# DEPARTMENT OF STATE
# AIRGRAM

| HANDLING | CLASSIFICATION | MESSAGE REFERENCE NO. |
|---|---|---|
| PRIORITY | UNCLASSIFIED | 002 |

TO: Department of State

Dept for EB/IFD/OIA, Room 2533A N.S.

FROM: Amembassy Tegucigalpa  DATE: February 11, 198

E.O. 12356: ~~11652~~: N/A

TAGS: ECRP, EINV, HO

SUBJECT: Investment Climate Statement for Honduras

REF: 84 State 248830

DEPT. DISTRIBUTION
ORIGIN/ACTION
ECON

| | | | |
|---|---|---|---|
| AF | ARA | CU | EA |
| EB | EUR | INR | IO |
| L | NEA | PER | PM |
| REP | SCI | SS | SY |
| | | | |
| AGR | AID | AIR | ARMY |
| CIA | COM | DOD | DOT |
| FRB | HEW | INT | LAB |
| NAVY | NSA | NSC | OPIC |
| STR | TAR | TRSY | USIA |
| XMB | | | |

1. This airgram transmits the Investment Climate Statement for Honduras. Please send published volume to Embassy when it is printed

2. Format is in accordance with reftel. A "Wang" diskette is being forwarded to:

EB/IFD/OIA, Room 2533A N.S.
Department of State
Washington D.C. 20520

3. Per reftel, text is done in single-spaced, 10 pitch pica with one inch margins all around. Maximum page length is 52 lines.

4. Department is requested to give Statement widest possible distribution among interested offices within State and among interested Departments and Agencies, including Agriculture, Commerce, Labor, USIS, AID, USTR, OPIC, EXIM, and others.

DEPARTMENT OF STATE IM/IPS/CR/IR Date: 7/22/98
(✓) RELEASE ( ) DECLASSIFY
( ) EXCISE ( ) DECLASSIFY IN PART EO Citations
( ) DENY

TS authority to
FOIA Exemptions ( ) CLASSIFY as ( ) S or ( ) C Sec.
PA Exemptions ( ) DOWNGRADE TS to ( ) S or ( ) C

NEGROPONTE

SUGGESTED DISTRIBUTION
AMB DCM POL SA LAB
CML CONS USIS AID/6
DAO MILGP JAO CHRON

UNCLASSIFIED
CLASSIFICATION

| DRAFTED BY: | DRAFTING DATE | PHONE NO. | CONTENTS AND CLASSIFICATION APPROVED BY: |
|---|---|---|---|
| LCOHEN:ECON | 2/11/85 | 243 | SCLOWMAN DCM |

CLEARANCES:
JLAMONT:ECON XWILKINSON:CML
MMEMBRENO/MBRANT:AID/PSP
JLAPITTUS:AID/EPA

FORM DS-323
11-72

Honduras' economy is basically free-market in structure, although some parastatal enterprises do dominate certain sectors (for example lumber). The government has maintained the official value of the Lempira at its historic exchange rate of two-to-one in relation to the U.S. dollar; an unofficial but active parallel market does exist, however, with the Lempira generally discounted around 30 to 35 percent. Exchange controls requiring licensing and a local currency prior deposit scheme for international payments are in effect.

Real growth in Gross Domestic Product (GDP) was 2.8 percent in 1984. Much of this growth, however, was due to the economic activity being generated by the construction of the El Cajon hydroelectric project, due to be completed by the end of 1985. The Consumer Price Index officially rose just 4.9 percent in 1984 after an increase of 8.9 percent the previous year. Price controls on many basic commodities may have contributed significantly to this figure.

## (B) GOVERNMENT ATTITUDE TOWARD FOREIGN PRIVATE INVESTMENT

Honduras has long maintained an open-door policy to foreign investment. U.S. firms have been engaged in profitable endeavors in Honduras for over a century. Since the onset of democratic, civilian rule under President Roberto Suazo Cordova in 1982, the Honduran Government has been seeking ways to encourage investment, particularly in enterprises which would increase exports. Some new operations have been begun recently with foreign capital and expertise.

A number of potential foreign investors have in the past been frustrated by the various segments of the Honduran bureaucracy which deal with investment and business. The regulatory climate for foreign investment has improved somewhat with the passage of a number of new laws; however, the judicial system and inefficient bureaucracy continue to hinder the smooth operation of more than a few foreign-owned companies. At the same time, whatever restrictions exist in general on investment and trade result more from a lack of coordination and goals by relevant agencies than from the legal restrictions.

Under the Honduran constitution, foreign firms enjoy equal treatment with national firms in terms of rights and obligations. Also, the 1928 U.S./Honduras Treaty of Friendship, Commerce and Consular Rights provides for Most Favored Nation treatment for investors of either party. Foreign companies operating in Honduras are subject to provisions of the Honduran Commercial Code and to the same tax laws as domestic enterprises, unless otherwise exempted. Several legally established investment incentives exist which generally favor new or expanding enterprises. Honduras' incentives laws generally operate to grant greater benefits to

Licenses and permits are necessary for a wide variety of activities. GOH administrative as well as legal procedures are reputedly not immune from influence and often amount to a frustrating, time-consuming process for the inexperienced foreigner. Occupational licensing by professional bodies is, in practice, limited to nationals. COHDEFOR, the national forestry authority, licenses woodworking firms under procedures which sometimes appear to be applied unevenly.

Joint ventures enjoy the full protection of Honduran law; however, in some cases 51 percent of the capital must be Honduran. In practice this is not a problem.

In theory, there are no restrictions on the remittance of royalties and dividends abroad, although dividends paid to nonresident foreign investors are subject to a 15 percent tax rate versus 10 percent for nationals and resident foreigners, as compensation for nonresident foreigners not paying income tax on dividend earnings. With the institution of foreign exchange controls, one result has been substantial delays in access to foreign exchange for the remittance of royalties and dividends.

Patents and trademarks are protected, but must be registered with the Ministry of Economy. The duration for a patent may be for 10, 15 or 20 years depending on the importance of the invention and the desires of the applicant. Honduras is a party to the General Inter-American Convention for Trademark and Commercial Protection (Washington 1929), the Convention on Literary and Artistic Copyrights (Buenos Aires 1910), and the Convention for the Protection of Inventions, Patents, Designs, and Industrial Models (Buenos Aires 1910).

Except for the non-traditional products which qualify for incentives under the Export Incentives Law, a tax of 1 percent is applied on the FOB value of all exports. Bananas, meat, seafood, coffee, and mineral concentrates (which make up the bulk of Honduras' exports) are taxed at a higher rate. Imports are presently taxed by category and are subject to surcharges of up to 30 percent. The present tariff schedule is the Central American Uniform Tariff Nomenclature (NAUCA) which was designed primarily as an import-substitution mechanism. Proposed changes in the tariff schedule include a switch to the ad-valorum Brussels Nomenclature.

The import of raw materials and all other goods and services is regulated by the Central Bank through an import licencing scheme. Under the controls, imports are divided into five catagories from highest to lowest priority. Category I comprises essential consumption items, medicines, and educational materials; Category II, fuels and lubricants; Category III, raw materials and other agricultural and industrial inputs; Category IV, machinery, equipment, and spare parts; Category V, other goods and services and dividends. In late 1983 the GOH began permitting the use of foreign exchange from "non-banking" sources to pay for imports, which meant, in effect, tacit official tolerance of a parallel market. This measure effectively was a 'de facto' recognition of the overvaluation of the Lempira, tolerating a floating rate alongside the official rate. Importers who are fortunate enough to have their foreign exchange applications approved receive the more favorable rate. An official devaluation and/or parallel market currently appears to be out of the question, at least for 1985, a presidential election year.

Application for, and approval of, the import permit constitutes only half the process required, since in most cases application must also be made for foreign exchange to pay for the imports. Delays of six months and more for approval are common because of the Central Bank's severe shortage of foreign exchange.

(D) INVESTMENT INCENTIVES

The industrial sector benefits from several legally established investment incentives. In general, these incentives favor new or expanding enterprises which significantly expand the country's industrial base, satisfy basic human needs, and either generate or conserve foreign exchange through import substitution and/or increased exports. Recent legislation, such as the Temporary Import Law and the Export Promotion Law, is aimed particularly at promoting non-traditional exports (which also may benefit from the Caribbean Basin Initiative). Enterprises whose products utilize at least 30 percent of their total value of raw materials, packaging materials, and semi-finished products from local or regional origin may qualify for exemption from duties, consumption taxes, and consular fees for up to twelve years under the Law for Promoting Small and Medium-sized Industries and Craftsmanship. Large export-oriented investors ($500,000 and above and employing 75 or more Honduran workers) are eligible for income tax liability reductions of up to 50 percent.

Incentives for the tourist industry include a one-time, 100 percent exemption from import duties, consular fees, etc. on imports of construction materials, furnishings, equipment, etc. depending on location within the country. (The law favors enterprises located outside of the population centers of Tegucigalpa and San Pedro Sula.) Tourist industry enterprises are also exempt from income taxes for up to ten years, depending on location and the ratio of net profit to invested capital. However, the income tax reduction incentives do not apply in any year in which net profit exceeds 20 percent of invested capital, regardless of location.

Under the Agricultural Development Law of 1970, revised in 1972, agricultural enterprises are exempt from import duties and related charges on imports of certain equipment, seeds, fertilizers, fuels and other selected items. Machinery, raw materials, semi-finished products, and packaging are subject to a 5 percent tariff on their CIF value.

The Mining Code permits any person or entity, national or foreign, to obtain exploration permits and exploitation concessions. The exploitation concessions are granted for a period of 40 years, renewable for 20 additional years. Revisions to the Code offer new mining ventures lower tax and royalty rates for the first five years of their existence.

The State of Honduras, although the sole owner of hydrocarbon deposits that may exist in the country, may grant exploration and exploitation permits to individuals and entities, national or foreign, that prove their financial and technical capability to undertake such ventures. Foreign capital ownership is limited to two-thirds. Concessionaires are able to import all equipment, machinery, materials, and accesories duty free, as long as these items are not satisfactorily produced in Honduras.

"Drawback" enterprises are totally exempt from import taxes on raw materials, semi-finished products, packaging materials and other goods incorporated into final products which are subsequently exported outside of Central America.

Foreign investors enjoy the same rights and privileges with regard to local sourcing of financing as domestic investors. No limits exist on the repatriation of capital and profits, although the Central Bank will require that new enterprises notify them in advance if the company anticipates repatriating capital. (Note: Some delays in the repatriation of dividends and capital have occurred, due largely to the shortage of foreign exchange in the Central Bank.)

The Central American Agreement on Fiscal Incentives for Industrial Development favors those industries which utilize a significant portion of raw materials of Central American origin. Incentives provided by implementing legislation in Honduras therefore vary according to the proportion of such materials used in the manufacturing, assembly, finishing, or packaging process: the greater the fraction of Central American-produced raw materials, the more liberal the incentives.

## (E) ANTICIPATED CHANGES IN INVESTMENT POLICIES

The stated investment policy of the Honduran Government is to support any foreign or domestic investment which promotes national development. Proposed changes may be expected in the near future in the Tourism, Mining, and Petroleum Laws, all of which have been rewritten but have yet to be officially passed into law. These anticipated changes should clarify ambiguities in the existing legislation.

(F) INVESTMENT DISPUTES

Historically, there have been few investment disputes in Honduras. When these have come up, Honduras has generally dealt with the issues involved pragmatically and has taken care to proceed in accordance with international law. Honduran law provides guidelines for expropriation and related compensation which, in accordance with national treatment, are applicable to foreign investors. The 1955 Agreement on the Guarantee of Private Investments and the 1966 Agreement on Investment Guarantees provide for standards of expropriation and compensation on investments insured by OPIC.

With regard to arbitration, Honduras -- unlike many Latin American countries -- does not have a "Calvo Clause" limiting jurisdiction to its own court system. Also, it has historically shown a willingness to enter into arbitration as a means of settling disputes. Binding arbitration is provided for in the 1955 and 1966 Investment Agreements insofar as OPIC-insured investments are concerned. Recently, the GOH has backed away from its enthusiasm for arbitration. This is likely in response to an unfavorable arbitral award in a dispute with the contractor who constructed a port facility at Puerto Castilla.

The Puerto Castilla controversy -- which is best described as a commercial dispute -- arose from contractual differences between the ENP (the national port authority) and a U.S. construction consortium (Construction Aggregates Corporation/Crescent Construction Company) over quality and timeliness in delivering required materials to the port site. The matter was submitted to the Inter-American Commercial Arbitration Commission, which issued a vaguely worded award to the construction company. ENP paid the award in March 1983.

The International Telephone and Telegraph Company (ITT), through one of its Florida subsidiaries, was involved in a commercial dispute with the Honduran national telephone company (HONDUTEL) concerning ITT's alleged failure to meet terms of a contract for the delivery of a telephone switching system in San Pedro Sula. A settlement was reached between the two parties in 1983.

The case of Morat Island, although not an expropriation <u>per se</u> by the Honduran Government, concerns the loss of ownership rights of a U.S. citizen to an island, based on a judicial decision that Morat Island had been improperly zoned as urban and thus that the sale of the island to a non-Honduran was also improper. The Government has affirmed, however, that the U.S. citizen would not lose the sum of his investment in the island. A final settlement is still pending.

The highly publicized case of Temistocles Ramirez -- which may best be described as an unresolved expropriation -- revolves around the efforts of the Honduran Armed Forces to establish their Regional Military Training Center on a small portion of Mr. Ramirez' land near Trujillo. While Mr. Ramirez demands a substantial level of compensation, the Honduran Government questions his ownership of the land. The government alleges long-standing tax evasion and has accordingly placed an embargo on Mr. Ramirez' assets. The government, however, is prepared to compensate Mr. Ramirez for improvements on the land and business losses involved. The GOH has stated its willingness to reach an accord with Ramirez; however, the Government position is that Ramirez has not fully utilized the Honduran legal procedures at his disposal.

(G) BILATERAL INVESTMENT AGREEMENTS

The 1928 U.S./Honduras Treaty of Friendship, Commerce and Consular Rights provides for Most Favored Nation treatment for investors of either party. The United States and Honduras also signed an Agreement for the Guarantee of Private Investments in 1955, and an Agreement on Investment Guarantees in 1966. Negotiations appear close to completion on a Bilateral Investment Treaty which would strengthen even further protection of U.S. investment in Honduras. Honduras is party to the Central American Agreement on Fiscal Incentives; however, it is not a participating member (since 1970) of the Central American Common Market. Provisions for bilateral investment are included in the commercial treaties Honduras has concluded with Costa Rica, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Columbia, Chile, Argentina, and Romania. (The commercial treaty with Guatemala lapsed in April 1984; although a new treaty was signed in November 1984, it has not yet been ratified.)

The Government of Honduras has expressed interest in reaching agreements with other regional countries, including Belize and the Dominican Republic.

(H) OPIC PROGRAMS

The Overseas Private Investment Corporation (OPIC) has long been active in Honduras. OPIC currently holds active insurance contracts with coverage of $36,958,740 against expropriation, $38,820,055 against war, and $35,183,343 against currency inconvertibility. OPIC has also financed the expansion of 7 U.S. businesses or joint ventures in Honduras since 1980.

## (I) LABOR

The labor force of Honduras exceeds 1.2 million, of which some 200,000 are organized. Unofficially, unemployment and underemployment is estimated at well over 50 percent. The Honduran Labor Code is considered progressive and is very favorable to the workers. Honduras has long had a vigorous, democratic trade union movement -- the best organized in Central America. Cooperation between unions, employers, and the government is generally high, and labor disputes are normally settled without major disruptions.

There is a variable minimum wage schedule ranging from a high of $3.55 per day for banana plantation, mining, refinery, port, and railroad workers, to $3.30 per day for industrial workers in the largest cities, to $2.50 per day for rural agricultural workers. However, in practice, the prevailing wage paid to workers in the productive sector (and by all foreign companies), is much higher. Textile and tobacco workers usually work on a piecework basis. The Honduran constitution provides for payment of 7 days' wages for 5-1/2 days' work for workers paid on a weekly or biweekly basis and 13 months' wages for 12 months' work for monthly salaried workers. The normal workweek is 44 hours. Almost all labor, whether paid monthly or not, expects the 13th-month bonus at the end of the year. The amount of indemnification for severance pay equals one month's pay for each year worked up to 8 years. The Labor Code also stipulates that once a negotiated concession is made by management to labor, it cannot be taken away in future labor contracts. Particularly the older, well-established U.S. multinationals, have over the years extended generous terms to their labor forces and thus now have the highest-paid labor forces in the country.

There is a general shortage of skilled workers. Most workers have had only a few years of primary schooling. A relatively small segment of the population (less than 20 percent) have more than a primary education. Within the educational system there is a strong tendency to prepare middle class individuals for the commercial and service sectors (e.g., economists, lawyers, secretaries, accountants). Very few individuals are prepared in the industrial trades.

Vocational training programs are available for a fee through the National Skills Training Institute (INFOP). However, newly-founded companies frequently find that employees trained in in-plant training programs -- which represent an additional investment cost -- are more effective than INFOP graduates. U.S. investors who have trained their own workers report good results in skills acquisition and retention and in productivity.

Mid-level management skills are also in extremely short supply, despite the fact that there appears to be a small, highly educated elite available in the cities. A number of upper income families send their children to U.S. universities to study business, engineering, or economics. There is a dearth of training available in management. High-technology industries that have need for highly skilled workers either send these workers out of the country for training or bring in outside technicians to provide in-plant training.

## (J) FOREIGN-TRADE ZONES/FREE PORTS

In 1976, the Government of Honduras established a free zone in the port city of Puerto Cortes (about 60 kilometers north of San Pedro Sula). The same law provided for free zone status for companies located in Amapala, Tela, Choloma, Omoa, Puerto Castilla, and La Ceiba. Enterprises operating in the free zone or under free zone status may import merchandise free of tariffs, customs, and related fees; manufacture, process, or handle any item not prohibited by law; and freely export finished goods outside of Central America without payment of export duties. At the same time, not more than 5 percent of production may be imported into Honduras upon payment of normal duties. Profits earned by enterprises covered by these provisions are exempt from taxes. These investment incentives are available equally to domestic and foreign investors, except as noted in Section (C) above.

At present, the Puerto Cortes Free Zone reports full occupancy (17 enterprises) and plans an expansion in 1985. Users of the free zone are very complementary of the administrative, logistical, and other services provided by the free zone authorities.

## (K) CAPITAL OUTFLOW POLICY

Capital outflow has been a significant problem for Honduras since 1979, following the rapid escalation of political violence in neighboring Nicaragua and El Salvador. A certain amount of capital flight has always occurred but was usually offset by larger capital inflows. This was especially the case in the late 1970's when international commercial banks, flush with loanable funds, substantially increased their lending here. Net capital outflows since 1979 are estimated at over $500 million. In December 1980, the government implemented its first measures to stem capital outflow by requiring a Central Bank permit for all foreign exchange payments exceeding $5,000. This was followed by measures to require documentation of return of export earnings in September 1981, import licencing in May 1982, a prior-deposit requirement on foreign exchange for imports in October 1982, and a 5-tier priority system for the granting of foreign exchange for imports in July

1983. Although present controls do not address the outflow of investment capital per se, they effectively limit capital outflow by making exchange procedures more bureaucratic and assigning higher priority to other uses of the increasingly scarce commodity.

Honduras is itself a developing country and is not in a position to provide incentives for investment by its citizens in other developing countries. However, elements of the Honduran private sector do have investments abroad, notably in other countries of Central America and in the United States.

(L) FOREIGN INVESTMENT

Embassy estimates total foreign investment in Honduras as of Dec. 1984, drawn from official and other sources, as $257 million. Of this amount, approximately 96 percent is from the U.S. By book value bananas and related enterprises account for roughly $125 million, mining for 55 million, and oil refining for 15 million. Four "Fortune 500" companies -- United Brands, Castle and Cooke, AMAX Corporation, and Texaco -- have significant installations in Honduras, ranking among the top firms in the country. In total, there are about 130 American firms, subsidiaries, and affiliates in Honduras, not counting representatives, dealers, or licensees.

## M. MISCELLANEOUS

Inquiries to the Government of Honduras regarding investment matters should be addressed to:

INVESTMENT PROMOTION OFFICE
Ministry of Economy and Commerce
Tegucigalpa, D.C., Honduras
Telephone: (504) 22-7746
Telex: 1396 MECONOMIA

Founded in 1984, the Foundation for Business Research and Development (F.I.D.E.) is a non-profit, private foundation, that was established for the purpose of strengthening the capabilities of individual enterprises, businessmen and private sector associations, to develop industrial investments and exports. Inquiries may be made to:

F.I.D.E.
P.O. Box 2029
2nd Floor, Centro Comercial Maya
Tegucigalpa, D.C., Honduras
Telephones: (504) 32-9345 and 32-0937
Telex: 1476 FIDE HO

The Foundation of Honduran Agricultural Producers and Exporters (FEPROEXAH) is a non-profit, Honduran private sector organization which provides technical assistance to investors in agriculture and agrobusiness.

FEPROEXAH
P.O. Box 1442
8A. Calle 19 Avenida S.O. No. 48
San Pedro Sula, Cortes, Honduras
Telephone: (504) 52-3793
Telex: 5643 TROPIC HO

The Honduran-American Chamber is also involved in assisting investors.

Honduran-American Chamber of Commerce
P.O. Box 1838
Seccion Comercial Hotel Honduras Maya
Tegucigalpa, D.C., Honduras
Telephone: 32-7043
Telex: Hamcham 1488