, more important, Honduras lacks the transmission capacity to tap into lower-cost sources of electricity, necessitating dependence on its fossil fuel power generation capacity. Going forward, Honduras would benefit greatly from increased access to lower cost electricity generated within the borders of its neighboring countries. Consequently, continued support in this area is highly recommended.

f. Telecommunications and the Internet

Fixed-line telecommunications services are currently provided by Hondutel, the nation's publicly owned telecommunications service provider. Hondutel currently maintains monopoly power over fixed-line services, as well as both fixed-line and mobile services for international calls. Hondutel's exclusivity provisions expired in December 2005, providing opportunities for an open and competitive marketplace for these services. Initiatives are currently under way to expand the nation's teledensity, currently estimated at 3–4 percent for fixed lines, through partnerships with private sector telecommunications companies operating under contract to Hondutel. After expiration of Hondutel's exclusivity provisions, these companies will have the opportunity to compete in an open market or to continue operating under contract to Hondutel. Two private sector companies currently provide mobile services, and Hondutel will enter this market in the near future.

Telecommunications services within Honduras contrast sharply with those of other regional countries in terms of cost. Currently, costs for local and national calls are considered the lowest in the region, whereas costs for international calls are the highest. This is the result of the nation's low fixed-line teledensity, which places increasing pressure on international calls to subsidize local and national calls. Even more than the telecommunications service providers interviewed in neighboring countries, providers in Honduras fear downward pressure on international call pricing, forcing a rebalancing of local and national call subsidies. In addition, it

is important to note that the region has yet to come to terms with a harmonized plan for recovering international termination costs for calls between Central American countries. Currently, the providers initiating the calls retain all revenues. This practice creates inequities in recovering costs depending on the ratio of outgoing to incoming calls between the Central American countries. It is highly recommended that support be provided for identifying and evaluating solutions for harmonizing the international telecommunications industry.

g. Trade Facilitation Issues to Address

To facilitate trade, Honduras should consider the following recommendation for its telecommunications infrastructure:

- ◆ Continue efforts to privatize Hondutel. The government-run telecommunications provider is one of the nation's major sources of revenue and is a highly profitable organization. However, interviews indicate that the high profitability of the company has come at the expense of investment in the nation's telecommunications infrastructure. Consequently, the profit margins are somewhat misleading. Efforts should be made to fully understand the financials of the company, identify investment requirements, and consider privatization of segments of the company to increase the service levels of the sector. As a government entity, Hondutel lacks the ability to operate as a private company, limiting its ability to provide high-quality, cost-competitive services. As indicated above, efforts are under way to expand the network through private sector participation. These efforts should be supported and expanded following expiration of Hondutel's exclusivity provisions.

3. Supporting Institutions

a. Trucking Companies

Private trucking companies operate throughout the country, with significant capacity provided at seaport and inland distribution terminals. Trucking companies provide drayage and inland distribution services for all international trade. The quantity and quality of the trucking companies available within Honduras are considered adequate and sufficiently scalable to facilitate trade.

b. Airlines

Honduras's airport infrastructure is served by almost all of the major airlines currently providing services to the region. Major carriers also provide air cargo service. Air service is considered adequate and sufficiently scalable to facilitate trade; however, terminal capacity constraints exist at Tegucigalpa, and government services are provided inconsistently to meet peak demands.

c. Ocean Carriers

Honduras serves a significant number of international ocean carriers, which call at regular intervals. Services include containerized cargo, break bulk, neo-bulk, and liquid bulk cargoes. Private sector stevedoring companies provide vessel stevedoring. Private sector transportation companies provide landside transportation. The supporting institutions participating in the maritime activities of Honduras are sufficient.

d. Railways

Railway service is currently unavailable within Honduras. Considering the economics of rail transportation, as well as Honduran geography and landmass, a Central American regional approach is necessary if investment in rail service for the nation is to be justified.

e. Power Distribution

Power distribution from private sector generating plants is provided through a number of private generation companies, with a large percentage of power generated from fossil fuel thermal systems. International transmission capacity is inadequate to accommodate future demands. Consequently, either upgrades of international transmission capacity or capacity building at local power generation plants will be necessary in the future.

f. Telecommunications and Internet Providers

Wireless telecommunications and Internet services are provided through private sector concessions in an open market and competitive environment. This environment provides users with a number of technologies and reliable services from which to choose. Further private sector participation is being implemented in the area of fixed-line communications. Efforts to open the telecommunications market should be supported going forward.

D. RECOMMENDATIONS

- ◆ **Implement key capacity upgrades to roadways.** The Honduran roadway network will require capacity upgrades along key corridors to provide seamless connections between production/consumption zones and international gateways. Targeted improvements include full realization of the nation's improvement plan for the roadway from Tegucigalpa to the Atlantic coast.
- ◆ Honduras is working on a key corridor development project that would link El Salvador's proposed Cutuco port facility on the Pacific coast, to the nation's Atlantic coast. This 100-kilometer stretch has the potential to be a key logistics corridor, providing opportunities for development of value-added services and jobs. Technical support with regard to the area's transportation economics will be required to realize the benefits of this important project.
- ◆ **Increase nongovernmental management and operation of Puerto Cortez.** Honduras's seaport facility requires separation from government control to realize its capacity building program. The existing facility has seen little investment over recent years despite its importance to the nation and the region. Revenues are not fully maintained by the port, nor can they be allocated at the discretion of port management for capital program initiatives. Efforts should be made to decentralize government involvement in port operations. Technical support will be required for implementation of privatization best practices to realize the full potential of this important facility.
- ◆ **Upgrade the international airport at Tegucigalpa.** Honduras's international airport facility at Tegucigalpa is reaching the limits of its operational capacity. The facility will need to be rationalized against development of a new international airport facility located

near the population center. Technical assistance with regard to transportation economics and airport facility planning will be required going forward.

- ♦ **Initiate regional planning regarding a rail network.** Honduras's rail network is currently non-operational. The country's border with Nicaragua provides a potential opportunity for development of a regional inter-modal rail network. Technical support on a regional planning level is required to fully determine the potential benefits of rail transportation for both the country and the region.
- ♦ **Identify more efficient means of electricity provision.** Honduras's electricity system suffers from very high power generation costs and organizational inefficiency. The nation is highly dependent on fossil fuel thermal power generation, currently a high-cost power generation technique. In addition, the nation's distribution network experiences unacceptable technical and non-technical losses, further increasing the cost of electricity. Honduras requires assistance in identifying alternatives for power generation and technical assistance for identifying and addressing the mix of distribution losses. An organizational privatization program is also needed.
- ♦ **Privatize telecommunications.** Honduras's telecommunications sector is dominated by a government monopoly, resulting in large cost disparities between international calls and local calls. The organization should be privatized to eliminate government influence on the telecommunications sector.

ATTACHMENT 1: COMPILATION OF RECOMMENDATIONS

COMPANY LAW

No.	Type	Recommendation	Priority	Duration
1.	Legal reform	<p>Update the Commercial Code.</p> <ul style="list-style-type: none"> ▪ Assessment of parts of the Commercial Code to be reformed. ▪ Draft a modern law on companies that includes corporate governance principles, protection of minority shareholders, divestment, non- capital requirements, possibility of treasury or same- company-owned shares and the treatment of exceptional cases when the legal personality of a company can be disregarded ▪ Establish private-public working groups about these laws and workshops. 	High	Long-term
2.	Institutional strengthening	<p>Modernize the Commercial Registry</p> <ul style="list-style-type: none"> ▪ Monitor and complement The World Bank-Interamerican Development Bank competitiveness project on Registry's modernization ▪ Monitor and complement the establishment of the Property and collaborate on automation of the registration processes and to acquire better equipment and better Registries' facilities 	High	Long term
3.	Institutional strengthening	<p>Reduce regulatory steps to do business</p> <ul style="list-style-type: none"> ▪ Monitor and complement the World Bank-Interamerican Development Bank competitiveness project. 	High	Medium term
4.	Institutional strengthening	<p>Conduct an in-depth analysis of SME sector to identify how to remove obstacles to increased growth and to promote more involvement in the formal sector.</p> <ul style="list-style-type: none"> ▪ Design economic incentives to promote the formalization and growth of SMEs. Focus resources on SME sectors with the greatest potential for progress. ▪ Design special programs for SMEs financing ▪ Set up a donors' conference on SMEs to design regional policies. 	Medium	Long term
5.	Assessment	<p>Undertake a tax assessment on Honduras</p> <ul style="list-style-type: none"> ▪ Identify discrepancies on taxes. Eliminate the unfavorable tax treatment to mergers, business asset and solidarity tax. ▪ Determine cost-benefit of taxes ▪ Draft changes in laws and institution to make the tax system efficient. Automate the tax agency and introduce planning and management techniques for tax collection. 	Medium	Medium term

No.	Type	Recommendation	Priority	Duration
6.	Institutional strengthening	<ul style="list-style-type: none"> ▪ Integrate of the Central American stock market ▪ Draft harmonized model of regulatory and procedural standards for stock market transactions ▪ Automation of stock market ▪ Promotional campaign about the advantages of the market addressed to small investors ▪ Devise a strategic plan for full integration ▪ Strengthen the Central American Stock Market 	Low	Long term

CONTRACTS

No.	Type	Recommendation	Priority	Duration
1.	Institutional Strengthening/ Legislative	<p>Reform the judicial system</p> <ul style="list-style-type: none"> ▪ Create a separate and independent entity in charge of appointing, training and removing judges. ▪ Promote involvement of the civil society in the creation of an independent entity in charge of the judiciary. ▪ Promote respect and compliance of the Law on Judicial Career through conferences, media discussion and workshops with stakeholders. 	High	Long term
2.	Legal reform	<p>Enhance the contract legal framework</p> <ul style="list-style-type: none"> ▪ Update the draft civil procedure code to include oral procedures. ▪ Draft laws on leasing, factoring, franchising, electronic contracts and electronic signatures. ▪ The Law on Distribution Contracts should be redrafted to make it equally fair to both parties. ▪ Set up a working group on possibility Honduras signing the Interamerican Convention on Legal Regime of Powers to be used abroad 	Medium	Long term
3.	Institutional strengthening and training	<p>Reform the legal profession</p> <ul style="list-style-type: none"> ▪ Draft law on legal practice and include admissibility requirements for lawyers such as bar exam ▪ Create independent supervisory and disciplinary body for lawyers ▪ Require compliance with continuous legal education credits for lawyers. ▪ Strengthen control and supervision on law schools. 	Medium	Long term

No.	Type	Recommendation	Priority	Duration
4.	Institutional strengthening	<p>Improve use of arbitration as an alternative means for settling contract disputes. See also Commercial Dispute Resolution recommendations.</p> <ul style="list-style-type: none"> ▪ Create more arbitration centers ▪ Create specialized arbitration centers devoted to settling disputes of SMEs. ▪ Undertake a promotional campaign on the use of alternative dispute mechanisms ▪ Restrict the use of <i>amparo</i> to exceptional cases in arbitration clauses and awards by legal reform and judge training. 	High	Long term
5.	Legal Education	<p>Improve knowledge of legal professionals and law students to support the international business community more effectively.</p> <ul style="list-style-type: none"> ▪ Develop/revise law school curricula to include international standards in business transactions, economic analysis of law, international principles and conventions on contracts (UNIDROIT and INCOTERMS) and enhance training on importance of rule of law, basic legal principles, foreign jurisprudence and doctrine such as “substance over form”. ▪ Introduce the case methodology to teach lawyers and judges better ways to understand the law and the merits of the cases. ▪ Conduct continuing legal education seminars for legal professionals (notaries, lawyers, judges, court clerks) on same topics. ▪ Conduct workshops for common citizens about basic legal principals. 	Medium	Long term

REAL PROPERTY

No.	Type	Recommendation	Priority	Duration
1.	Institutional Reform/legal reform	<p>Regularize private property.</p> <ul style="list-style-type: none"> ▪ Monitor and support the implementation of the Property Law. ▪ Set up working groups of justices, lawyers, members of the presidential commission on property reform, members of the chambers of commerce and peasant associations to be coached by international experts on property reform to build consensus on property reforms. ▪ Organize workshops on the Property Law should be offered in law schools, the Bar Association, other lawyers’ associations and <i>Instituto de Notariado</i> ▪ Launch a promotional campaign on the benefits of the Property Law addressed to the public at large. 	High	Long term

No.	Type	Recommendation	Priority	Duration
2.	Institutional strengthening	<p>Reform the Real Property Registry to improve services, reduce costs, and increase confidence in information.</p> <ul style="list-style-type: none"> ▪ Monitor and complement the World Bank project on integration of the cadastre data, the establishment of a unified national registry system and the establishment of the <i>Instituto de Propiedad</i>. 	High	Near term
3.	Judicial reform	<p>Reform the judicial system.</p> <ul style="list-style-type: none"> ▪ Appoint judges in accordance with the Law on Judicial Career. ▪ Assess the current condition of the judges' selection process ▪ Establish an independent body for administration of the judiciary. 	High	Long term
4.	Legal reform	<ul style="list-style-type: none"> ▪ Draft a law on securitization of real estate rights ▪ Set up working groups on the law on securitization of real estate rights to build consensus. 	Medium	Long term
5.	Legal reform/ Housing	<p>Reduce the housing deficit.</p> <ul style="list-style-type: none"> ▪ Asses the housing deficit ▪ Draft a specialized legal framework to offer incentives for building for low-income dwellers. ▪ Draft a law on real estate brokers in order to increase performance and admissibility standards. Initiate negotiations for agreement with the United States relevant authorities whereby Honduran Real Estate Brokers should be authorized to promote their services in the United States only in connection with Honduran real estate. 	Medium	Long term
6.	Institutional strengthening	<p>Set framework for remittances investment in real estate:</p> <ul style="list-style-type: none"> ▪ Coordination should be led by the <i>Instituto de Propiedad</i> ▪ Design a plan with technological support to banks and the stock market ▪ Begin a public educational campaign in Honduras and abroad about the opportunities available through the real estate electronic investment mechanism ▪ Institutional strengthening for the entities involved provided through management, information technology and financial training. 	Low	Long term

COLLATERAL

No.	Type	Recommendation	Priority	Duration
1.	Legal reform	A new law of secured transactions is needed, shaping the draft law of <i>Garantías Reales Mobiliarias</i> to make sure that it is consistent with all aspects of the OAS Model Law of Secured Transactions. This should include participation in an effort to regionalize key credit institutions, such as the commercial registry.	High	Long term
2.	Legal reform	As mentioned also in the Bankruptcy recommendations, enact a new law of Civil and Commercial Procedures, currently in draft form before the Supreme Court, that maintains and even improves current expeditious judicial enforcement of collateral guarantees.	High	Near term
3.	Institutional reform	The courts and judicial system must undergo significant reforms in order to meet the demand of modern commercial transactions.	High	Long term

COMMERCIAL DISPUTE RESOLUTION

No.	Type	Recommendation	Priority	Duration
1.	Misconduct Prevention	Investigate evidence of corruption among judges in order to ensure the integrity and functioning of the courts. Currently, public confidence in the courts is low.	High	Long term
2.	Institutional reform	Revisit the process for selection of Supreme Court judges. While reform to the process was only recently passed, there are strong suspicions that they did not go far enough to remove, to the greatest extent possible, political influences on the selection process. If that has not been accomplished, judicial selection will remain questionable throughout the judicial system. Since the changes to the law were only recently passed, efforts in this regard in the near term may be more effective since interest is still high.	High	Near term
3.	Institutional Promotion	While a law on alternative dispute resolution (ADR) currently exists, it remains relatively unknown and grossly under used. A promotional campaign should be undertaken within the business community so that the efficacies of ADR could be better understood and accordingly employed to a greater extent.	High	Long term

BANKRUPTCY

No.	Type	Recommendation	Priority	Duration
1.	Legal reform	The law of insolvency must be extensively amended, taking into account the concepts, principles and rules included in modern bankruptcy laws such as those promulgated recently in Eastern Europe and other recent national laws of insolvency. In particular, new laws should provide for a discharge from all debts upon completion of bankruptcy and should do away with the concept of blame for the bankrupt debtor.	High	Long term
2.	Legal reform	A new law of Civil and Commercial Procedures and a new law of <i>Garantías Reales Mobiliarias</i> , both of which take account of and harmonize with insolvency law reforms, should be passed. The Honduran Supreme Court currently has before it a draft of a reform Code of Procedures, which should be carefully reviewed with an eye to eliminating the delays and bottlenecks in current judicial enforcement of commercial laws, including insolvency. Likewise, a draft law of <i>garantías reales mobiliarias</i> is circulating in congressional counsels' circles and could soon come forward for consideration, but it needs to be carefully vetted to make sure that it conforms with the principles of the OAS Model Law on Secured Transactions.	High	Near term
3.	Institutional reform	Extensive reforms of the Honduran judicial system and courts are needed, beginning with the selection of judges in such a way that capable jurists may make a career of the judiciary. Only then can any meaningful training take place, making it possible to build judicial competence in applying insolvency laws and other commercial laws. Additionally, programs for training of judicial officials are needed as well.	High	Long term

COMPETITION

No.	Type	Recommendation	Priority	Duration
1.	Assessment/ Legal Drafting/ Legal Reform	<ul style="list-style-type: none"> ▪ With a view towards regional convergence/harmonization, consider carefully the competition laws of Mexico and Panama; consult with the drafting committees in El Salvador, Guatemala, and Nicaragua. ▪ Consider comments made by private sector representatives, including those made by Cámara de Comercio e Industria de Tegucigalpa and Consejo Hondureño de la Empresa Privada. ▪ Consider comments on the current draft made by international experts, including those made by the World Bank and the U.S. antitrust authorities. ▪ Revise and circulate a new draft based on these comments and on the on-going experiences of regional efforts. 	High	Short-term
2.	Outreach/ Education	<ul style="list-style-type: none"> ▪ Consider promoting passage and implementation of a competition law through a twofold strategy: <ul style="list-style-type: none"> • Develop a series of seminars to promote private sector support, focusing on recent experiences, for example, in the telecommunications sector, regional initiatives, etc. • Develop a series of seminars to educate the Legislative Assembly about competition law. <ul style="list-style-type: none"> ○ As a first step, prepare an advocacy brochure for the Deputies who will vote on the Bill, explaining in clear, basic language the principle purposes of a competition law in the Honduran context, drawing on examples from previous studies. ○ Hold a two day training seminar for the Legislative Assembly, bringing in foreign experts from the region (including at least one expert from Mexico.) 	High	Short-term
3.	Institutional Capacity Building	<ul style="list-style-type: none"> ▪ Develop a policy strategy to make the law operational, including institutional arrangements (e.g., staffing and training). ▪ Develop an enforcement strategy that focuses on investigating anticompetitive conduct in sectors that are important to consumers and that address Honduran market failures. 	Medium	Long-term

No.	Type	Recommendation	Priority	Duration
4.	Outreach/ Education	<ul style="list-style-type: none"> ▪ Continue advocacy initiatives, including reviews of government policies and regulation affecting competition, and preparing studies on key sectors. ▪ Promote a competition culture through public communication including: preparing communication/media materials; enhancing the capacity of media in publication of competition-related issues through dialogue/workshop with journalists; engaging in dialogue/workshops with related law enforcement officers, other government regulators, and the business and academic communities. Strengthen the regulatory and enforcement capabilities of the agency, including analyzing and achieving synergies with consumer protection law and its implementation; and developing capacity for detecting, investigation, analyzing and remedying suspected violated of the competition law, etc. ▪ Develop regional training programs with universities and bar associations. 	Medium	Long-term

INTERNATIONAL TRADE

No.	Type	Recommendation	Priority	Duration
1.	Institutional reform	Seeks reforms and increased efficiency and transparency in customs administration and operations (see recommendations for Goods and Services).	High	Long term
2.	Strategy development/ regional harmonization	Address the lack of a national legal framework for foreign trade, taking into consideration that significant reforms will become necessary. A starting point in this endeavor could be in the internal administration and procedures for applying countervailing duties.	Medium	Long term
3.	Public/ Private Partnership	While there may be no pressing legal issues in this sector for the immediate future, soon issues may become important, such as encouraging growth of cooperation between the private and public sectors	Low	Long term

FLOW OF GOODS AND SERVICES

No.	Type	Recommendation	Priority	Duration
1.	Institutional strengthening	Implement the risk management system which, <i>inter alia</i> , identify areas of continued non compliance or error rates and provide for a methodology to take corrective action through specific seminars to address those areas to promote compliance.	High	1-2 years
2.	Institutional strengthening	Modernize export process/CENTREX: Expand its functions, automate the export process and allow more private industry participation in the operation.	High	1-2 years
3.	Institutional strengthening	Upgrade the express consignment system	Medium	6-12 months
4.	Institutional strengthening	It is necessary to review all Customs procedures and begin the process of benchmarking to identify redundancies, unnecessary review, and steps and start to remove those from the process. Currently procedural change is very slow. If required the Committee on Customs Modernization can oversee and review the process.	High	6-12 months
5.	Institutional strengthening	The Customs authority needs upgrade of facilities including the Customs laboratory, examination equipment, personnel skills and resources.	Medium	6-12 months
6.	Improving professional services	Professionalize trade-related public agencies. The Customs Authority must become a professional organization and develop a personnel policy that provides for a professional workforce. Customs officers should be hired with an expectation that this will be a long term career and not a short term job for the duration of the current administration.	High	6-12 months
7.	Regional Harmonization	Strengthen Customs Union through increasing private sector involvement in decision-making process through establishment of a private sector group that will be involved in planning future modifications. This group could than act a vehicle for notifying their sector as to upcoming changes and training. A common web site should be established for this purpose.	High	6 to 12 months

No.	Type	Recommendation	Priority	Duration
8.	Regional Harmonization	<p>To facilitate the movement of products requiring SPS or food safety regulation and to harmonize procedures within the region, the following actions should be initiated:</p> <ul style="list-style-type: none"> ▪ Make OIRSA SEPA services standard throughout Central America. OIRSA personnel, representing a regional body, could perform inspections for all regional goods in accordance with each country's requirements even if not standardized. ▪ Establish a regional coordination and information center where all exporters and public SPS agencies can obtain information as to US import requirements and what the public agencies require in the way of technical assistance to meet these standards. This would be supplemented with seminars held throughout Central America by representatives of relevant US and international agencies and associations. ▪ Reengineer SPS and food safety procedures to reduce costs and time to comply while maintaining sufficient controls to safeguard public health, in particular for international goods. This re-engineering process should include all agencies involved public and private parties. 	<p>High</p> <p>High</p> <p>Medium</p>	<p>18 to 24 months</p> <p>12 to 18 months</p> <p>12 to 18 months</p>
9.	Customs/Other Agencies/ National issues	Establish a special anti-smuggling and fraud unit, using a combination of officers from Customs and the Special Investigations Unit of the National Police to improve security. This unit would develop a threat assessment and corresponding action plan to combat smuggling and set specific priorities and goals.	High	6-12 months
10.	Customs/Other Agencies/ National issues	Streamline Customs Processing and Costs at free trade zones and Bonded Warehouses. Presently, customs officers in these zones are not fully utilized. By directly linking the warehouses and zones to the Customs operational system, which is anticipated by the end of the year, on-site Customs supervision should be eliminated and Customs adopt a post audit approach to oversight.. Once the operator's inventory control systems were certified as able to competently perform this function, Customs would be withdrawn from the site.	Medium	12 – 18 months
11.	Customs/Other Agencies/ National issues	Request participation in the Container Security Initiative at Puerto Cortez once scanning equipment is operational. Presence of a US Customs officer who would review outbound manifests to the US prior to export and cooperate with local Customs officials to examine any suspicious shipments prior to loading would expedite release of the shipment on arrival in the US and serve as a major selling point in the port's marketing strategy. Regional support for this initiative should be secured at a minimum from both Nicaragua and El Salvador, significant users of the port.	Low	12 to 18 months

No.	Type	Recommendation	Priority	Duration
12.	Customs/Other Agencies/ National issues	Eliminate Customs requirements that double the time and cost of delivery of goods to a bonded warehouse. Customs should implement procedures that require the filing of only transfer document at point of arrival under which the cargo can proceed directly to warehouse. In addition the informal policy of requiring 30% of all goods arriving at Cortex to be cleared there negatively impacts the business opportunities of the bonded warehouse operator as does the Customs requirement that all Panamanian goods be cleared at point of arrival. Both of these procedures should be reviewed and alternative measures to control the widespread undervaluation of the latter goods found. Such policies inhibit the importers right to designate clearance location and are inappropriate if not illegal.	Medium	6 to 12 months
13.	Customs/Other Agencies/ National issues	Upgrade enforcement efforts related to IPR. This would include cooperation of the business community in the identification of IPR infringements. In this connection, develop a modern automated system for registration and tracking or for communication with its enforcement entities on IPR issues, using the World Intellectual Property Organization (WIPO) to assist with design and securing funding.	Medium	12 to 18 months
14.	Customs/Other Agencies/ National issues	Identify a national authority for quality control standards. This body would assume the role of identification and codification of industry international standards, assist producers or sectors in implementation and perform certification of company processes as well as laboratories. Their role would be similar to that of CONACYT, the National Council for Science and Technology, in El Salvador.	Medium	18 to 24 months

FLOW OF PEOPLE

No.	Type	Recommendation	Priority	Duration
1.	Training	Upgrade the professionalism and modernization of immigration agency by focusing on the following key areas: <ul style="list-style-type: none"> ▪ Assist government in implementation of integrity program, including strengthened independent internal affairs. ▪ Develop a comprehensive personnel system that would upgrade candidate qualifications, improve recruitment procedures, and establish job-specific performance and evaluation standards. ▪ Provide training in document examination, investigative and interviewing techniques. 	High	Medium term

2.	Regional Harmonization/Regulatory reform	Harmonize and implement CA-4 immigration visa so that trade-related visitors may enter one country and visit all with appropriate security.	Medium	Long term
3.	Legal reform	Amend laws to create streamlined process for highly skilled individuals (engineers, doctors, attorneys, etc.). Simplify the process by implement one-stop processing center at most appropriate ministry. This process should include, at a minimum, filing of applications and payments through one agency with transparent, predictable process for review and determination. Also, eliminate review requirement for all exiting parties by strengthening risk assessment and enforcement function. It should be mandatory for citizens and visitors to “check in” but departure procedures should be unencumbered and lead to less delays at borders.	High	Long term
4.	Institutional strengthening	Modernize and upgrade automation for people processing at the border. This includes passport readers and networked computers so that borders have capacity for the following: <ul style="list-style-type: none"> ▪ electronic exchange of people information among border sites and headquarters ▪ electronic exchange of people information with other CAFTA countries ▪ enhanced risk analysis system and automate risk processes 	High	Short term
5.	Training	Provide training to increase capacity of Customs officers. Work to do this especially in the following areas: <ul style="list-style-type: none"> ▪ Document fraud detection techniques ▪ Customer service ▪ Risk management 	High	Medium term

FINANCIAL CRIMES

No.	Type	Recommendation	Priority	Duration
1.	Legal implementation	The laws dealing with financial crimes in Honduras comport with relevant standards. Implementation of these laws is lacking, however, in particular with respect to compliance by banks with reporting suspicious money transactions. Steps must be taken to improve compliance in this area.	High	Near term
2.	Institutional strengthening	Efforts have been undertaken to ameliorate the level of corruption among police and customs officials through greater investigation and prosecution. These efforts must be supported to ensure that these services do not backslide to prior behaviors.	Medium	Long term
3.	Institutional focus	Currently, high levels of smuggling and undervaluation or under-taxation of imported goods is adding to an atmosphere which seemingly tolerates corruption and contributes to misfeasance. Efforts should be made to target and eliminate these behaviors.	Medium	Long term

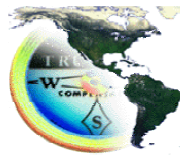
FLOW OF MONEY

No.	Type	Recommendation	Priority	Duration
1.	Strategy development/ Assistance to private sector/Training	<p>Improve access to credit for small and medium-sized exporters and importers. While the basic tools for conducting exchange of payment for trade (i.e., letters of credit), trade and financial institutions must develop strategies to more effectively extend credit to reliable small and medium-sized traders. A robust trading system provides small and medium-sized traders with the ability to finance their export and import activities, yet the current system often requires many smaller traders to self-finance their activities. This reality imposes serious costs on importers and exporters making them less competitive. Strategies to pursue include such activities as:</p> <ul style="list-style-type: none"> ▪ establishing guarantee funds that offer credit to exporters for fewer guarantees than currently demanded; ▪ developing associations/cooperatives among producers for pooling of resources and risks to acquire lower cost credit; ▪ increasing importers' and exporters' understanding of existing bank instruments through seminars and training. 	High	Long term

INFRASTRUCTURE

No.	Type	Recommendation	Priority	Duration
1.	Roadway Network Development	Promote roadway capacity upgrades along key corridors <ul style="list-style-type: none"> ▪ Provide seamless connections between production / consumption zones and international gateways. ▪ Eliminate bottlenecks ▪ Targeted improvements must include the corridor between Tegucigalpa and Puerto Cortez 	High	Near-term
2.	Roadway Network Development	Promote development of proposed logistics corridor and bypass corridor linking El Salvador's proposed Cutuco port facility to the nation's Caribbean coast. <ul style="list-style-type: none"> ▪ 100-kilometer highway project ▪ Development of value added services and positive economic impact potential ▪ Alternative to Panama Canal transits ▪ Reduce truck traffic at existing Tegucigalpa population center 	High	Near-term
3.	Roadway Network Safety / Security	Promote safety and security measures to minimize accidents <ul style="list-style-type: none"> ▪ Develop social awareness and educate users with regard to traffic safety ▪ Eliminate encumbrances and user distractions along the nation's right-of-ways. (i.e. keep the right-of-way clear.) ▪ Incorporate pedestrian and human-powered vehicle right-of-ways within corridor cross-section design. ▪ Minimize pedestrian access to highway network 	Medium	Near-term
4.	Seaport Operations (Fiscal Control)	Decentralize approval requirements for capital improvement programs at Puerto Cortez <ul style="list-style-type: none"> ▪ Existing facility requires investment in order to meet demands of its customers ▪ Revenues are not fully maintained by port management ▪ Revenues are not allocated to capital programs at the discretion of port management 	High	Near-term
5.	Seaport Facilities	Implement the adopted capacity building master plan at Puerto Cortez <ul style="list-style-type: none"> ▪ Puerto Cortez has developed a solid capacity building conceptual master plan. ▪ Plan execution will place Puerto Cortez as the leader in port services to the Caribbean coast. ▪ The level of manufacturing activity located proximate to the port, necessitates investment in port infrastructure 	Medium	Medium-term

No.	Type	Recommendation	Priority	Duration
6.	Seaport Facilities	Establish priorities to complete ongoing operations improvement projects. <ul style="list-style-type: none"> ▪ Existing investments in traffic improvement projects are incomplete ▪ Funding is not available to acquire land to complete projects ▪ Completion of these projects should be made a priority. 	High	Near-term
7.	Airport Facilities	Evaluate options for new airport facility development serving Tegucigalpa <ul style="list-style-type: none"> ▪ Honduras' international airport facility located at Tegucigalpa is reaching the limits of operational capacity. ▪ The facility will need to be rationalized against development of a new international airport facility located proximate to the population center. ▪ Technical assistance with regard to transportation economics and airport facility planning will be required going forward. 	Medium	Medium-term
8.	Electricity	Decentralize Honduras' electricity implementing institution: <ul style="list-style-type: none"> ▪ Existing institution (ENEE) is highly inefficient ▪ Investments in system upgrades are limited by government approval processes ▪ Technical staff attrition rates are high, negatively affecting system performance 	High	Near-term
9.	Electricity	Reduce technical and non-technical distribution losses <ul style="list-style-type: none"> ▪ Current distribution losses approach 27% ▪ Allocation of losses must be identified and measured to identify solutions 	High	Medium-term
10.	Electricity	Reduce dependence on fossil fuel thermal power generation plants <ul style="list-style-type: none"> ▪ The nation is highly dependent on fossil fuel thermal power generation facilities ▪ Costs of power generation are comparatively high ▪ Continue to pursue Plan Puebla y Panama and IADB initiatives 	Medium	Long-term
11.	Tele-communications	Support decentralization of Honduras' Telecommunications implementing institution: <ul style="list-style-type: none"> ▪ Existing institution (HONDUTEL) is expanding service capacity through private sector franchise agreements – Continue to support as a first step towards opening the marketplace to competition ▪ Investments in system upgrades are limited by government approval processes ▪ Technical staff attrition rates are high, negatively affecting system performance 	High	Near-term
12.	Railroad	Evaluate benefits associated with redevelopment of nation's existing rail corridors <ul style="list-style-type: none"> ▪ Seek optimal length-of-haul opportunities through partnering with international neighbors 	Low	Long-term

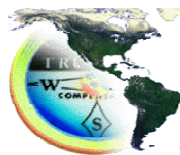


ATTACHMENT 2: ROUNDTABLE PACKAGE

**Preparación para el CAFTA y la Armonización Regional
Comercio, Derecho Comercial y Estrategia para el Fortalecimiento Institucional
Mesa Redonda**
23 de septiembre de 2004
Hotel Marriott • Tegucigalpa, Honduras

Temario

- 1:30 – 2:00 **Registro**
- 2:00 – 2:30 **Palabras de bienvenida**
- Presentación del temario: Lic. Emad Tinawi, Booz Allen Hamilton
 - Ministro Norman Garcia, Secretaría de Industria y Comercio
 - Paul Tuebner, Mission Director, USAID/Honduras
- 2:30 – 3:00 **Sesión I: Presentación de las conclusiones del diagnóstico sobre el comercio y el Derecho Comercial**
- Perspectiva de un Experto Hondureño: Lic. Dennis Matamoros, Arias y Muñoz
 - Conclusiones referentes al Derecho Comercial: Prof. Dale Furnish, National Law Center for Inter-American Free Trade
 - Conclusiones referentes a las aduanas y el comercio: Ing. John Corley, Booz Allen Hamilton
- 3:00 – 3:15 **Café**
- 3:15 – 4:30 **Sesión II: Discusión en grupos**
- **Eliminando las Barreras al Comercio Internacional**
 - **Creando lo Elemental para el Sector Privado: la Nueva Ley de Propiedad**
 - **Enfatizando el Ambiente Comercial en Honduras a través de las Reformas Legales**
 - Mejorando la Competitividad en Honduras
- 4:30 – 5:00 **Presentación de los resultados de la discusión grupal**
- 5:00 – 5:30 **Comentarios finales y clausura**
- Jim Stein, Director, Office for Trade and Economic Analysis, USAID/G-CAP
- 5:30 – 7:00 **Cóctel**



Breakout Discussion Topics – Honduras

Breaking Down Barriers to Trade

- What are the major obstacles to international trade? What are the major obstacles to doing business in Honduras?
- What are some solutions to reducing or eliminating previously identified bottlenecks?
- What are the impediments to implementing these solutions?

Building the Fundamentals of Private Enterprise: the New Law of Property

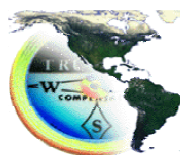
- What other things are needed to be included to make the law completely effective, e.g. collateral guarantees?
- How best to carry out the transition from the old to new registry?
- In what ways will the new law on property change the ability of businesses to gain access to credit?

Enhancing the business climate in Honduras via judicial reform

- How does the current status of the rule of law promote or prevent conducting business in Honduras?
- What judicial and legal reforms are needed to ensure a sound business environment?
- What are the implementation priorities among the recently passed commercially-related laws in Honduras?

Improving Competitiveness in Honduras

- What are the lessons from previous privatization efforts? What is the future for privatization?
- Should the adoption of a competition law/policy be a priority in Honduras? Should the public and private sectors work to promote such a policy?
- What are the regulatory obstacles to doing business in Honduras? What steps, if any, should the private sector take to encourage regulatory reform?



Roundtable Discussion Conclusions

GROUP 1 – BREAKING DOWN BARRIERS TO TRADE

1. The recently established Pro-Committee, CEIMSA (*Comisión Especial Interinstitucional para el Modernización de Servicios Aduaneros*, or Special Interinstitutional Commission for the Modernization of Customs Services) provides an excellent opportunity for cooperation between the public and private sectors. This body should be used to expedite customs processes and accordingly improve trade. Generally speaking, cooperation between the public and private sectors must continue and improve. Policies should be developed in a consensual manner so that government efforts more closely meet private sector demands and all parties feel ‘ownership’ of the processes.
2. While technological advances have been made in Honduras with respect to customs and trade processes, it is important that these continue to be used and developed in order to eliminate certain barriers such as delays and corruption. The use of technology creates greater transparency and accountability, which is needed to improve processing.
3. As a result of currently established political practices, the majority of customs and other relevant trade officials are replaced every four years with the change in administration. As a result, trade processing is hampered as new personnel are brought up to speed. In order to combat this, greater continuity must be provided for with the creation of a permanent and highly professional staff.
4. There is a lack of knowledge and information regarding procedures and requirements, both for export and import, in other countries, such as with respect to sanitary and phyto-sanitary standards. There needs to be a greater exchange of information in this regard between Honduras and its trading partners, and in particular the United States, so that this barrier can be removed.

GROUP 2 – BUILDING FUNDAMENTALS OF PRIVATE ENTERPRISE: THE NEW LAW ON PROPERTY.

There seems to be support, in general, for the new law on property, but because there are questions as to its constitutionality – which is being considered in the Honduran courts – support for its implementation has been inconsistent.

Relatedly, while there is a sentiment that given the law’s recency it should be given an opportunity to succeed, the mechanisms to be employed in the transition from the old to the new law are unclear. For example:

- The new law creates the Institute of Property to act as the equivalent of a national registry. The Institute has the potential to regularize the status and processes of property ownership in Honduras. However, the transition to the Institute from the Supreme Court, which currently acts as the property registry, has not gone smoothly to this point as the Supreme Court is falling behind in preparing the materials to effect the transition. Given the recent and similar transition in El Salvador, however, expectations must be kept realistic. Sufficient funds have been allocated to the Institute in order for it to be a success.
- There is uncertainty as to how or if there will be any continuity among those officials who are directly responsible for the work of the registry/Institute.
- There is concern that the information contained in the property cadastre and the registry (or soon to be Institute) is not the same, although it should be, and there is a lack of clarity on how this information will be harmonized.
- Previous corruption in this area will continue but there is a belief that the new law will provide a basis through which this can be overcome.

A modernized registry is currently functioning in the city of Comayagua, and can serve as model for the rest of the country. As the majority of property implicated by the new law is in Tegucigalpa and San Pedro Sula, those are the locations where the greatest efforts should be made to ensure proper implementation of the law and the Institute of Property.

Other steps and laws are currently being considered and others are needed to ensure that the new law is successful. One such law is the law on movable property guarantees (i.e. inventory, vehicles) which is currently before Congress and was drafted with the help of the Organization of American States and other Latin American countries. A better law in this regard will help businesses secure credit and spur growth, as well as facilitate foreign capital and investment entering the country.

Other laws should be reformed as well. Laws with respect to company formation must be simplified in order to encourage small and medium enterprises to enter the formal sector. Additionally, the Code on Civil Procedure should be modified to ease administrative procedures. Lastly, training should be undertaken for officials in the Institute to ensure that they are not only technically savvy but also of the highest integrity.

GROUP 3 – ENHANCING THE BUSINESS CLIMATE IN HONDURAS VIA JUDICIAL REFORM

The process for the formation of a company must be improved and made consistent throughout the country. For example, currently it takes far less time to register a company in San Pedro Sula than in Tegucigalpa as a result of both form and material inconsistencies.

- Requirements should be standardized from municipality to municipality in order to secure, for example, a “*permiso operación*.”
- In addition, costs of registration should be reduced, both at registries and for those intermediaries involved in the process, such as notaries. Moreover, costs should be standardized from municipality to municipality to the greatest extent possible.

- Last, mechanisms should be created that allow for the immediate formation of a company. One step in this direction would be widespread use of “*ventanillas unicas*” or “one-stop shops.”

A greater degree of transparency and expertise must be introduced into the judicial system. This can be achieved through various reforms.

- Despite the passage of the judicial career law, there is still concern the selection of judges is not sufficiently de-politicized. A system should be established where selection is based on merit, exempted from outside influences/interest groups.
- Judges at lower levels need greater independence to assure that they will not be subjected to influence and pressure from higher courts or politicians to shape decisions in a particular way. In this connection, judges should have the assurance their jobs will be there for them, i.e. they should be given them permanent status.
- Courts of specific jurisdiction should be created with judges having area expertise, e.g. commercial courts.
- Currently there are gaps between the practice and the content of the law. For example, factoring and leasing contracts are used in Honduras but the concepts are not sufficiently developed in the law. Similarly, while electronic contracts are used, there is no law to control their validity and judges are not sure how they should be interpreted. In addition, not only should these areas be dealt with, but a system should be established so that such gaps can be more quickly recognized and Congress can more quickly bring the law in line with practice.

With respect to the recently passed commercially-related laws, priorities for implementation need to be set in order to encourage foreign investment. Primary among these is the intellectual property law, which currently exists, but the application of which is not yet well understood. Similarly, the copyright law has been passed but it is seemingly being overtly ignored. The new law on Property, specifically dealing with real estate, and the draft law on collateral guarantees are an important pieces of legislation and should be supported so that there is certainty for those that own property and are seeking guarantees. Lastly, the *Ley de Mercado de Valores*, passed more than a year ago, needs promotion and added incentives to encourage support for and investment in the stock market.

GROUP 4 – IMPROVING COMPETITIVENESS IN HONDURAS

There are a number of basic steps that need to be taken to improve competitiveness. These include the passing a law on competition; strengthening the relationship between the public and private sectors and encouraging greater private sector participation; simplifying the legal framework and bureaucratic procedures; and privatizing key industries through appropriate and regulated means. More specifically:

- Services currently provided by the state, such as energy and electricity, should be opened to augment competition throughout the country. Obviously, this will require greater private sector involvement.
- Despite prior unsuccessful efforts, privatization should be pursued with the goal of lowering costs and increasing competition.

- Collusion in those areas where only a few providers exist should be discouraged and controlled. In this connection, consumers need sufficient legal mechanisms to have means of fighting against collusion.
- Transportation costs should be reduced. This can be accomplished through more efficient customs procedures, a regional customs union, and reduced and simplified administrative requirements.
- The efficiency and professionalism of public sector must be improved. In addition, efforts should be made to ensure greater stability and consistency in key administrative areas.

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