COUNTRY PRIVATE SECTOR DIAGNOSTIC

CREATING MARKETS IN HONDURAS

Fostering Private Sector Development for a Resilient and Inclusive Economy

May 2022

WORLD BANK GROUP
THE WORLD BANK IBRD • IDA
IFC International Finance Corporation

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ACKNOWLEDGMENTS

The Honduras Country Private Sector Diagnostic (CPSD) was prepared by a joint World Bank-IFC team under the leadership and guidance of Gabriel Goldschmidt (former Regional Director, Latin America and the Caribbean, IFC), Martin Spicer (Regional Director, Latin America and the Caribbean, IFC), Mona Haddad (Director, IFC), Seynabou Sakho (Director, Strategy and Operation, World Bank), Michel Kerf (Country Director, World Bank), Tatiana Nenova (Regional Manager, IFC), Damien Shiels (Manager, IFC), Alejandro Alvarez de la Campa (Manager, IFC), Jorge Araujo (Former Practice Manager, World Bank), Yira Mascaro (Practice Manager, World Bank), and Boris Weber (Resident Representative, Honduras, World Bank), Sanaa Abouzaid (Country Manager, IFC).

The CPSD team was led by Elena Bondarenko (Economist, World Bank) and Denny Lewis-Bynoe (Senior Economist, IFC). The team is thankful for the deep engagement of the following team members who contributed to the sector deep dives: Lillian Thyssen (Financial Sector Specialist, IFC), Lars Johannes (Senior Strategy Officer, IFC), Ramon Ernesto Arias Moncada (Agricultural Specialist), Arnau Gallard-Agusti (Consultant), Nuria Alino Perez (Consultant), Jose Acevedo (Consultant), Guillermo Rabadan (Consultant), Finn Holm-Olsen (Consultant), John Savageau (Consultant), and Natalia Campora (Consultant). In addition, the team is thankful for the sector-specific knowledge and guidance from Carolina Cardenas, Mia Rodriguez, Douglas Randall, Jeffrey Bower, Martin Spahr, Fredesvinda Montes, Guillermo Galicia Rabadan, Helene Meurisse, Thomas Haven, Rocio Vigueras, Pedro Rodriguez, Barbara Cunha, Carlo Maria Rossotto, Alejandro Perez, Doyle Gallegos, Augusto Garcia, Maria Mogollon, Dieter Fischer, Fernanda Lopez, Miguel Pereira Mendes, David Bassini, Samuel Rosenow, Kelly Johnson, Victor Steenbergen, Monica Paganini, Emmanuel Pouliquen, Javier Posas, Vally Khamisani, Camilo Mondragon-Velez, Shoghik Hovhannisyan, and Santosh Ram Joshi. Initial drafts of this CPSD were edited by Sean Lothrop (Consultant) and Patrick Ibay (Consultant), with final edits provided by Marcy Gessel and the team at Publications Professionals. Further editing and formatting support was provided by Patricia Holt (Former Program Assistant, World Bank) and Caroline Miranda (Consultant), and the final report was designed by Christiane Wakim.

The team is grateful to Patricia Dacarett (Operations Officer, World Bank), Carlos Roberto Aguirre Larios (Operations Analyst, World Bank), Noris Salinas (Program Assistant, World Bank), and the Honduras country office Administrative and Client Support team, including Daniela Velásquez (Consultant) and Belkis Delcid (Team Assistant, World Bank), who made all the necessary arrangements for the extensive series of mission meetings and provided critical administrative support.

The team is grateful for the comments provided by peer reviewers Christopher Ian Brett (Lead Agribusiness Specialist, World Bank), Lilian Pozzo (Principal Operations Officer, IFC), Santiago Porta (Principal Investment Officer, IFC), and Rocio Sanchez Vigueras (Digital Development Specialist, World Bank).

Finally, the team would like to express its sincerest gratitude for the excellent contributions received from representatives of the Honduran public and private sectors during the preparation of this report.

EXECUTIVE SUMMARY

Country Context

Honduras has significant investment potential, with ample productive resources, a solid industrial base, a market-oriented reform agenda, a strategic location with access to many international markets, and a growing labor force. A variety of microclimates along its fertile plains yield diverse agricultural products, while clean lakes and coastal resources with fishing grounds in two oceans have made Honduras the world's largest exporter of tilapia and Latin America's second-largest exporter of shrimp. The growing manufacturing sector contributes close to 20 percent of gross domestic product (GDP), and industrial production continues to diversify, supported by the creation of free-trade and export-processing zones, trade liberalization policies and other market-oriented reforms, and the free-trade agreement between Central American countries and the United States. In addition, Honduras is strategically located, and a deep-water port on the northern coast offers convenient access to the US eastern seaboard and the Caribbean. The country's young and growing population is yielding a demographic dividend, which presents new opportunities for economic growth and diversification, especially in the service sectors such as business-process outsourcing (BPO) and in development of digital financial services (DFS).

Honduras's rich endowment of resources and improving business climate have attracted rising levels of private investment, and the country achieved the second highest trade-to-GDP ratio in the Latin America and the Caribbean region prior to COVID-19 crisis. Net foreign direct investment (FDI) inflows to Honduras have averaged 5.6 percent of GDP over the past 20 years, well above the regional average of 3.2 percent. FDI inflows are concentrated in the manufacturing and telecommunications sectors. Trade flows have averaged 117 percent of GDP since 2000, nearly three times the regional average of 43 percent. However, growth of trade and investment decelerated in recent years, prompting the need for the government to increase efficacy in facilitating trade, thus creating a virtuous cycle that encourages further investment.

However, large-scale investment and trade have yet to generate rapid economic growth and robust poverty reduction. With 9.9 million inhabitants and a per capita annual income of US$2,340.10 in 2020, Honduras remains the second-poorest country in the Western Hemisphere after Haiti: nearly one in six Hondurans lives on less than US$1.90 per day, while annual per capita income growth has averaged just 1.2 percent since 1960. A heavy reliance on agriculture, a high rate of informality across all sectors, high vulnerability to external shocks, including natural disasters, combined with high crime rates and violence, political instability, and a weak institutional and business environment inhibited economic growth and perpetuated structural poverty. Robust foreign investment has generated limited cross-sector spillovers, while inefficient public investment management and burdensome regulatory requirements constrain the development of new economic opportunities. In turn, sluggish economic growth and a limited distribution of returns exacerbate crime and incentivize migration, contributing to a vicious cycle of persistent poverty and underdevelopment.

Facilitating private investment beyond the current FDI-oriented sectors will be crucial to accelerating economic growth and broadening the distribution of returns. While the government has made considerable progress in expanding economic openness, private sector development remains constrained by a weak regulatory and business environment. Honduran firms cite complex tax policies and onerous tax administration as the top constraints to doing business, followed by insecurity due to crime and violence; limited access to finance, especially for micro, small, and medium enterprises (MSMEs); inadequate infrastructure, especially road networks and public utilities; an undereducated and inadequately skilled labor force; and weak rule of law, policy uncertainty, and other governance issues. Such an adverse business climate severely undermines competitiveness, productivity, and return on investment across the private sector.

The Impact of the COVID-19 Pandemic and Tropical Cyclones

The economic shocks induced by the COVID-19 crisis have underscored the urgent need to create high-quality jobs and accelerate private sector growth. The pandemic has taken a particularly heavy toll on Honduras by regional standards: as of March 2022, Honduras had reported more than 417,000 COVID-19 cases and nearly 11,000 deaths. Honduras entered a sharp recession in 2020, with real GDP growth contracting by 9 percent, year on year. Weak export demand and declining investment inflows, compounded by the prolonged suspension of domestic business activity, caused output to contract across all sectors. In response to the pandemic, the government is implementing its Containment and Response Plan[1] that prioritizes health care and humanitarian services, including aid to poor households struggling to meet their basic needs, as well as targeted support for MSMEs, including favorable loans to the agricultural sector. However, despite a number of temporary macrofinancial measures designed to support companies affected by the crisis, banks impose onerous requirements for MSMEs attempting to access credit, which has prevented many firms from sustaining production and employment during the crisis.

The impact of the crisis was exacerbated by tropical cyclones Eta and Iota, which damaged infrastructure, destroyed crops, and potentially increased COVID-19 infection rates by driving hundreds of thousands of people into shelters. Agricultural production declined because of the extensive flooding of key plantations, which has damaged existing crops and delayed the next cultivation cycle. The resulting shortage of agriculture products adversely affected exports and compromised food security. The social and economic costs of the two tropical cyclones are estimated at US$1.8 billion, or about 7.5 percent of 2019 GDP, with an estimated 20,000 jobs lost. By December 2020, about 10.2 percent of firms had closed permanently, and only 16.2 percent had been able to return to the pre-pandemic level of operations. As a result, about 400,000 people lost their jobs in 2020, with the majority in manufacturing and services. Unemployment increased significantly, especially among smallholder farmers, which will push more households below the poverty line. Poverty under the US$5.50 per person per day line is estimated to have increased from 49.0 percent in 2019 to 55.4 percent in 2020, an increase of more than 700,000 people. Left unaddressed, the economic impact of the pandemic and the two cyclones could inflict lasting damage on productivity, livelihoods, income growth, and social cohesion.

The public and private sectors will both play vital roles in Honduras's economic recovery. Ongoing targeted support will be necessary to address the health and humanitarian consequences of the pandemic, mitigate the resulting increase in poverty and inequality, and support the resumption of economic activity. The pace of the recovery will also hinge on Honduras's trade and investment relationship with the United States and other key partners. Given a supportive policy environment, the light manufacturing (maquila), agriculture, and digital sectors could drive renewed growth. However, the country will need to adapt to a new global and domestic economic context, as the pandemic accelerated the deployment of technologies and production models (for example, digitalization, teleworking, nearshoring) that spurred growth in digital and financial sectors. To support the recovery, the government should work closely with the private sector, which can help ease short-term budgetary constraints while generating long-term gains in employment and poverty reduction. The authorities can catalyze a private sector–led recovery by developing investment opportunities necessary for growth and job creation.

Before the onset of the pandemic, the government outlined strategies for supporting private sector growth, exports, investment, and competitiveness in six priority sectors.[2] These strategies aim to accelerate productive diversification by developing human capital, infrastructure, and logistics capabilities and by improving the regulatory framework and business environment. The six priority sectors are (a) manufacturing, especially automobile parts and electrical equipment; (b) textiles; (c) business-process outsourcing; (d) tourism; (e) agro-processing and related activities; and (f) housing. The Honduras 20/20 Plan targets the creation of 1.26 million jobs by 2025 in the first four sectors alone. The government prepared a Plan for Reconstruction and Sustainable Development, which presents a long-term strategy for rebuilding productive assets and infrastructure damaged by the tropical cyclones, strengthening sustainability and resilience to natural disasters, and expanding social protection programs, among other key priorities. Additionally, the new administration that took office in early 2022 aims to promote the development and modernization of the manufacturing and agro-industrial sectors to stimulate growth, create jobs and reduce poverty through policies aimed at increasing innovation, adaptation of new technologies, product and market diversification, strengthening investment climate and competitiveness, while tackling corruption and crime.

This Country Private Sector Diagnostic (CPSD) is designed to help guide Honduras's private sector development agenda in this challenging and rapidly evolving context. The CPSD prioritizes sectors where more private sector participation could have a significant development impact, whether through job creation, increased value addition, productivity, or spillovers to other sectors; that have the capacity to contribute to export diversification; that government has identified as a priority sector; and that, with necessary reforms, it would be feasible over the near term to unlock the investment potential of the sector. On this basis, agriculture/agribusiness, manufacturing, BPO, and DFS were identified. These sectors have significant potential to drive growth and create jobs and could play a greater role in enabling private sector-led growth in Honduras and export diversification. Specifically, agriculture, as a key pillar of the Honduran economy, can generate jobs by diversifying beyond traditional goods and contributing to foreign exchange via exports. Manufacturing has a strong revealed

competitive advantage based on an established industrial base with the potential for moving into more complex, higher value-added products. BPO has the potential to harness a demographic dividend and create jobs and contribute to export diversification by transitioning to higher-value outsourcing services. Increased financial services for MSMEs would allow businesses to invest and add jobs, while digital financial services reduce the business cost and widen the reach of these services for MSMEs.

Agriculture

Due to Honduras's agro-ecological conditions, strategic location, and liberal trade policies, the agribusiness sector offers attractive opportunities for investment, employment creation, and broad-based growth. Agriculture and agro-processing contribute almost 23 percent to GDP and employ 36.5 percent of the national workforce. Honduras's agro-ecological conditions are suitable for producing a wide range of agricultural products and primary commodities; and the country has diverse crop, livestock, forestry, and fishery subsectors. Proximity to large consumer markets in the United States and Canada allows Honduras to overcome the limitations of its small domestic market. Supported by a liberal trade regime, Honduras is a globally competitive producer of coffee, fruits, vegetables, and crustaceans. Strengthening the competitiveness of the poultry, dairy, and staple-grains subsectors could greatly expand the socioeconomic impact of agricultural trade. Honduras also has unexploited opportunities in nontraditional agricultural products, including high-value vegetables, cocoa, cashew nuts, crustaceans, horticulture, and agro-forestry products; and the country can add value to its agricultural export portfolio by improving product quality, expanding processing, and identifying complementary value chains for current products including coffee, avocados, and tilapia.

In the agricultural sector, lack of access to high-quality inputs, financing, infrastructure, logistics services, knowledge systems, and food quality and safety verification, as well as exposure to climate change impacts are key constraints on growth and diversification. Agriculture and agribusiness in Honduras are dominated by small-scale farmers and producers with limited technical knowledge, market information, and financial resources. Market failures inhibit the supply of high-quality inputs, including seeds, fertilizers, and agro-chemicals, while underinvestment in irrigation systems, weak energy infrastructure, and inadequate agro-logistics capacity limit the scope for diversification and value addition. Most food production and processing infrastructure does not meet minimum safety and quality requirements. Limited certification systems, inadequate branding, and regulatory noncompliance restrict access to valuable export markets. Insecure land tenure discourages private investment, and a large informal market results in unbalanced competition. Climate change and extreme weather events (for example, heavy rains, droughts) are major sources of risk in the Honduran agricultural sector, where producers have limited capacity to cope with shocks. The sector would benefit from an institutionalized long-term vision and closer cooperation among public sector stakeholders and between the public sector and producers.

Manufacturing

Honduras's light manufacturing sector, which is largely built on the maquila model,[3] shows a strong revealed competitive advantage in several products. Light manufacturing has led the growth of the Honduran industrial sector since the trade-liberalization reforms of the late 1990s. A combination of increased trade openness, the creation of industrial zones with efficient access to a deep-water port in Puerto Cortés on the north coast, preferential tax treatment, and a relatively low minimum wage in industrial zones helps provide investors with long-term financial security. Over time, light manufacturing has transformed from a simple assembly-based production model to an increasingly sophisticated, vertically integrated sector, driving technological innovation and attracting a large amount of investment. Building on a strong base of relatively low-complexity knitted apparel and a focus on exporting to the US market, Honduras is repositioning itself to compete in markets for more diverse and complex products, including technical textiles, sustainable fibers, and automotive parts and components. As Honduras strives to capture higher-value segments of the production chain, producing woven fabric and artificial fibers (for example, polyesters, synthetics, and synthetic blends), as well as garments made from those materials, will help diversity the product mix and increase the complexity of apparel exports. To advance the development of light manufacturing, Honduran producers can leverage their established business relationships with large brands and retailers. In addition, closer collaboration with Central American countries could yield efficiency gains in the auto-parts subsector by enabling regional firms to engage in more sophisticated forms of production.

Inadequate public services, a lack of appropriate workforce skills, and the limited local sourcing of raw materials present key challenges in the maquila subsector. Producers require more reliable electricity, better security, expanded transportation options, greater access to training, and improved health services for workers. In business surveys, expensive, unreliable power is often cited as a key obstacle that slows the expansion of the maquila and agribusiness industries and prevents firms from developing more complex products with greater value addition. Inadequate local transportation infrastructure and logistics services also pose a major challenge for export-oriented manufacturing, and while some maquila companies within the industrial zones provide regular logistics services, the increased costs associated with limited transportation options could adversely affect future competitiveness and deter foreign investment. In addition, a dearth of investment in the domestic production of raw materials has led to excessive reliance on imports, constraining the ability of apparel manufacturers to expand their product lines beyond basic cotton garments. Insufficient education and workforce skills present another constraint on diversification, and the limited availability of specialized academic and technical training inhibits the production of more complex manufactures. Finally, corruption and crime further increase operating costs, while a burdensome tax administration and a complex customs regime hinder the creation of backward linkages to other domestic sectors.

Business-Process Outsourcing

One of the fastest-growing sectors in Honduras is BPO, which offers opportunities to create high-quality jobs while increasing domestic value addition. Honduras offers an attractive setting for international companies to outsource their business processes, and the country has well-established call centers for customer service, sales, technical support, logistics and freight management capabilities, and other BPO services. Honduras is in the central time zones of the United States and Canada, with access to a young, low-cost, English-speaking labor force that can swiftly develop new technological skills. Increased corporate telecommuting amid the COVID-19 pandemic could intensify demand for BPO services. To take full advantage of this opportunity, the Honduran BPO subsector will need to develop a wider range of higher-value functions and digital services, such as software development, information security, business analytics, and social media production and management. An existing skills mismatch in the subsector offers opportunities for BPO companies to transition an overqualified workforce into new higher-value services, albeit with training programs to close the skills gap.

The growth of the BPO industry is inhibited by insufficient access to telecommunications infrastructure, the inadequate capacity of national telecommunications networks, low levels of broadband penetration, complex registration processes, and skills mismatches. The global BPO industry relies on high-performance bandwidth, but the quality of internet services in Honduras is poor by regional standards. While mobile providers have diversified their networks into cable and satellite services, improving the scale of internet access and data transmission, overall indicators of telecommunications quality have not substantially improved and continue to constrain the growth of BPO. Moreover, the national telecommunications company, Hondutel, does not share public infrastructure despite service-level agreements to compete with the private sector on price and quality. The complex, inconsistent, and slow registration process for BPO companies presents additional challenges to starting a business. Firms also require a tech-savvy workforce to fulfill the requirements of highly skilled jobs, and Honduran workers have little access to training in digital literacy. Finally, as in other sectors, corruption and crime increase operating costs and create negative reputational effects that discourage international investment in Honduras's BPO industry.

Digital Financial Services for Micro, Small, and Medium Enterprises

Expanding access to DFS among MSMEs could catalyze growth and diversification. The Honduran financial sector is stable, liquid, and well capitalized. The sector offers a variety of DFS solutions for MSMEs, including noncash merchant payments, advanced data analytics, underwriting process automation, value-chain and supply-chain financing, and nonfinancial services (for example, business management tools). Nevertheless, many MSMEs require greater financial intermediation, and DFS can offer cost-effective solutions tailored to their unique circumstances. The digital economy itself has enormous growth potential, and various local initiatives and incubators—notably in San Pedro Sula—are fostering digital innovation. Transitioning to e-government services could boost the growth of the information technology subsector—enhancing productivity and accelerating job creation across the economy—and kick-start digital financial flows while improving the quality of governance, lowering the cost of public administration, and facilitating regulatory compliance.

Insufficient capital, limited access to financial infrastructure, and regulatory gaps slow the development of digital financial services among institutions best placed to serve MSMEs. Smaller financial institutions typically lack sufficient financial and human capital to develop digital products. Mobile infrastructure is crucial to the provision of DFS, but access and connectivity are limited. While a range of DFS services are available, MSMEs report difficulty finding institutions offering comprehensive support that meets their needs, including affordable pricing. Meanwhile, savings and credit unions and cooperatives, smaller banks, and microfinance institutions have limited access to the infrastructure required to offer e-wallets; credit or debit cards; and electronic payment acceptance through point-of-sale devices, ATMs, agent networks, or real-time transfers, unless they partner with a large bank. Additionally, the financial regulatory framework does not foster the creation of financial technology firms and is among the most restrictive in Latin America.

Recommendations

Fully leveraging the potential of these sectors will require the government to address key obstacles to productivity and competitiveness. The most binding constraints on private sector development in Honduras are (a) high production costs due to relatively high minimum wages (except in the manufacturing sector), expensive and unreliable electricity, burdensome tax compliance, and security costs associated with crime and violence; (b) insufficient capital due to skills shortages or mismatches arising from inadequate tertiary education and vocational training, limited credit access (particularly among MSMEs) due to high collateral requirements and high borrowing costs, and inadequate infrastructure, especially road networks, public utilities and broadband services; (c) weak governance and regulatory risks due to onerous processes for formalization, market entry and exit, and other elements of regulatory compliance, as well as uneven implementation of laws and policies and a high degree of policy uncertainty.

This CPSD proposes policy recommendations designed to address these challenges and enable the growth of more diverse and sophisticated markets in Honduras (see table ES.1). These recommendations are intended to inform the Honduran government's near-term (3-5) policy priorities and underpin a robust dialogue between policy makers, the private sector, and Honduras's development partners. Recommendations are classified as short term, (1-2 years) or medium term (3-5 years) on the basis of their feasibility given government's capacity and resources to implement. The fiscal implications of some of these recommendations will undoubtedly delay the speed of implementation. The CPSD's recommendations are key inputs into both the IFC's Country Strategy for Honduras and the World Bank's Country Partnership Framework.

TABLE ES.1 SUMMARY OF CHALLENGES, RECOMMENDATIONS, AND IMPLEMENTING AGENCIES BY SECTOR

Agriculture/Agribusiness

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Firm consolidation and supply-chain efficiency			
Small-scale farming and dispersed production prevent the formation of economies of scale.	1. Explore the possibility of expanding digital platforms to connect producers, off-takers, and end markets.	1. SAG	1. Short-term
Export competitiveness			
Limited technical capacity weakens export competitiveness.	1. Support the adoption of irrigation systems, production models, and climate smart technologies that improve productivity and build climate resilience.	1. SAG, SEDUCA	1–2. Short-term
	2. Explore the possibility of creating private partnerships to provide ICT-enabled extension services.	2. SAG, ProHonduras	
	3. Promote the upgrading of production, post-harvest handling, and processing facilities to meet national and international safety and quality standards.	3. SAG, SENASA, ARSA; ProHonduras	3. Medium-term
Inadequate access to finance inhibits productivity growth.	1. Strengthen rural savings funds (cajas rurales) by providing financial assistance and capacity-building in areas such as digital transformation.	1. SAG, SDE; BCH; BANHPROVI	1. Short-term
	2. Support the development of tools to incentivize agriculture insurance; encourage private participation in agricultural insurance by addressing market and regulatory imperfections	2. SAG, SDE, BCH, BANHPROVI	2. Medium-term
	3. Explore the possibility of offering public insurance for players that cannot be insured in the private market (for example, providing catastrophe reinsurance based on the models used in Mexico and Spain).	3. SAG, SDE, BCH, AHIBA	3. Medium-term

Note: Short-term = 1–2 years; medium-term = 3–5 years. AHIBA = Honduran Association of Banking Institutions (Asociación Hondureña de Instituciones Bancarias); ARSA = Sanitary Regulation Agency (Agencia de Regulación Sanitaria); BCH = Central Bank of Honduras (Banco Central de Honduras); SAG = Secretariat of Agriculture and Livestock (Secretaría de Agricultura y Ganadería); SDE = Secretariat of Economic Development (Secretaría de Desarrollo Económico); SEDUCA = Secretariat of Agriculture and Livestock Honduras (Servicio de Educación Agrícola, Capacitación y Desarrollo Agro-Empresarial); SENASA = National Directorate of Agricultural Health (Servicio Nacional de Sanidad Agropecuaria);

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Weak institutional and regulatory systems undermine the efficiency of public spending and create regulatory distortions.	1. Evaluate and reform public expenditure policies for the agriculture sector and modernize the SAG. 2. Establish a long-term agriculture and agribusiness strategy, and create a clearly defined state policy for the sector. 3. Improve the regulatory environment in the agricultural sector by accelerating the harmonization of national legislation with the RTCAs in areas including fertilizers and agricultural amendments (fertilizantes y enmiendas de uso agrícola), certified seeds (semillas certificadas), and nutritional labeling (etiquetado nutricional). 4. Improve cross-border coordination and switch from a two-border control system to one or none.	1. Government of Honduras, SAG 2. Government of Honduras, SAG 3. SAG, Ministry of Foreign Affairs 4. Ministry of Foreign Affairs, Customs, SAG	1–3. Short-term 4. Medium-term

The light manufacturing/maquila sector

Challenges	Recommendations	Implementing agencies	Short- or medium-term
The business environment and trade facilitation			
The lack of a strategic vision for light manufacturing weakens policy design.	1. Building on the Honduras 20/20 vision, develop a comprehensive strategy for light manufacturing that identifies areas for institutional capacity-building, addresses policy constraints, and fosters an organized collaborative relationship with the private sector.	1. Office of the President, SDE, Pro-Honduras	1. Short-term
Unreliable and expensive energy raises operating costs and diminishes competitiveness.	1. Identify policies to reduce energy costs and promote the adoption of efficient energy, water, and waste-management technologies. 2. Improve energy distribution and bring down the cost of electricity to improve the business environment and attract new investors, especially in the capital-intensive area of textile mills.	1–2. SEN, ENEE, IMF, World Bank Group, and donor community	1-2. Short-term

Note: Short-term = 1–2 years; medium-term = 3–5 years. ENEE = National Electricity Company (Empresa Nacional de Energía Eléctrica); IMF = International Monetary Fund; RTCA = Central American Technical Regulations (Reglamentos Técnicos Centroamericanos);SAG = Secretariat of Agriculture and Livestock (Secretaría de Agricultura y Ganadería); SDE = Secretariat of Economic Development (Secretaría de Desarrollo Económico); SEN = Secretariat of State in the Energy Office (Secretaría de Estado en el Despacho de Energía);

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Limited regional integration inhibits integration into global value chains.	1. Improve regional integration to better capitalize on proximity to the US market. 2. Support efforts to enhance regional integration, particularly via harmonized customs administration within the Northern Triangle.[a] Specifically, streamline customs procedures in the Northern Triangle to create more efficient regional value chains by reducing the time and cost involved in trading across borders.	1–2. SRE, SDE	1–2. Medium-term
Competitiveness and diversification			
Limited sourcing of local raw materials narrows the returns to export-oriented manufacturing.	1. Encourage vertical integration along value chains to increase the competitiveness of the maquila industry and create a more conducive business environment with investment policies that enable the formation of backwards linkages and foster the growth of domestic MSMEs. 2. As the global textiles and apparel sector further consolidates, and major US brands and retailers shorten their supply chains, a more robust, vertically integrated value chain within Honduras could strengthen linkages with MSMEs and expand the economic impact of the sector beyond export-oriented firms.	1–2. AHM, maquila operators	1–2. Short-term
Product complexity			
Insufficient skills inhibit the transition toward higher value-added production.	1. Augment the training currently available through AHM with additional programs focused on more advanced technical skills in areas such as technical supervision and chemical engineering; as Honduras moves more fully into raw materials manufacturing, training will also be required on new machines, especially mechanical looms for woven garments.	1. SDE, ProHonduras, AHM, maquila operators	1. Short-term
Limited amounts of inbound FDI slow capital formation and technology transfer.	1. Strengthen investment-promotion outreach by fostering new strategic partnerships in the maquila industry. 2. Help light manufacturers attract new partners with new technologies and access to new segments of the global value chain, such as fast fashion, through targeted investment missions, the development of tailored investment "pitch decks," and, potentially, though the creation of a one-stop shop for investors.	1–2. SDE, ProHonduras, AHM	1-2. Short-term

Note: Short-term = 1–2 years; medium-term = 3–5 years. AHM = Honduran Maquila Association (Asociación Hondureña de Maquiladores); FDI = foreign direct investment; MSMEs = micro, small, and medium enterprises; SDE = Secretariat of Economic Development (Secretaría de Desarrollo Económico); SRE = Secretariat of Foreign Affairs of the Republic of Honduras (Secretaría de Relaciones Exteriores de Honduras).

a. The Northern Triangle refers to the three countries of Central America: El Salvador, Guatemala, and Honduras.

Business-process outsourcing

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Industrial, residential, and international telecommunications infrastructure			
Insufficient bandwidth, unreliable broadband access, and a limited range of telecom services slow the uptake of digital communications in the industrial sector and limit the diversification of telecom services.	1. Enable CONATEL to promote the construction of fixed-line and cable distribution by streamlining licensing and approval requirements and providing additional incentives to competitive carriers. 2. Support CONATEL in developing policies for shared infrastructure, such as long distance and metro conduit access for competitive cable and expansion of the shared use of other infrastructure such as electrical towers, telecommunications towers, metro and long-distance conduit, and interconnection points, to rapidly deploy high-performance broadband. 3. Form partnerships between CONATEL and public utility and transportation providers to obtain the long-distance easements and rights of way needed to further extend high-bandwidth infrastructure.	1–2. CONATEL, domestic and international telecom firms 3. CONATEL, ENEE, and other utilities or public service providers	1. Short-term 2. Medium-term 3. Medium-term
Low IXP-HN usage, limited access to submarine cable, and weak international fiber links reduce international telecom service capacity.	1. Encourage internet and telecommunications network providers to participate in IXP-HN, preferably without charges. 2. Allow foreign and domestic international telecommunications networks to establish a point of presence in Hondutel-operated cable landing stations. 3. Promote the development of additional international fiber links, including terrestrial and submarine cables, and support efforts by private telecommunications companies to build and operate gateway and cable landing stations.	1–3. CONATEL, private telecom firms and internet service providers	1–3. Short-term

Note: Short-term = 1–2 years; medium-term = 3–5 years. CONATEL = National Commission of Telecommunications (Comisión Nacional de Tele Comunicaciones); ENEE = National Electricity Company (Empresa Nacional de Energía Eléctrica); IXP-HN = Honduras internet exchange point;

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Electricity quality and stability			
Frequent power outages and lack of alternative power sources increase operating costs and discourage investment.	1. Provide BPO companies with backup power generation via either the facility landlord or the BPO company itself. Provide work-from-home employees with battery backups that can provide at least two hours of power sufficient to operate a computer and maintain a home internet connection. 2. Require carriers to install infrastructure that will minimize or eliminate telecommunications network outages due to power loss, including cellular antennas, distribution points, and backup power sources for end-user distribution that are independent of ENEE.	1–2. Government of Honduras, ENEE, private telecom firms, CNE	1–2. Short-term
The registration process for BPO firms			
A time-consuming, inconsistent, and complex registration process discourages the formation of BPO firms.	1. Simplify the processes for registering BPO firms as formal businesses and as exporters, and consolidate the two processes into a single, standardized procedure.	1. DEI, CONATEL, AHM, ProHonduras, chambers of commerce, international agencies	1. Short-term
Market risk and BPO sector growth			
Global demand is shifting toward more sophisticated BPO services (for example, ITO and KPO), and Honduras's BPO sector may not be prepared to participate in these markets.	1. Assess the competitiveness of the domestic BPO sector in ITO and KPO services and develop a plan to either pivot away from BPO or work with the private sector and academic community to begin developing the necessary skills and infrastructure to compete in global markets for more sophisticated BPO services.	1. Private BPO firms, ProHonduras, Government Innovation Office, Ministry of Education	1. medium-term

Note: Short-term = 1–2 years; medium-term = 3–5 years. AHM = Honduran Maquila Association (Asociación Hondureña de Maquiladores); BPO = business-process outsourcing; CNE = National Energy Commission (Comisión Nacional de Energía); CONATEL = National Commission of Telecommunications (Comisión Nacional de Tele Comunicaciones); DEI = Executive Directorate of Income (Dirección Ejecutiva de Ingresos); ENEE = National Electricity Company (Empresa Nacional de Energía Eléctrica); ITO = information technology outsourcing; KPO = knowledge-process outsourcing;

Digital financial services for MSMEs

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Financial access among MSMEs			
MSMEs lack access to appropriate financial products, including payments and credit.	1. Leverage value-chain data and partnerships with private financial institutions and corporations to develop new lending products and digital platform solutions in order to capture remittance inflows. 2. Increase the flexibility of the INDEL Law; facilitate the creation of real-time, low-value payment systems; strengthen the Factoring Law; and support the development of digital identification. 3. Examine climate risk assessments and stress testing guidelines and work to support private sector actors: banks, insurance companies, and other financial institutions in climate risk management and climate financing, such as finance-linked CSA products.	1. Private financial institutions and corporations 2. BCH, Office of Presidential Priorities and Public Innovation, all digital agenda supporters 3. Central bank and regulators, international development institutions	1–3. Short-term
The fintech ecosystem			
The presence of few fintech firms in Honduras slows technological innovation.	1. Provide fintech firms with access to low-cost financial infrastructure, especially payment systems. 2. Expand fintech regulation beyond the INDEL Law while increasing its flexibility. 3. Promote open banking to allow access to financial-system data.	1–3. BCH, CEPROBAN	1-3. Short-term

Note: Short-term = 1–2 years; medium-term = 3–5 years. BCH = Central Bank of Honduras (Banco Central de Honduras); BCH = Central Bank of Honduras (Banco Central de Honduras); CEPROBAN = Interbank Processing Center (Centro de Procesamiento Interbancario); CSA = climate smart agriculture; fintech = financial technology; MSMEs = micro, small, and medium enterprises;

Challenges	Recommendations	Implementing agencies	Short- or medium-term
MSMEs access to large banks			
Large banks are not motivated to serve MSMEs.	1. Employ new technologies that enable banks to target new customers, create payment platforms to reduce cash-outs, and leverage large corporate clients as anchor firms in value-chain financing.	1. Private banks	1. Short-term
Challenges of small and medium-sized financial institutions			
Smaller financial institutions have difficulty accessing infrastructure utilization at a reasonable cost.	1. Support digitalization among financial institutions. 2. Provide smaller institutions with access to bank-managed financial infrastructure (ACH-Pronto, POS/card infrastructure, ATMs) at a reasonable cost.	1–2. IFC Digilab, BCH, CEPROBAN	1–2. Short-term

Note: Short-term = 1–2 years; medium-term = 3–5 years. ACH = automated clearing house; BCH = Central Bank of Honduras (Banco Central de Honduras); CEPROBAN = Interbank Processing Center (Centro de Procesamiento Interbancario); POS = point of sale;

1. On April 2, 2020, the government presented a COVID-19 Containment and Response Plan costed at US$2.5 billion and requested financial support for its implementation from multilateral development banks and donors.
2. Country Vision 2010–2038, Decree #PMC-015-2016 (2020), and the Strategic Government Plan. Government of Honduras, Country Vision 2010–2038, and National Plan 2010–2022 of Honduras: January 2010. https://observatorioplanificacion.cepal.org/sites/default/files/plan/files/HondurasPlandeNacion20102022.pdf; Government of Honduras, Strategic Government Plan (PEG 2018-2022; El Plan Estratégico de Gobierno), April 2019, https://www.scgg.gob.hn/sites/default/files/2019-06/PEG%202018-2022%20-Versio%CC%81n%20Actualizado%20abril%202019.pdf.
3. The maquila (or maquiladora) model is a form of light manufacturing that focuses on assembly of goods from imported intermediate inputs. Maquilas are typically financed by international corporations and are found throughout Latin America. In Honduras, the maquila subsector is largely devoted to the production of garments and apparel using imported fabric and other inputs.

CONTENTS

ABBREVIATIONS AND ACRONYMS

3G	third generation telephone service
4G	fourth generation telephone service
ACH	automated clearing house
ADSL	asymmetric digital subscriber line
AHIBA	Honduran Association of Banking Institutions (Asociación Hondureña de Instituciones Bancarias)
AHM	Honduran Maquila Association (Asociación Hondureña de Maquiladores)
ARSA	Sanitary Regulation Agency (Agencia de Regulación Sanitaria)
ASEMTECH	Association of Technology and Communications Companies of Honduras
ASP	application service provision
BANHPROVI	Honduran Bank for Production and Housing (Banco Hondureño de la Producción y la Vivienda)
BCB	Central Bank of Brazil
BCH	Central Bank of Honduras (Banco Central de Honduras)
BPO	business-process outsourcing
CA	Central America
CAC	Credit Cooperatives (Cooperativas de Ahorro y Crédito)
CACM	Central American Common Market
CAFTA-DR	Central America-Dominican Republic Free Trade Agreement
CATV	cable television operator
CEPAL	Economic Commission for Latin America and the Caribbean (Comisión Económica para América Latina y el Caribe)
CEPROBAN	Interbank Processing Center (Centro de Procesamiento Interbancario)
CITECH	Caribbean Innovation Technology
CNBS	National Banking and Insurance Commission (Comisión Nacional de Bancos y Seguros)
CNE	The National Energy Commission (Comisión Nacional de Energía)
COHEP	Honduran Council of Private Enterprise (Consejo Hondureño de la Empresa Privada)
COMRURAL	Government's Productivity- and Competitiveness-Focused Initiative
CONATEL	National Commission of Telecommunications (Comisión Nacional de Tele Comunicaciones)
COPECO	Permanent Contingency Commission (Comisión Permanente de Contingencias)
CPSD	Country Private Sector Diagnostic

CRM	customer resource management
CSA	climate-smart agriculture
DEI	Executive Directorate of Income (Dirección Ejecutiva de Ingresos)
DFS	digital financial services
DICTA	Directorate of Agricultural Science and Technology (Dirección de Ciencia y Tecnología Agropecuaria)
DOCSIS	data over cable service interface specification
DRGD	General Directorate of Irrigation and Drainage (Dirección General de Riego y Drenaje)
E&S	environmental and social
EAS	extension and advisory services
ENEE	National Electricity Company (Empresa Nacional de Energía Eléctrica)
ERM	enterprise resource management
ESG	environmental, social, and governance
FAO	Food and Agriculture Organization
FDI	foreign direct investment
fintech	financial technology
FMO	Netherlands Development Bank
G2P	government to person
GCI	Global Competitiveness Index
GDP	gross domestic product
GPV	gross production value
GSLI	Global Services Location Index
HND	Honduras
HRM	human resources management
ICT	information and communication technology
ID	identification
IHHT	Honduran Institute of Land Transportation (Instituto Hondureño del Transporte Terrestre)
ILO	International Labour Organization
IMF	International Monetary Fund
INFOP	National Professional Training Institute (Instituto Nacional de Formación Profesional)
ISP	internet service provider
IT	information technology
ITC	International Trade Center
ITO	information-technology outsourcing

IXP	Internet Exchange Point
IXP-HN	Honduras Internet Exchange Point
KPO	knowledge-process outsourcing
L	Honduran lempira
LAC	Latin America and the Caribbean
LEED	Leadership in Energy and Environmental Design
LTE	long term evolution telephone service
M2E	square meter equivalent
MFN	most-favored nation
MSMEs	micro, small, and medium enterprises
NGO	nongovernmental organization
NPL	nonperforming loans
NTM	nontariff measure
OECD	Organisation for Economic Co-operation and Development
OPDF	Private Development Finance Organizations (Organizaciónes, Privadas de Desarrollo Financiera)
P2P	person to person
PESAMR	Agri-Food Sector and the Rural Environment (Política de Estado para el Sector Agroalimentario y el Medio Rural)
POS	point of sale
PPE	personal protective equipment
PPP	public-private partnership
PROSAUR	Corredor Seco Food Security Project
QR code	quick response code
R&D	research and development
RCA	revealed comparative advantage
REDMICROH	Honduran Microfinance Network (Red de Microfinancieras de Honduras)
RTCA	Central American Technical Regulations (Reglamentos Técnicos Centroamericanos)
SaaS	software as a service
SAG	Secretariat of Agriculture and Livestock (Secretaría de Agricultura y Ganadería)
SBI	Honduras Sustainable Banking Initiative
SCD	Systematic Country Diagnostic
SDE	Secretariat of Economic Development (Secretaría de Desarrollo Económico)

SEDUCA	Secretariat of Agriculture and Livestock Honduras (Servicio de Educación Agrícola, Capacitación y Desarrollo Agro-Empresarial)
SEN	Secretariat of State in the Energy Office (Secretaría de Estado en el Despacho de Energía)
SENASA	National Directorate of Agricultural Health (Servicio Nacional de Sanidad Agropecuaria)
SEZ	special economic zone
SMEs	small and medium enterprises
SRE	Secretariat of Foreign Affairs of the Republic of Honduras (Secretaría de Relaciones Exteriores de Honduras)
TFP	total factor productivity
UNAH	National Autonomous University (Universidad Nacional Autónoma de Honduras)
UK	United Kingdom
UN	United Nations
UN Comtrade	United Nations Commodity Trade Statistics Database
UNCTAD	United Nations Conference on Trade and Development
US	United States
USAID	United States Agency for International Development
VAT	value added tax
VPN	virtual private network
WBG	World Bank Group
WEF	World Economic Forum
WTO	World Trade Organization
y/y	year on year

01. INTRODUCTION AND COUNTRY CONTEXT

1.1 MODEST GROWTH AND UNEXPLOITED INVESTMENT POTENTIAL

Honduras, Central America's second-largest country, is endowed with enormous productive resources, and recent market-oriented reforms aim to position the country as a major investment destination. Honduras has a variety of microclimates along its fertile plains, coastlines, mountain forests, and savannas, which could support the production of a diverse array of fruits, vegetables, and grains, as well as sugarcane, palm oil, coffee, wood, and cattle. Productive fishing areas in two oceans and considerable coastal resources have made Honduras the world's largest exporter of tilapia and Latin America's second-largest exporter of shrimp.

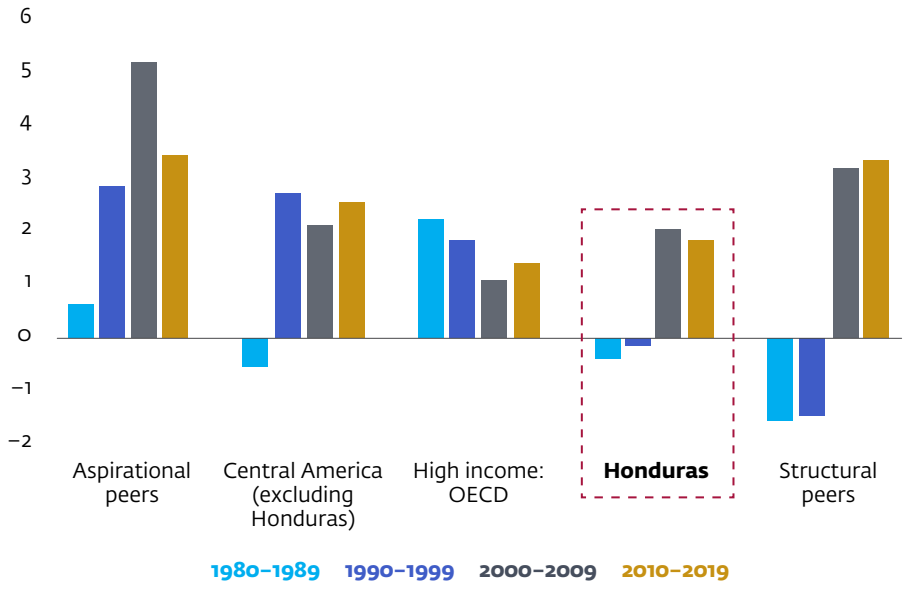
Despite a gradual process of structural transformation, the Honduran economy remains largely focused on the agricultural sector. Agriculture and agro-processing contribute almost 25 percent to value added and employ 36.5 percent of the national workforce. The role of agriculture has diminished since the late 1980s, when the sector accounted for 60 percent of employment and 83 percent of total merchandise exports. However, the country's lingering dependence on agriculture, coupled with the relatively anemic development of industry and services, has been identified as a binding constraint on medium-term growth.[1]

Over the past several decades, successive administrations have attempted to attract foreign investment through trade openness and industrial policies, but Honduras's investment potential remains largely unrealized. Advances in economic diversification, the creation of free-trade and export-processing zones, measures to foster the development of the industrial sector, trade-liberalization policies, and the signing of the Central America-Dominican Republic Free Trade Agreement (CAFTA-DR) with the United States supported the expansion of the tradable sector and accelerated job creation. In 2018, net foreign direct investment (FDI) was equal to about 6.0 percent of gross domestic product (GDP), well above the 3.6 percent average for Latin America and the Caribbean and the 3.1 percent average for structural peers, while the trade-to-GDP ratio reached 102 percent. Honduras's close proximity to major North American markets and the expansion of the Puerto Cortés, a deep-water port on the Caribbean coast, enhance its appeal as a destination for foreign investment. However, being concentrated in the maquila[2] and telecommunications sectors, robust foreign investment and trade have generated limited cross-sector spillovers, while inefficient public investment management and burdensome regulatory requirements constrain the development of new economic opportunities.

Despite its productive potential, Honduras has one of the lowest levels of GDP per capita in the Western Hemisphere. Continued reliance on agriculture, high rates of informality across all sectors, large-scale migration, and high crime rates contribute to structural poverty and modest growth in Honduras.[3] Over the past three decades,

the country's growth has been volatile and modest relative to both its structural and aspirational peers (figure 1.1).[4] Moreover, Honduras's average income has diverged from those of advanced economies. In 1960, Honduras's real GDP per capita was 6.3 percent of the US level, but by 2019 it had fallen to just 4.0 percent. On average, almost one in six Hondurans has lived on less than US$1.90 per day over the past two decades—the second-highest international poverty rate in the Latin America and the Caribbean region after Haiti.[5] Almost half the population (4.8 million people) lived on less than US$5.50 per day in 2019, and an estimated 14.8 percent, or about 1.5 million people, lived in extreme poverty. Income inequality in Honduras has declined since 2005, but it remains among the highest in the world.

FIGURE 1.1 REAL GDP PER CAPITA GROWTH RATES, HONDURAS AND COMPARATORS



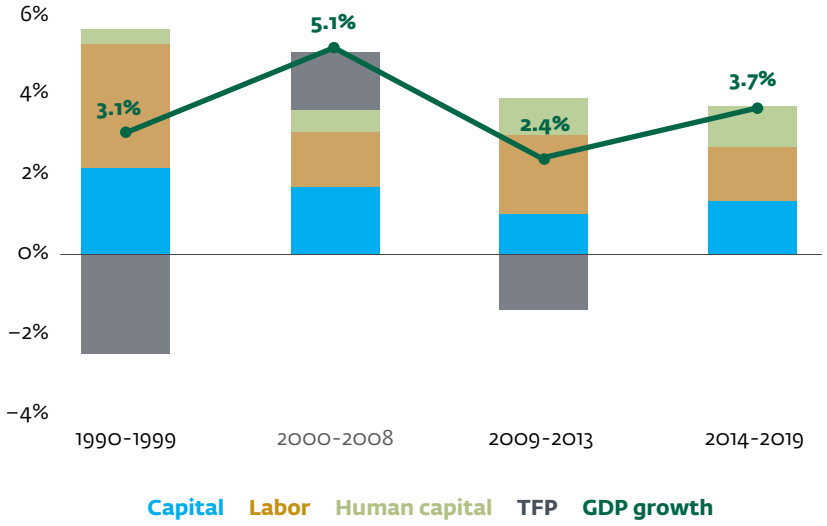
Source: World Bank estimates based on World Development Indicators data, https://databank.worldbank.org/source/world- development-indicators/preview/on.

Note: GDP = gross domestic product; OECD = Organisation for Economic Co-operation and Development. For information on aspirational and structural peers, see appendix A.

Low productivity has slowed growth and poverty reduction. Historically, economic growth in Honduras has been driven by factor accumulation: infrastructure investment has contributed to a steady increase in the physical capital stock, while population growth—magnified by rising labor-force participation rates and the increasing share of the working-age population—has added to the stock of human capital. However, and despite the relative economic openness, this process has not translated into greater total factor productivity, likely because of a suboptimal allocation of resources across sectors combined with the inefficient use of physical and human capital (figure 1.2).[6]

Meanwhile, economic growth has been further inhibited by an adverse institutional and business environment marked by pervasive corruption, poorly defined property rights, and insecurity, as well as by limited domestic innovation, high levels of informality, and constrained access to finance.[7] Honduras has an opportunity to harness a demographic dividend from its expanding labor force, but without substantial gains in marginal productivity, growth will have only a limited effect on income levels and poverty rates.

FIGURE 1.2 CONTRIBUTIONS TO REAL GDP GROWTH, HONDURAS



Sources: World Development Indicators, Penn World Table (PWT) version 10, World Bank staff calculations.

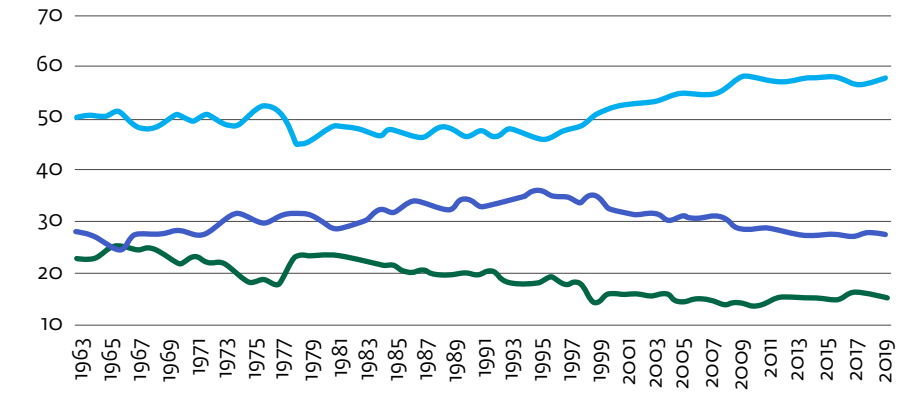
Note: GDP = gross domestic product; TFP = total factor productivity.

Modest economic expansion has been accompanied by an incomplete structural transformation. Over the past 30 years, the Honduran economy has experienced a significant shift in its sectoral composition and in the structure of employment across sectors. Agriculture's share in total value addition declined steadily from about 23 percent in the early 1960s to about 15 percent in 2019, while the industrial sector's share rose to a peak of 36 percent during the 1990s and then declined gradually as the share of services rapidly increased during the 2000s before stabilizing at about 57 percent in recent years. Meanwhile, agriculture's share of total employment declined from nearly 40 percent to 30.2 percent, while the share of services increased from 40 percent to near 50 percent, reflecting the movement of agricultural workers to services and, to a lesser extent, industry (figure 1.3). This process is broadly aligned with the standard model of structural transformation, in which labor reallocates from traditional, low-productivity agriculture to more productive activities in the industrial and services sectors. However, in

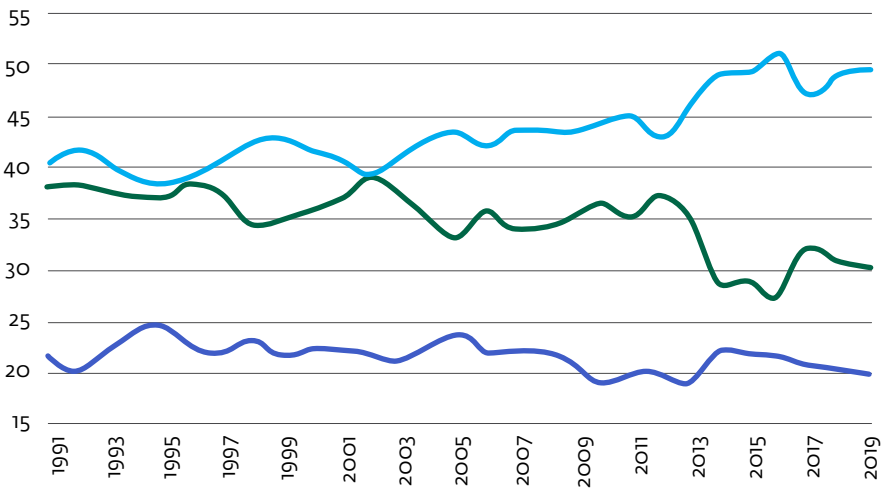
a successful structural transformation process, labor flowing out of agriculture is replaced by mechanization, while the growing industrial and service workforce progressively upskills and diversifies to capture higher segments of the value chain, yielding a simultaneous improvement in productivity within and between sectors.[8] In Honduras, by contrast, labor productivity remains low in every sector, and productivity gaps with advanced economies have been growing over time, mirroring the weak contribution of total factor productivity to growth. At the same time, the shrinking role of industry is depriving the Honduran economy of one of the fundamental drivers of growth in developing countries and could signify a process of premature deindustrialization.

FIGURE 1.3 STRUCTURAL TRANSFORMATION IN HONDURAS

a. Value added by sector, 1960–2019 (%)



b. Employment by sector, 1996-2019 (%)



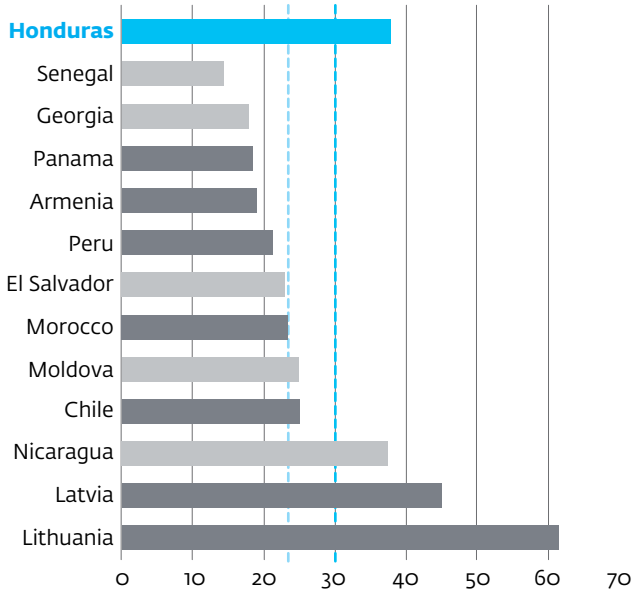
Agriculture **Industry** **Services**

Source: World Bank staff estimates using data from the World Development Indicators database.

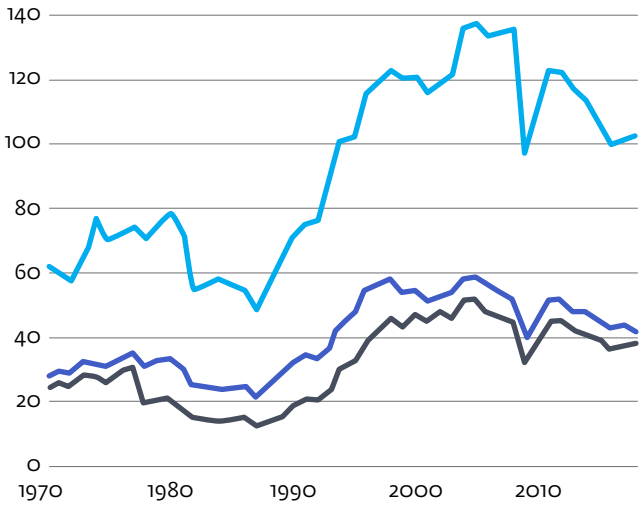
A relatively open trade regime has supported exports and economic growth in Honduras, though its effects have been largely offset by the negative impact of governance challenges and weaknesses in the business climate. Preferential and free-trade agreements are increasingly important elements of trade liberalization in Honduras. Its economy is now more open than those of most other countries at a similar level of development, and its share of trade in GDP is larger than those of most of its peers (figure 1.4, panel a). At 37.7 percent, the share of merchandise exports in Honduras's GDP is above the averages for both its aspirational (30.3 percent) and structural (23.3 percent) comparators (figure 1.4, panel a). In addition, the share of services exports has increased significantly over the past three decades, rising from close to zero in the late 1990s to almost 10 percent in recent years. For a small open economy like Honduras, an export-oriented economic strategy is a sound approach to creating job opportunities and generating sustainable growth.

FIGURE 1.4 MERCHANDISE EXPORTS VERSUS GOODS AND SERVICES EXPORTS

a. Share of GDP, 2016–18 average (%)



b. Share of GDP (%)

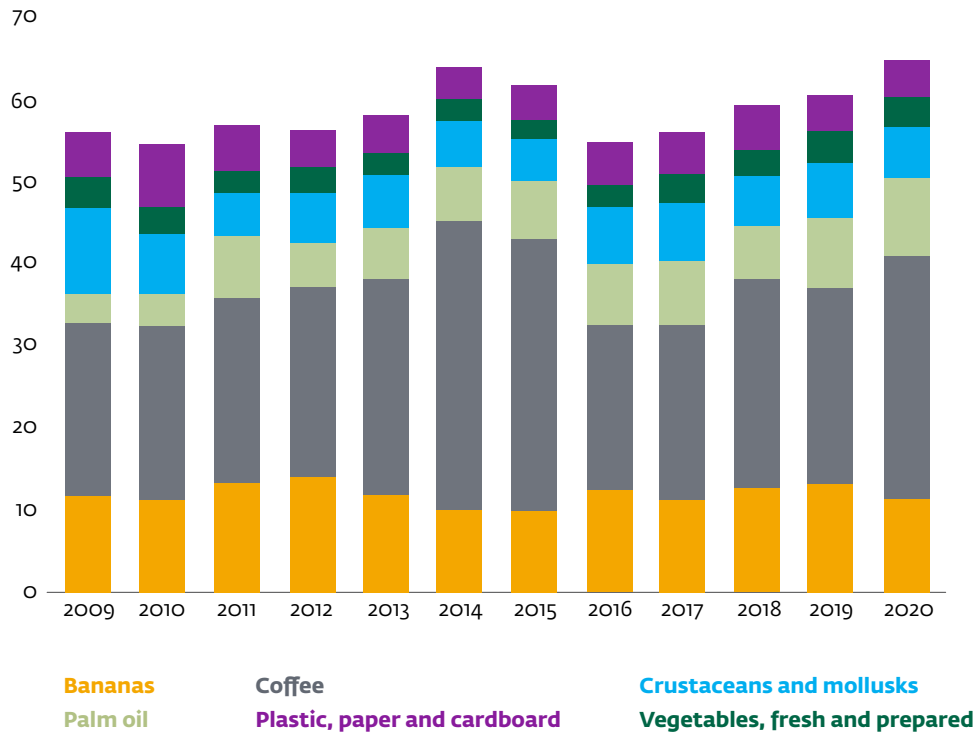


Sources: World Development Indicators database; World Bank staff estimates.

Note: GDP = gross domestic product. In panel a, dashed lines show average for peer groups

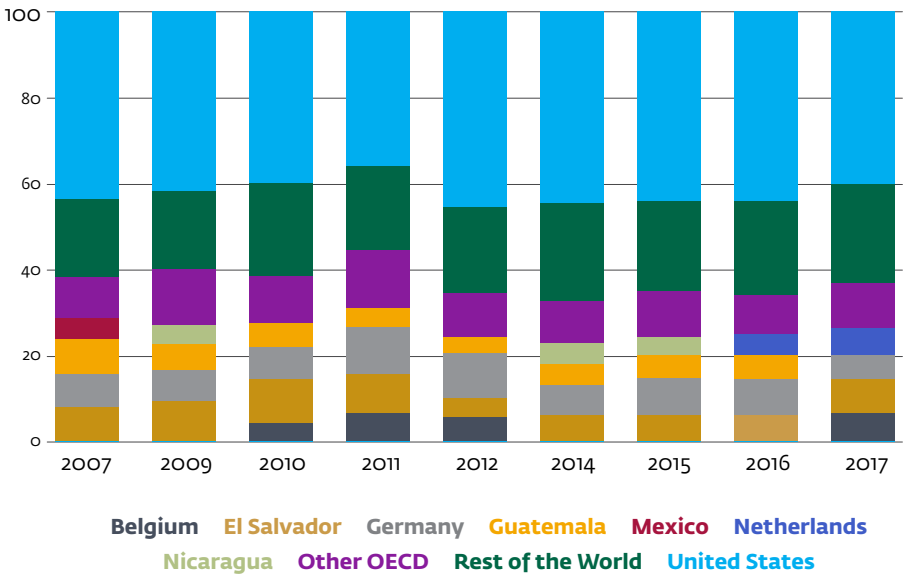
Consistent with its stalled structural transformation, the Honduran economy has achieved an intermediate level of diversification, largely exporting low-complexity goods to a few markets. The composition of Honduras's exports diversified over the past two decades: the share of apparel products declined, while the share of more complex products, such as material manufacturing and machinery and vehicles, increased. However, Honduras's export basket is still highly concentrated in traditional agricultural commodities and low value-complexity manufactures (figure 1.5). Moreover, Honduras remains among one of the least internationally integrated countries in the world, and the United States alone absorbs more than 40 percent of its goods exports (figure 1.6).

FIGURE 1.5 MAIN EXPORT PRODUCTS, HONDURAS, SHARE OF TOTAL EXPORTS, %



Sources: World Bank Staff estimates; Central Bank of Honduras (Banco Central de Honduras), United Nations COMTRADE, Standard International Trade Classification 2 level.

FIGURE 1.6 MAIN EXPORT DESTINATIONS, HONDURAS, SHARE OF TOTAL EXPORTS, %



Sources: Ulku, Hulya; Zaourak, Gabriel. 2021. Unleashing Central America's Growth Potential : Honduras. World Bank, Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/36050 License: CC BY 3.0 IGO.

Note: OECD = Organisation for Economic Co-operation and Development.

Further diversification will be vital to expand employment and boost productivity, especially in the context of current global trends. Decelerating trade with the United States, increasing trade in services, greater production fragmentation, increasing levels of automation, and rapidly growing population in Honduras present both challenges and opportunities for Honduras's long-term development. Diversifying products and export markets will be essential for Honduras to reduce its reliance on a narrow range of sectors and export destinations, thereby limiting its exposure to external shocks and commodity cycles. Greater integration into global value chains could enable Honduran firms to diversify production and adopt new technologies. Building on the country's comparative advantages by upgrading the quality of existing exports while also developing new products and services could boost productivity and support an export-oriented growth strategy. The most attractive opportunities to increase export competitiveness involve products in which Honduras already has a comparative advantage and a sizeable market share, but exploiting the full potential of existing exports will require strategic repositioning within current and new value chains. Honduras also could cash in its demographic dividend if it can create enough good-quality formal jobs for the emerging workforce and improve the quality and market relevance of education programs. Finally, addressing longstanding challenges related to governance, institutional capacity, security, and business climate will be necessary to increase value addition, encourage participation in the formal sector, and accelerate high-quality job creation.

1.2 CHALLENGES POSED BY THE COVID-19 PANDEMIC AND BY TROPICAL CYCLONES ETA AND IOTA

Honduras entered a steep recession in 2020, as it grappled with both the burgeoning COVID-19 pandemic and the aftereffects of two major tropical cyclones. March 2022, Honduras had reported more than 417,000 COVID-19 cases and nearly 11,000 deaths. Real GDP declined by 9 percent year-on-year (y/y) in 2020 owing to a sharp fall in trade, investment, and consumption amid the global recession and damages caused by the cyclones. Output dropped across nearly all sectors, especially textiles and apparel (that is, the maquila sector) and the services sectors; the only exception was telecommunications. As the pandemic worsened worldwide, international supply chains were disrupted, external demand faltered, and investment dwindled. Meanwhile, prolonged containment and mitigation measures, as well as the adoption of precautionary behaviors by firms and consumers, slowed domestic economic activity. As unemployment spiked in the United States, growth in remittances to Honduras decelerated from an average of 10 percent y/y to 3.8 percent y/y in 2020, further suppressing private domestic demand and domestic investment, and contributing to rising levels of poverty.[9] In high-frequency phone surveys conducted by the World Bank, about 68 percent of households reported income losses, and more than one-third of households reported food insecurity due to lack of resources in mid-2020. About 400,000 people lost employment in 2020, with the majority being in manufacturing and services and primarily being women and low-skilled workers.

In November 2020, amid the COVID-19 crisis, Honduras was struck by Tropical Cyclones Eta and Iota. The cyclones affected about 4.8 million people, or about 49 percent of the population. The hurricanes caused significant destruction across nearly all of Honduras's 18 departments, with flooding damaging thousands of hectares of crops, destroying critical infrastructure and private assets, and paralyzing domestic production. More than 92,000 houses, 300 roads, 48 bridges, and 595,964 hectares in the agriculture sector were damaged. The severe impact of the cyclones on rural infrastructure further reduced accessibility in rural areas. The magnitude of the damage is comparable to the devastation caused by Hurricane Mitch in 1998, and its combined social and economic costs are estimated at US$1.8 billion, or 7.5 percent of 2019 GDP. Meanwhile, the ongoing pandemic continues to complicate disaster relief and recovery efforts. The transportation, local infrastructure, agriculture, and housing sectors have borne the brunt of the impact. Poverty is estimated to have increased from 49.0 percent in 2019 to 55.4 percent in 2020, under the US$5.50 per day line, an increase of more than 700,000 people. Rising poverty coupled with large asset losses, especially among the poorest (including destruction of crops and land due to hurricanes), could have triggered large illegal migration to the United States. A full recovery from the two cyclones could take between 6 and 12 years, and failing to effectively address the socioeconomic shocks inflicted by the crisis could reduce long-term productivity, slow income growth, and strain social cohesion.[10]

Honduras faces three major challenges posed by the COVID-19 crisis and the tropical cyclones. First, agricultural production is expected to decline owing to the extensive flooding of key plantations, which has damaged existing crops and delayed the next cultivation cycle. The resulting shortage of agriculture products is expected to adversely affect exports and could compromise food security. Second, unemployment is expected to rise significantly, especially among smallholder farmers, which will push more households below the poverty line. Third, the cost of the reconstruction and recovery process will greatly increase budgetary pressure in a context of significant uncertainty regarding the availability of additional multilateral support. At the local level, banks impose onerous requirements on micro, small, and medium enterprises (MSMEs) attempting to access credit, preventing many firms from sustaining production and employment during the crisis. By December 2020, about 10.2 percent of firms had closed permanently amid the pandemic, and only 16.2 percent had been able to return to the prepandemic level of operations.[11]

The government responded swiftly to the COVID-19 crisis and is working on a sustainable reconstruction program to address the impact of the tropical cyclones. The authorities adopted strict containment measures and used targeted fiscal and monetary policies to cushion the impact of the pandemic on economic activity and welfare. These policies required US$2.5 billion (or about 10 percent of GDP) in additional borrowing, which triggered the escape clause under the Fiscal Responsibility Law. The government has focused its efforts on emergency response in the health sector while also assisting vulnerable households and affected firms by providing liquidity support, transfers, forbearances, and credit relief.[12] In addition, the government substantially loosened financial conditions, increasing liquidity among financial institutions and easing access to credit for firms. In particular, the Honduran Bank for Production and Housing (Banco Hondureño de la Producción y la Vivienda; BANHPROVI) provided financial resources to the agriculture and agribusiness, commerce, tourism, construction, forestry, and other priority sectors, many of which include numerous MSMEs. Together, BANHPROVI's target sectors employ about 70 percent of the workforce but only generate about 25 percent of tax revenue. The government prepared a reconstruction plan designed to counter the impact of the two tropical cyclones, though its ability to mobilize adequate funding is in doubt.

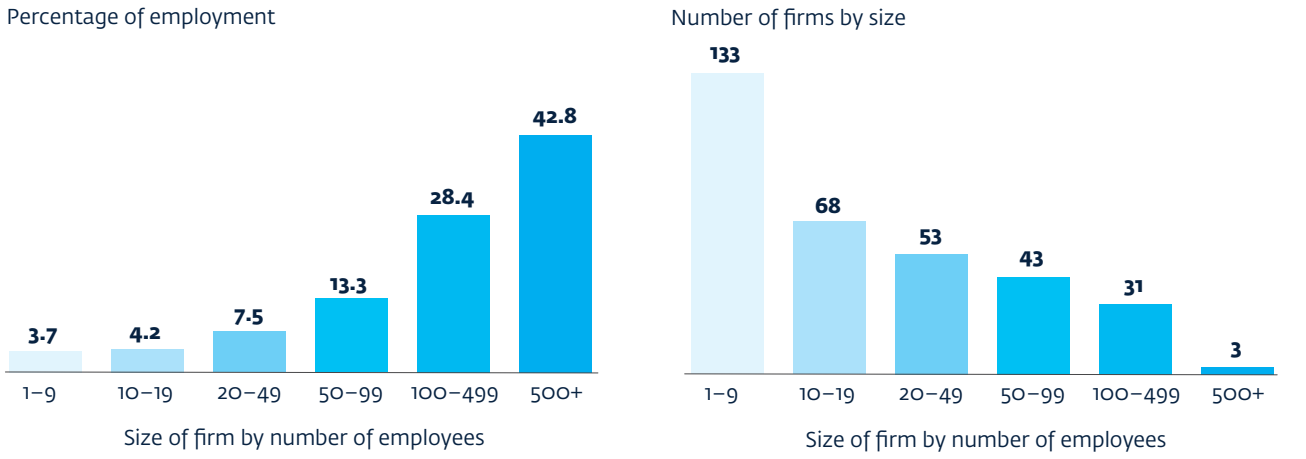
1. International Monetary Fund (IMF), Western Hemisphere Department, "Honduras: Staff Report for the 2019 Article IV Consultation and Request for a Stand-By Arrangement and an Arrangement under the Standby Credit Facility-Press Release; Staff Report; and Statement by the Executive Director for Honduras" (Country Report No.2019/236, IMF, Washington, DC, July 2019), www.imf.org/en/Publications/CR/Issues/2019/07/18/Honduras-Staff-Report-for-the-2019-Article-IV-Consultation-and-Request- for-a-Stand-By-48509.
2. The maquila (or maquiladora) model is a form of light manufacturing that focuses on assembly of goods from imported intermediate inputs. Maquilas are typically financed by international corporations and are found throughout Latin America. In Honduras, the maquila subsector is largely devoted to the production of garments and apparel using imported fabric and other inputs.
3. The informality rate was estimated at 58 percent in 2016. Roughly 940,000 Hondurans live in the United States, over half of whom are undocumented. The national homicide rate was 41.7 per 100,000 inhabitants in 2019. The estimated informality rate is by Michel and Walker. Estimates of the number of Honduran immigrants in the United States are based on Pew Research Center tabulations of the 2000 Census and the 2010, 2015, and 2017 American Community Surveys. Veronica Michel and Ian Walker, "Honduras Jobs Diagnostic" (Job Series No. 17, World Bank, Washington, DC, 2019), https://openknowledge.worldbank.org/handle/10986/33304.
4. See appendix A for how the aspirational and structural peers are identified.
5. The international poverty rate is calculated in 2011 US dollars in purchasing-power-parity terms.
6. Marco Antonio Hernandez Ore, Liliana D. Sousa, and J. Humberto Lopez, "Honduras: Unlocking Economic Potential for Greater Opportunities" (Systematic Country Diagnostic, World Bank, Washington, DC, 2016), https://elibrary.worldbank.org/doi/pdf/10.1596/23119. Net FDI inflows were 6.0 percent of GDP (2018), concentrated mainly in the maquila industry and telecommunications. This is higher than the average for the Latin America and the Caribbean region (3.7 percent) and for structural peers (3.1 percent). In that context and amid inefficient public investment and regulatory structures, limited investment spillovers on the economy may be eroding the possible growth impact from Honduras's relatively high level of investment. The reasons for the low impact of investment on the growth rate are not yet fully understood and remain a knowledge gap.
7. World Bank, "Growth Study" (World Bank, Washington, DC, forthcoming).
8. W. Arthur Lewis, "Economic Development with Unlimited Supplies of Labour," The Manchester School 22, no. 2 (1954): 139–91 ; John C. H. Fei and Gustav Ranis, Development of the Labor Surplus Economy: Theory and Policy (Homewood, IL: Richard A. Irwin, 1964); H. B. Chenery, Structural Change and Development Policy (World Bank, Washington, DC, and Oxford University Press, London, 1979).
9. Remittances represent 30 percent of household income for the poorest remittance-receiving households (World Bank staff estimates); a decrease in the amount of remittances increases the likelihood of food insecurity. Additionally, remittances in Honduras are associated with greater investment in human capital and support to small enterprises, according to Sousa and Garcia-Suaza. Liliana D. Sousa and Andres Garcia-Suaza, "Remittances and Labor Supply in the Northern Triangle" (Policy Research Working Paper, World Bank, Washington, DC, 2018), https://openknowledge.worldbank.org/bitstream/handle/10986/30446/WPS8597.pdf?sequence=1&isAllowed=y.
10. FOSDEH of Honduras (Social Forum on Eternal Debt and Development), https://fosdeh.com/.
11. These figures are from 2020 survey data reported by COHEP (Consejo Hondureño de la Empresa Privada), English Honduran Council of Private Enterprise, http://cohep.com/.
12. See appendix B for a detailed list of policy actions.

02. STATE OF THE PRIVATE SECTOR

2.1 THE PREVALENCE OF MSMEs AND INFORMALITY

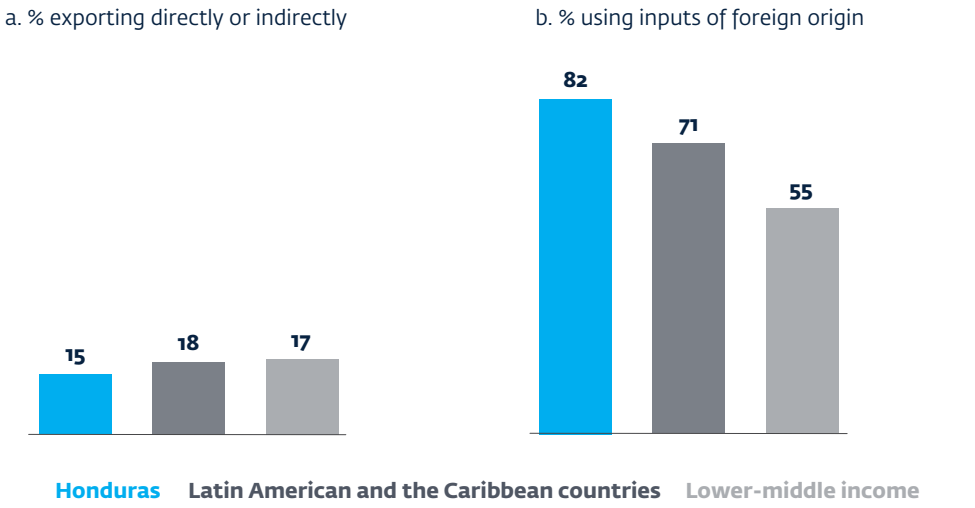
MSMEs are the dominant firm type in Honduras, employing about 70 percent of the workforce and generating 50 percent of GDP.[1] An estimated 500,000 MSMEs operate in Honduras, 95 percent of which have fewer than five employees.[2] MSMEs operating in the commercial sector represent 14 percent of total sales, construction MSMEs represent 11 percent, and MSMEs providing services represent 20 percent. However, pervasive informality among MSMEs complicates efforts to estimate their economic contribution. As of 2016, the informal sector in Honduras produced about 45 percent of GPD and accounted for 58 percent of total employment, of which nearly half is self-employed.[3] In the industrial and services sectors, about 40 percent of formal firms have fewer than 10 employees, whereas just 11 percent of firms have more than 100 employees. Moreover, small firms provide just 7 percent of these jobs, while the large firms provide 62 percent (figure 2.1). Female entrepreneurs own 54 percent of all formal firms and 63 percent of all small formal firms.[4] Only 15 percent of formal firms export, slightly below the level of comparator countries, while 82 percent of manufacturing firms import, well above the comparator-group average (figure 2.2).

FIGURE 2.1 COMPOSITION OF THE FORMAL INDUSTRIAL AND SERVICE SECTORS BY AVERAGE EMPLOYMENT AND FIRM SIZE, HONDURAS



Source: World Bank Enterprise Survey, Honduras 2016 Country Profile, www.enterprisesurveys.org.

FIGURE 2.2 SHARE OF EXPORTING AND IMPORTING FIRMS, HONDURAS AND COMPARATORS



Source: World Bank Enterprise Survey, Honduras 2016 Country Profile, www.enterprisesurveys.org.

The widespread informal sector in Honduras is associated with underemployment and lower productivity, job quality, and earnings. A persistently high level of informality across all sectors (agriculture, industry, and services) and in both urban and rural settings is not limited to jobs in self-employment and household enterprises. About 41 percent of wage jobs are also informal.[5] Because of the absence of scale economies and the difficulties that small business have in accessing capital, informal jobs tend to be lower-productivity and lower-earning jobs than formal jobs. The poor quality of jobs is an important driver of low participation rates, especially among women. Agriculture is marked by an especially high degree of informality and low job quality, productivity, and earnings, and agricultural wages average about one-fourth of the formal sector's minimum wage. Additionally, high level of remittance inflows, while having enormous potential to reduce poverty, also may be draining the country's human capital, potentially discouraging labor force participation. Despite the shift from agricultural subsistence jobs to wage jobs and better urban job opportunities, particularly in services and industry, the challenge of improving job quality in the formal sector remains.

Changing from a primarily agriculture-based economy to a more service-oriented economy entails the migration of people from rural areas to urban areas; while this applies in Honduras, urban jobs remain largely informal and of low quality. Over the past 20 years, the constant urbanization of the Honduran population and workforce has been related to the rise of better urban job opportunities, particularly in services and industry. This urbanization was accompanied by a shift from agricultural subsistence jobs to wage jobs, in which most workers are employed in services and industry. The challenge is changing those opportunities toward better-quality jobs in formal services.

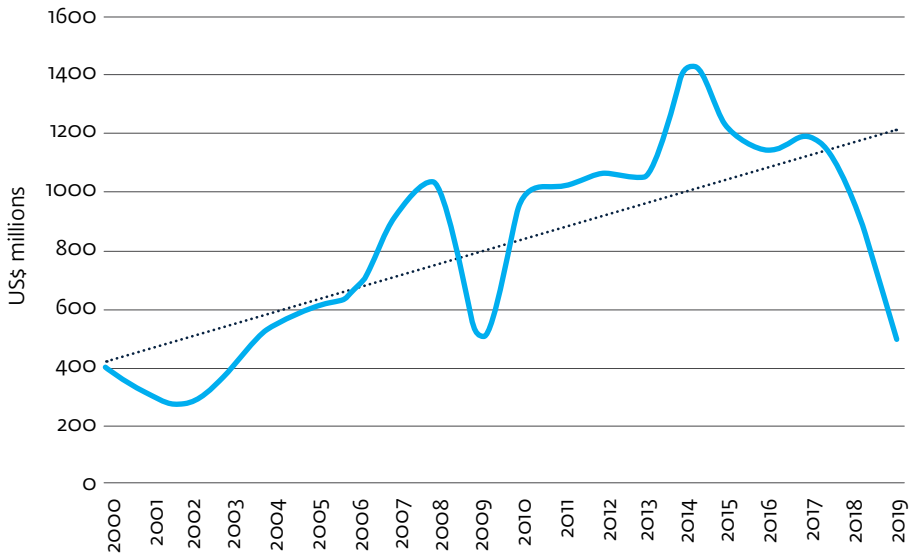
Most workers in Honduras are in elementary occupations and middle-skill activities.[6] Around 24 percent of Honduran workers are in elementary occupations (in services, jobs like street vendors, domestic helpers, shoe-cleaners, building caretakers, messengers, garbage collectors, and vehicle cleaners; in agriculture, jobs like farm laborer; in industry, jobs in maintenance, basic laborers, and handlers). Another 24 percent are in services and market sales, 16 percent in crafts, and 13 percent in skilled agriculture. This is the result of three factors: (a) most available jobs are in low-productivity activities, (b) most workers are low and mid-skilled, and (c) labor market segmentation impedes the redistribution of workers across sectors and occupations. Productivity and earnings of workers in all sectors (agriculture, commerce, manufacturing, and other services) need to increase. This implies promoting structural transformations within each sector, moving workers away from traditional activities and toward better capitalized, more productive jobs with stronger market linkages.

However, the private sector has struggled to create jobs in recent years. Net formal employment growth in Honduras averaged just 2.5 percent per year between 2012 and 2015,[7] with job creation driven almost entirely by the textile industry. Employment growth has been faster among firms that have operated for 20 years or more and slower among younger firms. Labor productivity tends to be greatest among larger firms, those with foreign investment capital, and those operating in the commercial sector. The agriculture, agribusiness, and textile sectors contribute the most to job creation via their extensive backward linkages, and they employ a large number of unskilled workers. Public sector competition and a relatively high minimum wage slow employment growth in the formal private sector. The average public sector wage premium is 33 percent, well above the global average of 20 percent, and over 50 percent of public sector jobs go to people with some tertiary education, versus just 9 percent of jobs in the private sector.[8] Meanwhile, minimum wages are both exceedingly high by regional standards and dispersed across different job types.

2.2 FOREIGN DIRECT INVESTMENT

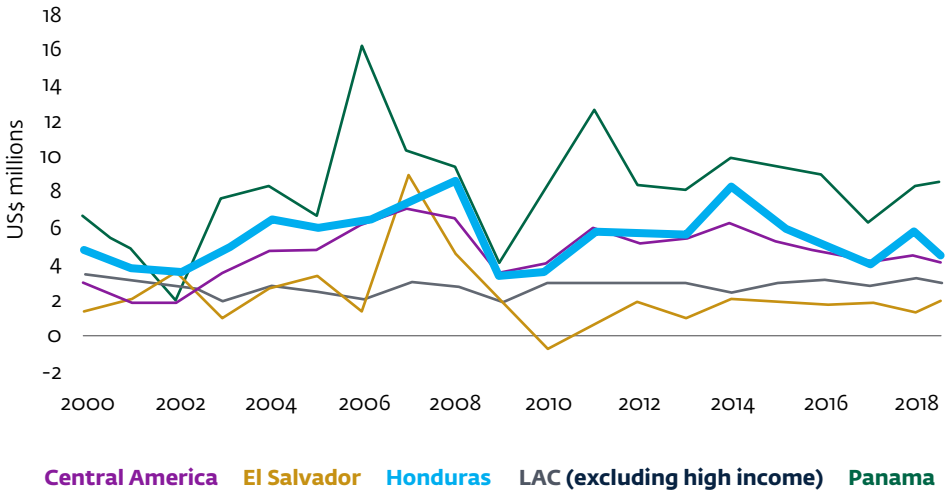
Driven by the private sector, Honduras's investment-to-GDP ratio has been high by regional standards. Investment as a share of GDP averaged 23.8 percent of GDP between 2010 and 2019, higher than the regional average (20.2 percent). The growth in investment has been driven by private investment, while public investment has shrunk. Total FDI rose from US$1 billion in 2010 to US$1.2 billion in 2017 (figure 2.3). At an average of 5.8 percent of GDP per year since 2010, FDI inflows in Honduras have consistently exceeded the regional average of 3.3 percent (figure 2.4). According to data from the Central Bank of Honduras (Banco Central de Honduras; BCH) the sectors that received the largest shares of FDI in 2019 have been financial, insurance and business-process outsourcing (BPO) services (52 percent of the total); transportation and telecommunications (39 percent); and electricity, gas, and water (28 percent). In 2019, the main (intermediary) sources of FDI included the United States (24 percent), Panama (18 percent), Guatemala (10 percent), and Mexico (9 percent). Honduras attracts export-oriented investments in its special economic zones (SEZs), which currently account for 39 of total FDI. Most SEZ projects focus on labor-intensive activities such as apparel and textile manufacturing.[9]

FIGURE 2.3 FDI INFLOWS, HONDURAS, US$, MILLIONS



Source: United Nations Conference on Trade and Development (UNCTAD) data.

FIGURE 2.4 FDI NET INFLOWS, HONDURAS AND REGIONAL PEERS, % GDP



Source: World Development Indicators, World Bank.

Note: GDP = gross domestic product; FDI = foreign direct investment; LAC = Latin American and the Caribbean countries.

However, private investment decelerated in recent years, further limiting cross-sector spillovers and complicating the economic recovery. Net FDI inflows to Honduras, including those into the maquila sector, decelerated in the past five years relative the 2010–15 period. Moreover, being concentrated in the maquila sector, robust foreign investment and trade have been generating limited cross-sector spillovers. Located within the Free Trade Zone, the maquila industry has not been integrated well with the domestic economy because of preferential tax treatment and regulatory incentives, thus reinforcing economic fragmentation. In that context, and amid inefficient public investment management and burdensome regulatory requirements, limited investment spillovers into the economy may have curbed the growth impact from foreign investment and constrained the development of new economic opportunities. Facilitating private investment beyond the current FDI-oriented sectors is crucial for an inclusive economic recovery.

1. For statistics on employment among MSMEs, see National Entrepreneurship and Small Business Administration (Servicio Nacional de Emprendimiento y Pequeños Negocios; SENPRENDE,) https://senprende.com/acceso-a-mercados/. For estimates of their contribution to employment, see English Honduran Council of Private Enterprise (Consejo Hondureño de la Empresa Privada; COHEP), http://cohep.com/ and the National Association of Small and Medium Enterprises (Asociación Nacional de Medianos y Pequeños Industriales; AMPI), https://www.ampi.com/.
2. SENPRENDE , https://senprende.com/acceso-a-mercados/.
3. Veronica Michel and Ian Walker, Honduras Jobs Diagnostic (Job Series 17, Washington, DC: World Bank, 2020), https://openknowledge.worldbank.org/handle/10986/33304.
4. World Bank Enterprise Survey, Honduras 2016 Country Profile, www.enterprisesurveys.org.
5. Wage workers in firms with fewer than five employees, unskilled self-employed people, and unpaid family workers are classified as informal. See Veronica Michel and Ian Walker, "Honduras Jobs Diagnostic" (Job Series No. 17, World Bank, Washington, DC, 2019), https://openknowledge.worldbank.org/handle/10986/33304.
6. Michel and Walker, "Honduras Jobs Diagnostic."
7. The World Bank 2016 Honduras Enterprise Survey reports data on net job creation between 2012 and 2015.
8. However, it is unclear whether the high salary differential between the private and public sector is justified by higher underlying productivity in the public sector.
9. United Nations Conference on Trade and Development (UNCTAD), "World Investment Report: Special Economic Zones" (Geneva: United Nations, 2019), https://investmentpolicy.unctad.org/publications/1204/world-investment-report-2019---special-economic-zones.

03. CROSS-CUTTING CONSTRAINTS ON PRIVATE INVESTMENT

The greatest obstacles to private sector development in Honduras are burdensome tax policies, an inefficient public administration, and inadequate security, followed by the low quality of public services. In recent surveys by the World Economic Forum (WEF),[1] 15.5 percent of Honduran firms identified tax policy as the most important obstacle to doing business, while 13.9 percent cited crime and theft, and 13.6 percent cited excessive bureaucracy. The World Bank's 2016 Enterprise Surveys found that roughly half of Honduran firms regarded tax administration as a major constraint to doing business, double the average for the region, while just under half identified business licensing and permits as a major constraint, compared to a regional average of only 16.5 percent. Firms also report a lack of regulatory predictability and transparency, poorly designed policies and regulations, costly regulatory compliance, and the inefficient delivery of government services as significant constraints on their operations. Competition from the informal sector is also a pressing challenge, along with an inadequate supply of infrastructure, limited workforce skills, and high levels of corruption. Honduras performs poorly on international measures of competitiveness and the ease of doing business.

The most binding constraints to private sector development in Honduras can be divided into three groups. First, the country's relatively high minimum wages, expensive and unreliable electricity, complex tax policies and burdensome administrative procedures, and inadequate security result in elevated production costs. Second, shortages of appropriately skilled and educated workers, combined with inadequate infrastructure, including road networks, public utilities, telecommunications and digital systems, and limited access to credit for MSMEs contribute to insufficient human, physical, and financial capital. Third, unpredictable policies and cumbersome regulations, uneven enforcement, and inadequate adherence to the rule of law, result in weak governance.

3.1 ELEVATED PRODUCTION COSTS

Labor-Market Regulations

Honduras's minimum wage is far above those of its regional comparators, and increased labor costs appear to be undermining the competitiveness of labor-intensive industries while disincentivizing formalization. Moreover, the minimum wage is inconsistent among formal activities. A 2009 increase pushed Honduras's minimum wage to twice the level of regional peer countries such as the Dominican Republic, Guatemala, Nicaragua, and Panama, and Honduras is now the only country in the region where the minimum wage exceeds the average value added per worker.[2] Additionally, the high level of remittances by migrants could have contributed to effects similar to Dutch disease, creating high reservation wages and appreciation of the real effective exchange rate. The new minimum wage reversed gains in formal employment achieved between 2001 and 2007, and while formal job growth picked up again in 2014, it was mostly limited to the maquila subsector, which is subject to a lower minimum wage. In addition, contingent liabilities linked to formal labor contracts, such as high but uncertain entitlements to severance pay (*prestaciones laborales*), reduce firms' willingness to hire formal workers. Honduras also imposes relatively large social contributions and regulatory charges, including payroll taxes and social insurance, which increase labor costs by close to 50 percent. The resulting "tax wedge" between the cost of formal labor and the net wages received by formal workers encourages informality both among firms and workers. In the manufacturing, wholesale and retail trade, and hotels and restaurants subsectors, the earnings of informal and formal firms are clearly separated by the latter's adherence to the minimum wage. There are currently 11 minimum wages for different types of economic activity, which range from a low of L 6,762 (about US$281) a month in the agriculture and fishing sectors to an average of about L 10,022 (about US$417). The maquila sector has a separate agreement on minimum wages, which prescribes an increase of 38.5 percent between 2019 and 2023. As a result, Honduras performs poorly on the WEF's Global Competitiveness Index (GCI) indicators of wage flexibility and on the relationship between wages and productivity, ranking 108th out of 141 countries on the former and 74th on the latter. Honduras also ranks 123rd on redundancy costs and 76th on the ease of hiring and firing.

Energy

Access to electricity remains limited in Honduras, and service is often costly and unreliable. Electrification rates are lowest in rural areas, where 22.5 percent of households lack access to electricity. Power shortages are common, with daily blackouts in some regions. In 2017, the cost of electricity losses was estimated at 36 percent of total production, the highest level in Central America.[3] The sector's dysfunctions pushed the debt stock of the National Electricity Company (Empresa Nacional de Energía Eléctrica; ENEE) to about US$3.4 billion in 2020 (about 15 percent of GDP), compared to US$1.8 billion (8 percent of GDP) in 2016. The persistent deficits of ENEE stem from a combination of structural weaknesses related to high commercial losses in the distribution system,[4] expensive and limited generation capacity, and misaligned tariffs, amid a weak institutional and governance framework. Inadequate infrastructure investment is increasing the fragility of the electricity system. In the 2019 GCI, Honduras ranked 110th out of 141 countries in electricity access and 103rd in electricity service quality. Moreover, there is limited use of renewable energy to support agribusiness development, especially in rural areas, while achieving cost efficiency and increased resilience to climate change.

Weak institutional arrangements, policy instability, limited planning, delayed investment in core infrastructure, sectoral mismanagement, opposition to reform from vested interests, and suboptimal decisions have caused the already underperforming electricity sector to rapidly deteriorate. This has created a situation in which a bailout may be required. Despite various legal and regulatory reforms enacted over the past decade to improve the functioning of the power system, the government is struggling to implement the Electricity Sector Law of 2014 and subsequent regulations. The sector's regulator lacks financial and operational independence, and the unbundling of the power utility mandated by the law has not yet been implemented. Other sectoral priorities, such as the purchase of new power capacity, are still being pursued without a comprehensive plan, standard tendering documents, a system for gauging off-taker creditworthiness, or the conditions to enable effective competition.

Tax Policy and Tax Administration

Tax administration and compliance represent a significant implicit cost to doing business in Honduras and may reduce business liquidity. In the 2016 Enterprise Surveys, firms with over 100 employees identified the burden of tax administration as being among the three most importance challenges in the business environment. Firms report that, on average, about 9.4 percent of senior management's time is spent dealing with regulatory compliance, and 0.9 percent is devoted solely to visits or required meetings with tax officials.[5] On average, 49.8 percent of firms identify tax administration as a major constraint in Honduras, relative to 29.20 percent and 21.44 percent in Latin America and the Caribbean and Central America and the Dominican Republic, respectively. Much of the compliance burden is due to an obsolete and costly system for tax-exempted purchase orders, coupled with an inefficient notification system for noncompliance. Accelerating the payment of VAT refunds the government owes to taxpayers is also important, since such delays may affect businesses' liquidity flow.

Recent changes to tax policy and tax policy enforcement may have also increased the cost of doing business. The authorities have been strengthening revenue mobilization efforts, reducing tax expenditures while simultaneously expanding the tax base, strengthening oversight, creating a new customs administration, modernizing tax procedures, and increasing information sharing to prevent tax evasion. Because statutory tax rates are broadly aligned with regional standards,[6] reducing tax expenditures offers a viable means to boost revenue mobilization, and the Fiscal Responsibility Law and the tax code include a framework for removing exemptions for companies that cannot show verifiable impacts on employment and growth.

Security

High levels of crime and violence adversely affect private investments in Honduras. The country is plagued by insecurity due to weak state institutions and policy instability.[7] Although the homicide rate fell from 60.0 deaths per 100,000 inhabitants in 2015 to 41.7 in 2019, it remains the third-highest rate in the region after those of El Salvador and República Bolivariana de Venezuela. Violent crime, increased gang activity, and demonstrations contribute to insecurity. The cost of crime and violence in Honduras is estimated to equal 6.5 percent of GDP, the largest share in the region. Victimization costs[8] in Honduras exceed 2.00 percent of GDP, more than four times the regional average of 0.48 percent. The precarious security situation has prevented the expansion of SEZs away from the San Pedro Sula area, in close proximity to Puerto Cortés, and is imposing additional costs owing to heightened safety precautions such as screening workers to prevent infiltration by criminal gangs.

The WEF Executive Opinion Survey ranked crime and theft as the second most problematic factor for doing business in Honduras in 2017. Some 64.1 percent of firms pay for security; 27.7 percent experience losses due to theft and vandalism; and 29.7 percent identify crime, theft, and disorder as major constraints on doing business. In the 2019 GCI, Honduras ranked 137th out of 141 countries on indicators of security and 136th on indicators of organized crime. The World Justice Project's 2019 Rule of Law Index ranked Honduras 108th of 126 countries worldwide and 25th out of 30 countries in the region on indicators of order and security.[9]

3.2 INSUFFICIENT HUMAN AND PHYSICAL CAPITAL

Workforce Skills

Deep and persistent disparities in education access are a structural barrier to acquiring the knowledge and skills required by the private sector. While Honduras has made progress in expanding access to primary education, enrollment at other education levels (that is, preprimary, secondary, and tertiary) remains low, and the quality of public education presents a serious challenge in both urban and rural areas. The World Bank's Human Opportunity Index reveals that the key factors influencing secondary school enrollment are the education of the head of household, the per capita income of the household, and location in a rural or urban area. The tertiary enrollment rate remains low, at just 20 percent. Boys are less likely than girls to remain in secondary and tertiary education, and in 2013 female enrollment in tertiary education exceeded male enrollment by 6.5 percentage points.[10]

The technical and vocational education and training system in Honduras requires an improved curriculum that provides in-demand skills to young workers. While 57 percent of trainees are between 15 and 29 years old, 87 percent of those enrolled at the National Professional Training Institute (Instituto Nacional de Formación Profesional; INFOP) are already employed and are looking to upgrade their skills. Only 11 percent of INFOP courses focus on labor-market entrants in either the informal or formal sector; just 2 percent of trainees funded by INFOP receive on-the-job training; and INFOP offers little job-placement support. Training programs are particularly relevant to young workers from lower-income households, as they have fewer opportunities to obtain the specific skills demanded by formal firms and are instead pushed toward the informal sector. On the 2019 GCI, Honduras ranked 77th out of 141 countries on indicators of the quality of vocational training, 70th on the skillsets of graduates, and 73rd on the ease of finding skilled employees.

New workforce skills will be required to seize the opportunities presented by the digital economy. The use of digital technologies among businesses in Honduras remains low by international standards. In the 2019 GCI, Honduras ranked 109th out of 141 countries on the subindicator for digital skills. While part of the challenge will be to raise the overall digital literacy of the population, Honduran workers will also require training in the specific competencies demanded by information technology. Organization for Economic Co-operation and Development (OECD) data indicate that, on average, almost 40 percent of workers lack basic level problem-solving skills in technology-rich environments, suggesting that additional training will be required to capitalize on the opportunities offered by the digital economy. [11]

Infrastructure and PPPs

Transportation and public-private partnerships

Weak transportation infrastructure limits the integration of domestic markets and raises the cost of accessing international markets. A significant share of rural areas are accessible only via unpaved roads, which limits opportunities for trade of agricultural goods and hinders access to basic services. Honduras's mountainous geography impedes the development of transportation infrastructure, and frequent heavy rains pose a threat to the road network. Furthermore, the recent imposition of low fares on road freight services, combined with an insurance requirement for heavy freight vehicles, poses a challenge to transportation companies. Trade and logistics are especially affected by crime, insecurity, and violence, with criminal groups frequently extracting informal payments. According to the 2016 Logistics Performance Index, direct transport costs for domestic trucking in Honduras are 14 percent higher than the regional average, while prices for international road shipments are 8 percent higher.[12]

A combination of limited fiscal space and lack of credibility around honoring long-term contracts may affect the government's ability to establish public-private partnerships (PPPs). These constraints apply both to availability-based and budget-dependent PPP projects. Honduras has launched an aggressive infrastructure plan that encompasses airports, roads, and port terminals designed to establish itself as the "logistics hub of the Americas,"[13] while also establishing a customs union with other Central American countries. The legal framework for this investment program allows mixed investment projects involving private companies and the government. To improve the framework for and expand the use of PPPs, the authorities have (a) issued new PPP regulations creating a fiscal-risk unit within the Ministry of Finance and a new unit in the Treasury to improve governance in the management of PPPs and (b) repealed a law allowing government guarantees for debt contracted by companies involved in PPP projects. Honduras's legal and institutional framework for PPPs, however, suffers from some ambiguities and contradictions regarding the roles and responsibilities of different institutional actors, which affect PPP processes including disclosure.[14] Private participation in municipal infrastructure is hampered by inconsistencies in the legal and institutional frameworks between levels of government. Municipalities are primarily responsible for providing infrastructure, while the national government has the legal authority to issue concessions and set fares. As a result, municipalities bear key risks arising from the private provision of infrastructure, but they lack full control over measures to mitigate these risks.

Telecommunications and digital systems

Low rates of internet access and wide geographic disparities reflect a lack of connectivity infrastructure and inadequate regulatory measures to promote competition. Honduras has little fiber optic infrastructure along its Caribbean coast and on its border with Nicaragua. Competition in mobile broadband services is limited, and in late 2018 the market shrank from four players to a duopoly between Tigo Honduras and Claro Honduras. The regulatory framework has not been updated since 2013. In 2016, the authorities announced that spectrum bands would be made available for 4G (fourth-generation telephone service) and LTE (long-term evolution telephone service) in an effort to attract a new player, but no new spectrum has been allocated since 2013. Most recently the authorities modified the National Frequency Allocation Plan to allocate new spectrum for international mobile telecommunications services.

Honduras's digital platform constitutes a barrier to doing business. Mobile calls in Honduras are among the most expensive in the region at a regulatory rate of US$0.15 per minute. In interviews, local mobile companies have observed that the access charges imposed on them to connect across networks have kept tariffs artificially high. According to the Honduras 2021 Statista Country Report, Honduras has low internet penetration rates, with about 46.6 percent of households having access to fixed internet connections in 2020,[15] a lower penetration rate than the average for Central America (53.7 percent). Geographic disparities in access and coverage also remain high. According to official data, only 34 percent of municipalities have fixed-broadband subscribers, and only half the population has access to 3G (third-generation telephone service) network coverage. In the 2019 GCI, Honduras ranked 124th out of 141 countries on indicators of information and communication technology.

Digital payment systems have unexploited potential, which can be increased in part by improvements in digital literacy and access. Digital payment systems created by the private sector can expand access to financial services, and the government can leverage similar platforms to provide direct transfers or enable access to public services. Although the share of Hondurans that have made or received digital payments rose from 21.9 percent in 2014 to 37.2 percent in 2017, this percentage remains below the regional average of 45.8 percent and far below the average of 91 percent for high-income countries. Digital literacy for both MSMEs and individuals requires improvement, and building this talent would enable capitalization on the digital agenda.

Access to credit for MSMEs

While financial infrastructure in Honduras has improved in the past decade, access to credit for MSMEs remains a challenge. MSMEs report access to credit as a top obstacle. Firms report low usage of formal financial services and turn primarily to internal sources to finance their operations and business growth. According to the 2016 World Bank Enterprise Survey (latest available data as of 2020), only 37.4 percent of firms in Honduras had investments financed by a bank. About 81.4 percent of Honduran firms have a checking or savings account, more than 8 percentage points below the Latin America and the Caribbean regional average. However, only 44.6 percent of these firms have a bank loan or line of credit, which is below the regional average of 51.3 percent. About 73 percent of loans require collateral, 10 percentage points above the regional average, with the total value of collateral needed exceeding 220 percent of the loan amount. Honduras also ranks the highest among the region's countries on the percentage of firms whose recent loan application was rejected. Coupled with relatively high interest rates, this deters development and growth of small and medium enterprises (SMEs), undermining their competitiveness and limiting opportunities to finance the expansion of their business operations.

3.3 WEAK GOVERNANCE AND AN ADVERSE BUSINESS ENVIRONMENT

Rule of Law, Property Rights, and Land Tenure

Weaknesses in land-market policy limit the private sector's ability to secure property rights, which discourages investment and prevents the use of land as collateral. Roughly 80 percent of privately held land in Honduras is either untitled or improperly titled and little progress has been made in formalizing land tenure in Honduras. With only 2 municipalities (Comayagua and Siguatepeque) out of 298 having decentralized land administration services, the decentralization of the delivery of cadastre, registry, and land tenure regularization services in order to expedite land market transactions is still in its early stage. This is a significant source of tension in territories inhabited by indigenous peoples and Afro-Hondurans, as land tenure issues have been at the forefront of their demands for years and have also been a concern in communities in the departments of Colón (Trujillo and Irona) and Atlántida (Esparta, La Rosita, and Cayo Venado). The country lacks a comprehensive policy for managing land as a strategic national asset. The property-registration process involves six procedures, requiring an average of 28.5 days and costing the equivalent of 5.7 percent of per capita GDP. This compares unfavorably with its regional peers such as Costa Rica, which has five procedures that take 11 days at a cost of 3.4 percent of per capita GDP. El Salvador and Guatemala also perform better than Honduras mostly on their cost (3.8 percent and 3.6 percent of per capita GDP, respectively.

The inefficiency of judicial processes means that individuals and businesses have limited legal recourse in resolving legal disputes. This is likely to discourage private investment and add to the cost of doing business. On the 2019 Index of Economic Freedom, Honduras's lowest scores were on indicators of judicial effectiveness (31 out of 100) and government integrity (25.3 out of 100).[16] Administrative corruption particularly affects small and medium-sized firms,[17] with a bribery incidence higher than 30 percent, triple the Latin American and the Caribbean average. A sense of impunity is disproportionally perceived by medium-sized firms, and more than 50 percent of firms identify the judicial system as their major constraint.[18] Corruption has long been perceived as one of the top challenges in Honduras, but it noticeably became the primary concern among Hondurans with the onset of the pandemic.[19]

Weak institutions and governance exacerbate the difficulty of doing business in Honduras. In 2020, Honduras scored poorly on all six dimensions of the World Bank's Worldwide Governance Indicators. The weakest area of governance was rule of law (17.3 percentile), followed by control of corruption (20.7 percentile), political stability and the absence of violence or terrorism (26.4 percentile), government effectiveness (29.8 percentile), voice and accountability (29.9 percentile), and regulatory quality (34.1 percentile). In addition, the International Budget Partnership's 2019 Open Budget Survey assigned Honduras a score of 59 out of 100, placing the country in the "limited transparency" range.

Regulatory and Trade Environment

While the Honduran economy is largely market driven, government regulations undermine the ability of small firms and start-ups to compete against larger incumbents. In principle, the Defense and Promotion of Competition Law opened state-dominated markets and private monopolies to competition, and the Commission for the Defense and Promotion of Competition enforces competition law. In practice, however, incumbent firms continue to dominate key markets, and the effectiveness of the competition authority remains weak. Surveys of investor perceptions and product-market regulatory data suggest that competition is limited throughout the economy, especially in the professional, retail, and network services subsectors. Despite reforms to the legal framework, price controls and state capture diminish competition. The 2019 GCI ranked Honduras 118th out of 141 economies on indicators of the burden of government regulation, 93rd on indicators of domestic competition, 92nd on the subindicator for market dominance, and 86th on the subindicator for competition in services.

Significant barriers to entry inhibit competition in domestic markets and encourage informality. Starting a business in Honduras involves 11 procedures, which take an average of 42 days to complete at a cost equivalent to 28.1 percent of per capita GDP. The high cost of registration confines a large share of firms to the informal sector, which is characterized by limited access to credit, lower income levels, and slower productivity growth compared to formal-sector firms.

High trade costs present an implicit barrier to doing business in Honduras. Overall, Honduran policies are conducive to trade, with low import tariffs and low tariffs in export markets due to preferential agreements with major trading partners. In the 2000s, the country joined the CAFTA-DR; Honduras grants preferential tariff treatment to imports from other Central American Common Market (CACM) members; and a recently established customs union with Guatemala (2017) and El Salvador (2018) is expected to further ease intraregional trade flows once it has been fully implemented. However, nontariff measures (NTMs) remain prevalent in Honduras, and some 896 export products are subject to NTMs—almost half of all exports identified in the Harmonized System.[20] The two most prominent NTMs are export registration requirements (imposed on 76 percent of products subject to NTMs) and inspection requirements (imposed on 17 percent of products subject to NTMs). NTMs on exports are especially concentrated in the metals products sector, followed by the animal and animal products subsector. Exporters spend an average of 156 hours and US$681 on border and documentary compliance, while importers spend 168 hours and US$553. The 2019 GCI ranked Honduras 119th out of 141 countries on indicators of the efficiency of border clearance.

Achieving the government's development objectives will require catalyzing private investment and deepening reforms to support private sector development. Going forward, several challenges are especially pressing. The first is increasing security to foster investment, growth, and social welfare. The second is strengthening institutions and improving the business and regulatory environment. The third is fostering the growth of the financial sector to offer better economic opportunities and enhance resilience to future shocks. Meanwhile, significant reform efforts will be necessary to strengthen public service delivery and narrow the infrastructure gap.

1. World Bank, Logistics Performance Index, 2016 rankings, https://lpi.worldbank.org/international/aggregated-ranking; Klaus Schwab, ed., The Global Competitiveness Report 2019 (Geneva: World Economic Forum, 2019), http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf.
2. Veronica Michel and Ian Walker, "Honduras Jobs Diagnostic" (Job Series; No. 17. World Bank, Washington, DC, 2019) https://openknowledge.worldbank.org/handle/10986/33304.
3. Comisión Económica para América Latina y el Caribe (CEPAL), "Informe nacional de monitoreo de la eficiencia energética de Honduras, 2018" (Documentos de Proyectos 43983, Naciones Unidas Comisión Económica para América Latina y el Caribe, 2018), https://ideas.repec.org/p/ecr/col022/43983.html.
4. In 2020, ENEE's technical and nontechnical system losses (combined) were estimated to be in nearly 34 percent in the distribution network.
5. World Bank Enterprise Survey, Honduras 2016 Country Profile, www.enterprisesurveys.org.
6. The total tax and contribution rate for Honduras is 39.1 percent of commercial profit, which is closer to the OECD high-income countries average (39.9 percent). Honduras's total tax rates and contributions indicator includes only the corporate income tax rate at 25 percent (and a 5 percent social contribution tax also applies to high-profit firms), labor tax and contributions at 8.8 percent, and other minor taxes. The tax rates for personal income tax and valued added tax (VAT) are slightly higher than regional averages but comparable to the regional average. The general VAT rate in Honduras is 15 percent for goods and services, and an 18 percent rate is applied on imports and supplies of alcoholic beverages and tobacco products.
7. Marco Antonio Hernandez Ore, Liliana D. Sousa, and J. Humberto Lopez, "Honduras: Unlocking Economic Potential for Greater Opportunities" (Systematic Country Diagnostic, World Bank, Washington, DC, 2016), https://elibrary.worldbank.org/doi/pdf/10.1596/23119; Sarah Chayes, When Corruption Is the Operating System: The Case of Honduras (Washington, DC: Carnegie Endowment for International Peace, 2017), https://carnegieendowment.org/files/Chayes_Corruption_Final_updated.pdf.
8. The victimization cost of crime consists of the costs that homicides, robberies, assaults, and other violent crimes impose on victims as well as the forgone income of imprisoned perpetrators. Victimization costs are direct and tangible economic costs, and they do not include indirect or intangible costs.
9. World Justice Project, World Justice Project: Rule of Law Index 2019 (Washington, DC: World Justice Project, 2019), worldjusticeproject.org/sites/default/files/documents/ROLI-2019-Reduced.pdf.
10. World Bank World Development Indicators.
11. OECD, "Skills Matter: Further Results from the Survey of Adult Skills" (OECD Skills Studies, OECD Publishing, Paris, 2016), http://dx.doi.org/10.1787/9789264258051-en.
12. World Bank, Logistics Performance Index, 2016. The Logistics Performance Index scores six dimension of logistics performance: customs clearance, infrastructure, international shipments, logistics competence, tracking and tracing, and timeliness.
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14. World Bank Group, "Improving Transparency and Accountability in Public-Private Partnerships: Disclosure Diagnostic Report for Honduras" (Working Paper, World Bank Group, Washington, DC, 2018), http://documents.worldbank.org/curated/en/776671524575615514/Disclosure- diagnostic-report-Honduras.
15. Defined as the share of individuals who have used the Internet (from any location) in the last 3 months 2. Retrieved from: https://www.statista.com/study/48443/honduras/.
16. Terry Miller, Anthony B. Kim, and James M. Roberts, 2019 Index of Economic Freedom (Washington, DC: The Heritage Foundation, 2019), https://www.heritage.org/index/pdf/2019/book/index_2019.pdf.
17. More than 60 percent of the firms in the 2016 Enterprise Survey identified corruption as a major constraint on their development, which is twice the average percentage in the Latin American and the Caribbean region and the world.
18. See Enterprise Survey, 2016.
19. "A hondureños les preocupa más el desempleo que el coronavirus: CID Gallup," La Prensa, February 3, 2021, https://www.laprensa.hn/honduras/1440085-410/hondure%C3%B1os-preocupa-mas-desempleo-coronavirus-cid-gallup.
20. The Harmonized System is maintained by the World Customs Organization. Its six-digit trade classification includes a total of 1,921 export products. World Customs Organization, Harmonized System Database, http://www.wcoomd.org/en/topics/nomenclature/instrument- and-tools/tools-to-assist-with-the-classification-in-the-hs/hs-online.aspx.

04. MARKET CREATION OPPORTUNITIES

The selection of sectors for more detailed assessment was guided by quantitative and qualitative information, including a wide range of internal and external consultations. There are five key criteria in sector selection:

1. **Macroeconomic and demographic trends.** The Country Private Sector Diagnostic (CPSD) sector assessments prioritize sectors where more private sector participation could have a significant development impact, whether through job creation, increased value added, productivity, or spillovers to other sectors. The potential of private investment to generate positive economic impacts in Honduras varies by sector. Agriculture and agribusiness, manufacturing, digital financial services (DFS), and business-process outsourcing (BPO) are among the sectors with greatest potential to drive growth, create jobs, and increase economic diversification in Honduras.[1] Honduras's sectoral GDP multipliers indicate that investments in most agriculture, agribusiness, and service subsectors could yield the greatest development impact. High-productivity, capital-intensive, nonfood manufacturing industries such as textiles and motor vehicles tend to have average GDP multipliers, but their potential for employment creation is greater than that of the agricultural sector. Employment multipliers for business services and communications are especially large relative to other sectors. DFS offer low-cost, contextually appropriate solutions for expanding access to payment platforms, lending, savings accounts, and other financial services among individuals and enterprises (figure 4.1).

2. **Diversification potential.** Countries grow by diversifying into new products of increasing complexity. According to the research at the Growth Lab at Harvard University, strategic new products aim to balance distance, opportunity gain, and product complexity.[2] Given Honduras's current exports, some of the sectors with high potential for new diversification are textiles, vehicle parts, industrial machinery, and articles of iron or steel. Moreover, these attractive opportunities for diversification require skills and know-how already present in Honduras.

3. **Government priorities.** In 2016, the government developed the Honduras Plan 20/20, a long-term economic development plan prioritizing six sectors as growth engines for the economy and thus for job creation: (a) textiles, (b) BPO, (c) manufacturing, (d) tourism, (e) agro-industry, and (f) housing. The plan targeted creation of 600,000 jobs by 2020 and claimed to have created 50,000 jobs in 2017 alone. The plan further targets the creation of 1.26 million jobs by 2025 in just the first four sectors. The government approved a national employment policy in April 2017, a policy framework promoted by the International Labour Organization (ILO), that aims to articulate the Plan 20/20 and the Active Labor Market Programs with a special focus on youth.[3] The framework has four pillars: (a) enable the business environment

for entry and development of enterprises, (b) promote competitiveness, (c) generate employment, and (d) develop human capital. In 2018, the law for small and medium enterprises was passed to promote the creation of SMEs by simplifying the entry of businesses, facilitating access to credit, and creating employment.

4. **Feasibility of progress on sector constraints.** The selection of sectors of focus is also grounded in the consideration of what is feasible in the context of addressing current constraints to investment in a given sector. The selected sectors may be subject to constraints that can be addressed in the short term (three to five years).

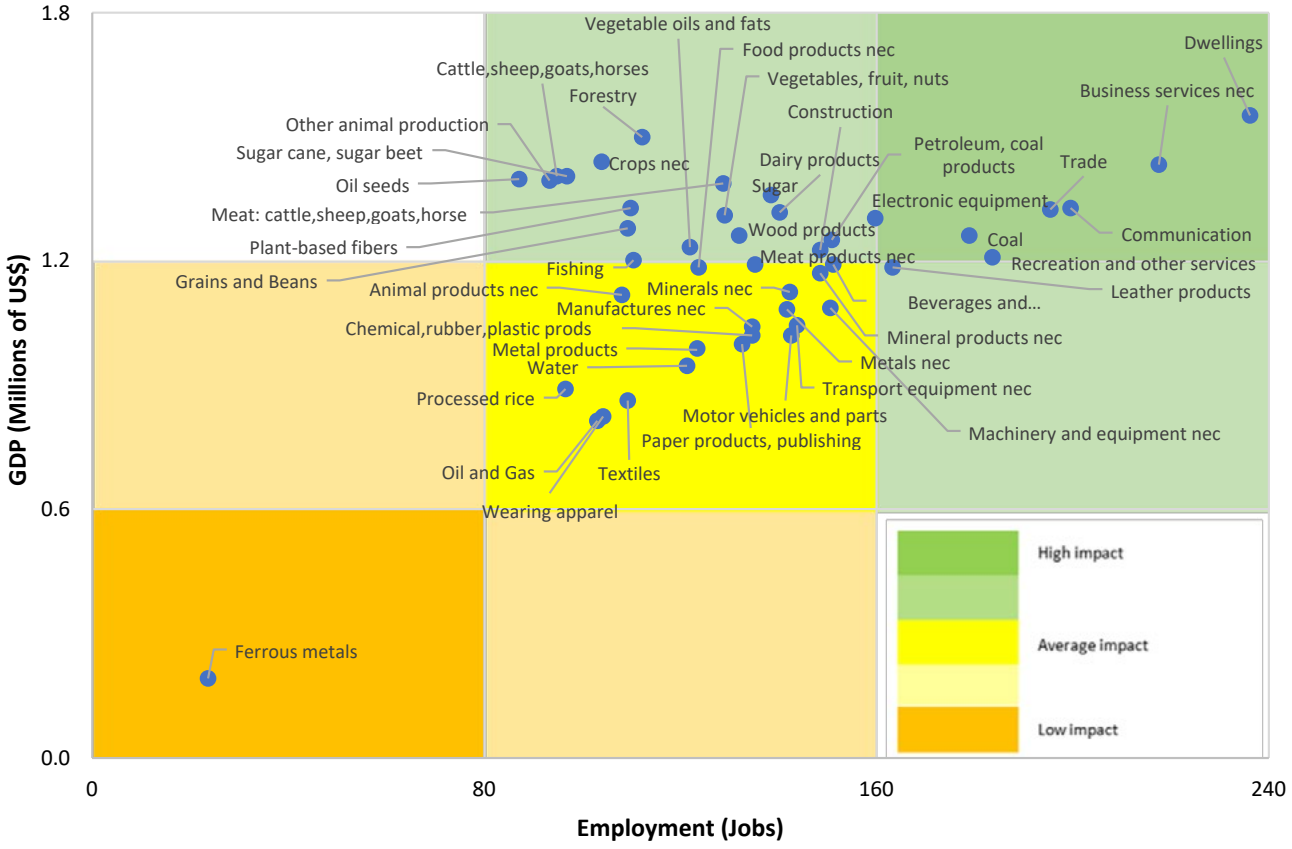
5. **Wide consultations with stakeholders and feasibility of the reforms.** The CPSD team consulted with the Global Practices and IFC experts in relevant areas and conducted a joint Systematic Country Diagnostics-CPSD mission that included about 40 meetings with private sector stakeholders, relevant government agencies, development partners, civil society, and IFC and World Bank colleagues in San Pedro Sula and Tegucigalpa. The government of Honduras has prioritized tourism in its 2020 vision, building on its sun, sea, and sand; coral reefs; and heritage and historic sites. However, given the globally competitive nature of this industry, if Honduras is to compete, it will need to address its infrastructure gaps and safety and security issues. Currently, Honduras is ranked below the regional and global average for travel and tourism competitiveness. Many of the challenges in the tourism sectors are unlikely to be resolved in a three- to five-year period but are likely to be part of a longer-term reform agenda. On this basis of these consultations, tourism services were not selected for deeper assessment.

On the basis of the previous five criteria, the sectors in table 4.1 were selected.

TABLE 4.1 SELECTED AND NON-SELECTED SECTORS

1. Agribusiness	1. Tourism
2. Maquila: light manufacturing and apparel	2. Retail
3. Business-process outsourcing	3. Housing, construction, and building materials
4. Digital financial services for micro, small, and medium enterprises	4. Telecommunications and information and communication technology (excluding business-process outsourcing)
	5. Energy
	6. Water
	7. Education
	8. Health

FIGURE 4.1 IMPACT OF US$1 MILLION OF ADDITIONAL REVENUE ON GDP AND EMPLOYMENT



Sources: Global Trade Analysis Project V.9 and World Development Indicators, 2000–16.

Note: GDP = gross domestic product; nec = not elsewhere classified

4.1 AGRIBUSINESS

Market Overview

The agriculture sector is an engine of growth in Honduras. Agriculture is a major employer, especially among poor households, and agricultural exports represent a large majority of total exports. In 2019, agricultural exports accounted for 71.4 percent of total exports by value. Historically, agriculture has accounted for larger shares of output and employment in Honduras than in comparable regional countries. Despite a relative decline since the 1980s, the agricultural sector in Honduras still represents 13 percent to Honduras's GDP and employs 32.2 percent of its total labor force, which is twice the average for Central America. When agribusiness activities are included, the sector's contribution to GDP rises to about 23 percent. However, there are more informal than formal jobs in agriculture, and these jobs tend to be lower-productivity jobs because of the absence of scale economies and the difficulties that small, informal enterprises face in accessing capital.[4] As a result, earnings and job quality remain low, and these workers tend to be poor or extremely poor.

The government has identified agribusiness as a priority sector for economic growth and job creation.[5] The 2004–2021 State Policy for the Agri-Food Sector and the Rural Environment (Política de Estado para el Sector Agroalimentario y el Medio Rural, PESAMR) aims to improve the sector's productivity and competitiveness, expand exports, meet internal demand through competitive domestic production, reduce rural poverty, and ensure food security. These objectives dovetail with those of the National Employment Generation and Economic Growth Program for 2020,[6] also known as Honduras 20/20. Launched in 2016, the Honduras 20/20 strategy identifies agro-industry as a driver of growth, with significant potential to create jobs, expand exports, and attract investment. The sector receives several tax exemptions and incentives, which are broadly in line with those offered by other Central American countries and are competitive at the international level.[7] Agricultural products, inputs, and machinery are exempt from sales tax, and agribusiness companies operating in free-trade zones, industrial processing zones, or under either the temporary import regime or a special tax regime are exempt from corporate income tax, sales tax, custom duties, and some municipal taxes.

Honduras's diverse agro-ecological conditions, strategic location, and external openness could enable the rapid development of the agricultural sector. Honduras can produce a wide range of agricultural goods, from crops and livestock to forestry and fishery products. The country's proximity to large markets such as the United States and Canada, coupled with its liberal trade policies, enables it to overcome the limitations of a small domestic consumer market. Honduras has been a member of the World Trade Organization (WTO) since 1995.[8] It is a party to multiple free-trade agreements, including CAFTA-DR as well as various bilateral treaties with the Canada, Chile, Colombia, the Dominican Republic, European Union, Korea, Mexico, Panama, Peru, and Taiwan, China, and the government is currently negotiating trade agreements with Cuba, Ecuador, and the United Kingdom.[9] Honduras also has a customs union with Costa Rica, El Salvador, Guatemala, Nicaragua, and Panama, which greatly facilitates intraregional trade.[10]

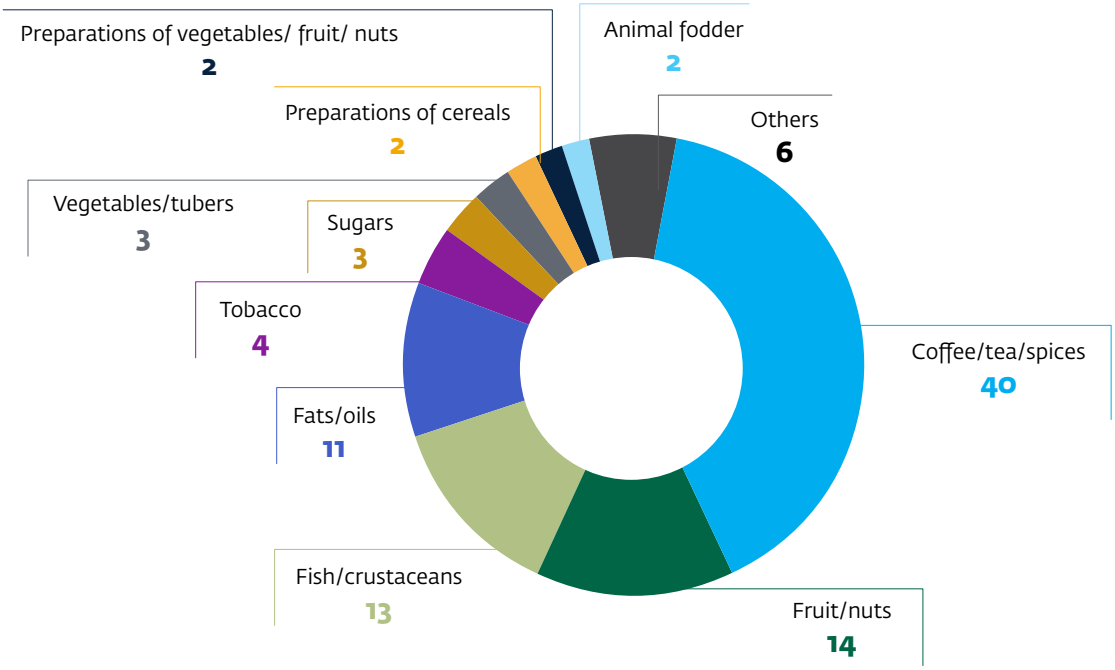
The Honduran agricultural sector is composed of a diverse group of value chains. Those with the largest shares of gross production value (GPV) include basic grains, coffee, fruit, palm oil, livestock (meat and dairy), poultry (meat and eggs), and vegetables (figure 4.2). Coffee and chicken meat generate the highest GPV. Between 2007 and 2016, the average GPV for agricultural products stood at US$3.7 billion, or 21.3 percent of GDP, with livestock, chicken, and cattle meat accounting for the largest share (28.4 percent), followed by coffee (19.2 percent). Honduran coffee is the largest agrifood export product, representing 40 percent of the total exports. Between 2009 and 2019, coffee accounted for the largest share of total agri-food export value growth at 35 percent, followed by bananas at 19 percent and shrimp at 11 percent (figure 4.3). Honduras is the 10th largest exporter of melons in the world (largely due to one highly successful producer), and the second largest in Latin America and the Caribbean.[11]

Honduras is highly competitive in the production of coffee, fruit, vegetables, and crustaceans. Marginal yields in Honduras outperform the global averages for bananas, papayas, melons, and other tropical fruits. The country has a revealed comparative advantage (RCA) in coffee, fruit, and crustacean production (table 4.2). However, both the domestic-to-global yield ratio and the RCA could be affected by policy distortions such as subsidized inputs. Moreover, a low RCA combined with a high yield ratio could indicate more robust domestic demand for a commodity relative to external demand, the inability to expand production beyond its current level, and weaknesses in farm-to-port infrastructure that reduce global trade competitiveness. Chicken meat, papayas, and cabbages all have yield ratios above 1 and RCAs below 1. Conversely, a low yield ratio coupled with a high RCA could indicate the presence of export subsidies, market dominance by export-oriented state-owned enterprises, or other policies that enhance the global trade competitiveness of goods with low productivity levels. Tobacco, palm oil, dry beans, and beef fall into this category, suggesting that they may be affected by policy distortions.

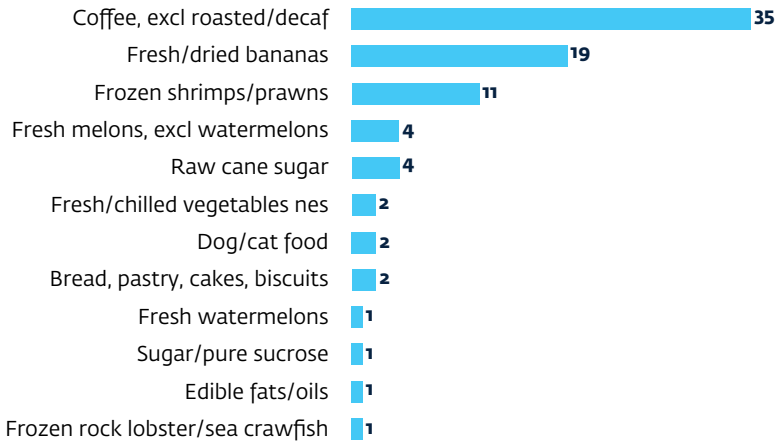
Despite the remarkable growth of several subsectors, Honduran agriculture tends to underperform key competitors in terms of yields and prices. Marginal yields for selected items, including bananas, coffee, pineapples, and tomatoes, exceed the Central American and world averages, but they have still lagged the yields for key individual competitors. The only exception is melons, for which Honduras has the highest yield of any peer country. Maize and oil-palm fruit, two of Honduras's leading commodities in the 2009–18 period, had yields below the Central American average. However, oil-palm fruit—from which palm oil, Honduras's second-largest agricultural export, is derived—had double the yield of neighboring Nicaragua. Honduras also lags peer countries in terms of the value of its top agrifood exports, and it receives lower prices per metric ton than most of its regional and global competitors.

FIGURE 4.2 EXPORT VALUES BY CATEGORY, 2009–2019, PERCENTAGE OF TOTAL AVERAGE EXPORT VALUE

a. Agribusiness exports, by category, % total average export value



b. Agricultural exports, by category, % total average export value



Source: IFC staff using United Nations COMTRADE data from the International Trade Center (ITC) Trade Map, https://www.trademap.org/.

Note: nes = not elsewhere specified.

TABLE 4.2 THE COMPETITIVENESS OF HONDURAN AGRICULTURE BASED ON MARGINAL YIELDS AND REVEALED COMPARATIVE ADVANTAGE

Honduras yield/world average yield score (A)			Revealed Comparative Advantage score (B)			Composite Competitiveness prioritization score (50%*A + 50%*B)		
1	Fruit, fresh nes*	2.66	1	Coffee, green	265.62	1	Coffee, green	0.71
2	Bananas	2.41	2	Melons	169.98	2	Melons	0.68
3	Papayas	2.30	3	Bananas	87.28	3	Bananas	0.62
4	Beeswax	2.00	4	Pineapples	65.59	4	Fruit, fresh nes	0.50
5	Melons	1.91	5	Crustaceans	44.93	5	Pineapples	0.46
6	Plantains and others	1.85	6	Oil, palm	41.14	6	Papayas	0.43
7	Pineapples	1.81	7	Vegetables, fresh nes	39.77	7	Beeswax	0.38
8	Coconuts	1.74	8	Sweet potatoes	38.80	8	Plantains and others	0.35
9	Nutmeg/mace/cardamom	1.63	9	Eggplants	38.40	9	Nutmeg/mace/cardamom	0.34
10	Sesame seed	1.62	10	Watermelons	19.88	10	Coconuts	0.33
11	Cashew nuts	1.46	11	Sugar cane	19.39	11	Sesame seed	0.31
12	Pumpkins/squash/gourds	1.21	12	Chillies, peppers, green	15.57	12	Vegetables, fresh nes	0.28
13	Meat, goat	1.20	13	Nutmeg/mace/cardamom	15.02	13	Cashew nuts	0.28
14	Cabbage/brassicas	1.18	14	Cucumbers and gherkins	11.92	14	Eggplants	0.27
15	Sugar cane	1.15	15	Pumpkins/mace/cardamom	10.90	15	Crustaceans	0.27
16	Coffee green	1.14	16	Beans, dry	10.55	16	Sugar cane	0.25
17	Onions, dry	1.14	17	Tobacco	9.93	17	Oil, palm	0.25
18	Meat, chicken	1.12	18	Pepper (piper spp.)	8.32	18	Pumpkins/squash/gourds	0.25
19	Eggs, hen, in shell	1.12	19	Groundnuts	7.60	19	Watermelons	0.23
20	Vegetables, fresh nes**	1.08	20	Sesame seed	4.27	20	Meat, goat	0.23
21	Eggplants	1.07	21	Milk, whole fresh cow	3.84	21	Cabbage/brassicas	0.22
22	Skins, goat, fresh	1.04	22	Tomatoes	3.49	22	Onions, dry	0.21
23	Watermelons	1.03	23	Plantains and others	2.96	23	Eggs, hen, in shell	0.21
24	Hides, cattle, fresh	1.02	24	Fruit, fresh nes	2.35	24	Meat, chicken	0.21
25	Tobacco	0.95	25	Cassava	2.18	25	Tobacco	0.20
26	Oil, palm	0.91	26	Eggs, hen, in shell	2.13	26	Skins, goat, fresh	0.20
27	Beans, dry	0.89	27	Fish	1.42	27	Hides, cattle, fresh	0.19
28	Mangoes/guavas	0.88	28	Meat, cattle	1.29	28	Fish	0.19
29	Meat, sheep	0.88	29	Hides, cattle, fresh	1.14	29	Molluscs	0.19
30	Rice, paddy	0.86	30	Oranges	1.10	30	Beans, dry	0.19

Source: IFC Staff calculations using United Nations Food and Agriculture Organization and Commodity Trade Statistics Database (UN Comtrade) data.

Note: nes = not elsewhere specified.

Moreover, the composition of the Honduran agricultural sector poses risks to its long-term growth. The agricultural sector is dominated by smallholder farmers and small-scale productive systems, which are characterized by low levels of productivity and competitiveness, low revenue generation, exposure to shifts in international prices, and vulnerability to exogenous production shocks such as pests, blights, and natural disasters. There are more informal than formal jobs in agriculture. Rural areas are home to over 60 percent of poor households,[12] most of which rely on agriculture or related activities for their livelihood. However, the agricultural sector also includes a small group of large-scale, organized, and competitive producers, which export commodities to high-income countries.

The Impact of COVID-19

The COVID-19 pandemic has had a significant, though largely indirect, impact on the Honduran agriculture sector. The pandemic has adversely affected domestic production and transportation. Mobility restrictions have taken a substantial toll on perishable agricultural products, and prolonged quarantine measures could limit the supply of labor available during the harvest seasons. Meanwhile, slowing economic activity has reduced the income of smallholder farmers and producers, eroding their purchasing power and threatening their solvency. Producers have also become more risk averse because of crop losses and weakening export demand, and many are either cultivating less or focusing on crops with a longer storage life (for example, grains rather than vegetables).

Disruptions to international supply chains have compromised food security, prompting a renewed focus on the staple-food subsector. The United Nations (UN) Food and Agriculture Organization (FAO) and the Economic Commission for Latin America and the Caribbean (Comisión Económica para América Latina y el Caribe; CEPAL) have warned that the economic shock of the pandemic could cause extreme poverty and hunger to increase across the region. To mitigate this impact, the government has (a) established systems to ensure the biosecurity of workers and consumers; (b) streamlined credit offered to farmers and agriproducers through BANHPROVI, increased the flexibility of financing conditions, and expedited application processes for MSMEs and agrifood producers; (c) accelerated the incorporation of information and communication technology (ICT) tools into trade procedures; and (d) created programs to promote the cultivation of staple grains to ensure food security.

Key Barriers to Address

Realizing the potential of the agricultural sector will require that policy makers address binding constraints on productivity and competitiveness. The smallholder farmers who dominate the agricultural sector often have limited knowledge of agronomic techniques, and many lack access to financing, high-quality inputs, irrigation systems, logistics services, or markets outside their immediate area. Few smallholder farmers are members of producer groups or cooperatives despite the efforts of multiple stakeholders, including the government, donor agencies, and nongovernmental organizations (NGOs). In the coffee subsector, rural savings banks and donor-sponsored productive alliances have made progress in improving productivity and competitiveness, but farmers across the agricultural sector face challenges in land ownership and informality. The COVID-19 crisis exacerbated these underlying weaknesses, as demand for food surged in a context of supply shortages and limited infrastructure. Additional sector-specific challenges include access to inputs, water services, and financing, as well as food safety issues. The agricultural sector is also subject to cross-cutting constraints—such as high rates of crime and corruption, limited workforce skills, and inefficient public institutions—that affect productivity, growth, and exports across the Honduran economy.

Public policy

Weak institutional capacity and inconsistent policy implementation undermine agricultural development. The PESAMR and Plan Honduras 20/20 will soon expire, leaving Honduras without a long-term strategic vision for the agricultural sector. Public sector organizations operating in the agricultural space lack coordination mechanisms to enable joint action. Coordination among development partners implementing projects in the sector is also limited and unsystematic. Moreover, externally financed agricultural development projects often have greater resources than those implemented by the public sector, but short project cycles threaten the sustainability of their intended outcomes.

Private firms and entrepreneurs in the agricultural sector report that informality generates unfair competition. According to stakeholder interviews, the large informal domestic market competes under unfair conditions, because informal producers and retailers are not subject to the tax burdens, price controls, or regulatory requirements (such as food safety and sanitary controls) that apply to their formal-sector counterparts. Interviewed stakeholders report that suppliers often cancel orders from formal firms when informal competitors offer better prices. Respondents indicate that this source of uncertainty can damage their relationships with downstream market chains.

Although some progress has been made in facilitating agricultural trade through regional integration, important trade barriers persist. While Honduras has a customs union with its Central American neighbors, inconsistent and uncoordinated product registration and labeling requirements inhibit intraregional trade in agricultural products and related goods. For example, agricultural inputs registered in other Central American countries are not incorporated into the Honduran product registry, and Honduran labeling laws do not conform to regional standards. Customs processes are uncoordinated, and a two-border system remains in effect.[13]

Issues related to land tenure constrain investment and slow the expansion of agricultural producers. In Honduras, an estimated 80 percent of private rural land and 30 percent of private urban land is not properly titled.[14] Dispute-resolution processes are lengthy, and anecdotal reports indicate widespread corruption in land sales and conflict resolution.[15] Uncertainty about property ownership limits producers' access to finance from the formal banking sector by precluding the use of land as collateral and prevents the development of a stable land market.

Knowledge systems

Data limitations are a key constraint on policy and investment decisions in the agricultural sector. Honduras lacks publicly available online, up-to-date information on the performance of the agricultural sector, which undermines public policy and investment decisions. The available data are not centralized, digitalized, externally validated, or mainstreamed into institutional decision-making processes. Most agricultural knowledge organizations make limited use of ICT,[16] and the country's public and private research and development (R&D) capacity is insufficient to meet the needs of the sector. Little research has been done on improved crop varieties and livestock breeds that are suitable to local conditions, climate and disease resistant, and aligned with consumer preferences.

Extension and advisory services (EAS) are fragmented and weak. Small-scale producers have limited skills in areas such as agronomics and marketing, and inadequate human capital is a binding constraint on agricultural competitiveness. The government stopped providing mass-scale EAS more than two decades ago. Currently, multiple stakeholders provide EAS, including some government agencies, research institutions, private input suppliers and output purchasers, and various international organizations and NGOs.

Access to inputs

Limited access to high-quality inputs constrains the productivity of smallholder farmers. Using high-quality inputs is one of the most effective mechanisms to increase the productivity of smallholder farming in Honduras. However, inadequate knowledge, high prices, limited access to finance, and weaknesses in the supply chain slow the adoption of improved inputs. In the coffee sector, insufficient access to disease-resistant plants is enabling the spread of the coffee-rust blight (roya), which has severely damaged production across the region.

Regulatory barriers slow the introduction of new agricultural inputs. Honduras's regulatory framework establishes the need to register agricultural inputs before commercializing them in the country. Honduran law forbids the sale of products registered in other countries, including Central American neighbors, unless those products have been specifically authorized in Honduras, and the results of safety and quality tests performed in other countries are not accepted in Honduras.[17] However, there is no publicly available information on the varieties or products that have been authorized, leading to uncertainty among producers. Honduras shares agro-climatic similarities with other Central American countries, and the government should seek to leverage the existing Central American Technical Regulations (Reglamentos Técnicos Centroamericanos; RTCAs) to authorize agricultural inputs such as seed, fertilizer, and agrochemicals.

Access to finance

Limited access to formal financial instruments inhibits investment in the agricultural sector. Agriculture contributes almost 11 percent to the GDP, but the sector represents less than 4 percent of the total bank credit portfolio.[18] Honduras's financial-inclusion indicators are below the regional average, especially in rural areas and among microenterprises and smallholder farmers. Less than 40 percent of rural adults have a bank account, and only 10 percent borrow from a financial institution.[19] Most rural financing comes from intermediaries or nonbanking lenders, who charge annual interest rates ranging from 60 to 240 percent.[20] Most financial entities' limited understanding of and management of climate risks exacerbate a predominant hesitance to enter the agricultural finance space. The market also lacks a green taxonomy that defines green asset classes, based upon which regulatory frameworks and climate finance incentives can be built.

Honduran banks typically perceive small and medium-size agriculture firms to be unattractive borrowers. The Honduran banking sector lends on the basis of sound financial records, good credit history, and collateral in the form of real estate. Banks provide financing to large agricultural producers and exporters, usually with production units exceeding 25 hectares. However, banks limit lending to smallholder farmers because of small investment amounts; high operational costs, including onsite visits; and a general lack of financial records and collateral. Banks have little confidence in SMEs' abilities regarding climate risk management and resilience. Additionally, the banking

sector perceives regulatory demands to be excessive, and although the government has supported agricultural lending and initiated programs like Agrocrédito 8.7, banks report that the regulatory requirements involved in providing credit to smallholder farmers are excessively burdensome. For instance, banks are required to audit producers' financial statements following the same criteria, whether the requested loan is for a small amount or for US$1 million.

Rural saving banks or cooperatives are slowly expanding agricultural finance, but the finance is limited to small amounts. Over 4,000 rural saving banks and cooperatives (cajas rurales) operate in Honduras, each serving between 15 and 50 households.[21] Traditionally these institutions have suffered from a lack of funding, but under Agrocrédito 8.7 some have accessed additional capital and financed agriculture projects. However, only a minority of producers have access to a rural savings bank or cooperative, and thus far the amounts invested have not been sufficient to transform the sector. Although some rural cooperatives provide financing, integrated programs of climate-smart agriculture and financing elements are not widespread.

Underdeveloped collateral and agricultural insurance markets further constrain credit access. Land-tenure issues prevent the growth of stable markets for the sale of immovable collateral, especially agricultural land. A registry of movable collateral exists, but credit based on future agricultural output is still rarely extended. As of August 2020, movable collateral used to secure agricultural financing represented just 0.3 percent of all registered collateral.[22] The agricultural insurance market is extremely modest. Only two banks provide agricultural insurance, and their requirements are not suited to the circumstances of smallholder farmers. For example, producers must have an irrigation system in place to apply for drought insurance. These limitations disproportionately affect small- and medium-size agricultural firms, which would benefit from low-cost options provided by portfolio-level products and coverage.

Infrastructure and logistics

Inadequate water and electricity access in rural areas pose a major challenge to agricultural development. Less than 4 percent of all agricultural land in Honduras is irrigated,[23] leaving the sector vulnerable to cyclical droughts.[24] The government aims to increase the amount of irrigated land by 3,000 to 4,000 hectares via several planned irrigation projects. While this is an important step, the Ministry of Economic Development estimates that an additional 300,000 hectares could be irrigated. Limited access to costly, unreliable electricity further constrains productivity, increases costs, and erodes competitiveness, especially in more remote rural areas.[25] Expensive generators are often used to prevent product damage or losses during power outages, greatly increasing operational costs for producers of perishable commodities and processed agricultural goods.

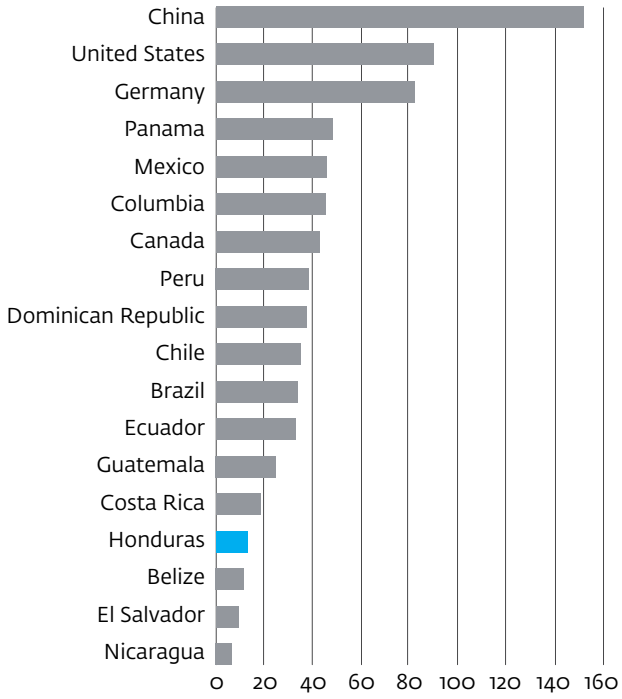
Postharvest facilities are insufficient, and some are deteriorating. Large producers and exporters have adequate postharvest facilities that conform to international standards. However, most production sites used by smaller producers lack sufficient postharvest infrastructure, including drying plants, humidity-controlled warehouses, or cold-storage installations.

Weak road connectivity and onerous transportation regulations further increase operational costs. Road infrastructure in Honduras has improved dramatically in the past five years, but road connectivity in most rural areas is poor, and many communities in mountainous regions are underserved.[26] Extended transportation times and poor road conditions damage agricultural goods, and stakeholder interviews suggest that many producers expect transportation-related food losses of over 25 percent. In addition, the authorities impose minimum prices for overland transportation, which creates a disadvantage for Honduran producers compared with their competitors in neighboring countries, as cost differentials may exceed 20 percent for equivalent routes.

Port infrastructure must be upgraded to increase agricultural capacity and enable export processing. Puerto Cortés, which is located along the north coast and through which most Honduran exports pass, is a newly developed, modern, and high-capacity port, but it is currently underutilized because of high costs. Puerto Trujillo, also at the north of the country, has good infrastructure and is mostly used for banana exports. All other seaports, as well as airports and overland transportation hubs, have serious infrastructure limitations. San Lorenzo, the country's main port on the Pacific Ocean, has low capacity, limited machinery, and few cold-storage facilities or other resources. The Tegucigalpa airport also has limited cold-chain capacity. Overland border checkpoints are unable to accelerate the movement of freight after clearance. Interviews indicate that exporters typically prefer to export goods from farm to port on the same day to avoid high storage costs and bottlenecks in their production sites during peak seasons.

Honduras's poor connectivity and cumbersome border-clearance process constrain the growth of the agricultural sector. Honduras ranks 89th out of 178 countries in the United Nations Conference on Trade and Development (UNCTAD) Liner Shipping Connectivity Index, which captures how well countries are connected to global shipping networks (figure 4.3).[27] Direct liner connectivity from Honduran ports to some key export locations is low, even by the standards of regional peers like Guatemala or the Dominican Republic. The World Bank's 2018 Logistic Performance Index ranks Honduras 93rd out of 160 countries for its overall logistics performance, below comparator countries such as Panama (38th), Mexico (51st), Colombia (58th), Ecuador (62nd), Costa Rica (73rd), and the Dominican Republic (87th). Honduras ranks particularly low on indicators of the efficiency of customs and border clearance (125th out of 160) and the frequency with which shipments reach consignees within scheduled or expected delivery times (118th out of 160).[28] Complying with border procedures takes an average of 108 hours in Honduras, double the regional average,[29] and an additional 72 hours are required to obtain agriculture-specific export documents.[30] Moreover, limited and expensive internet services in rural areas inhibit the use of online customs portals or logistics systems.[31]

FIGURE 4.3 LINER SHIPPING CONNECTIVITY INDEX SCORE, 2019



Source: UNCTAD (United Nations Conference on Trade and Development) STAT, https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=92.

Food quality and safety

Interviews with stakeholders in the public and private sectors indicate that most Honduran food production and processing infrastructure does not meet either domestic or international safety and quality requirements. Honduran food safety and sanitary regulations have improved in recent years, with the introduction of hazard analysis and critical control-point mechanisms across several value chains. However, some value chains, such as the dairy sector, are still largely unregulated or fail to meet regulatory requirements. Implementation is inconsistent, and among all but the largest producers, food production and processing facilities do not adhere to minimum safety and quality standards. Traceability is almost nonexistent, though the government has recently announced the launch of a national traceability system.[32] Laboratory capacity is weak, few types of analysis are offered, and some installations do not conform to ISO 17025 requirements.[33]

Certification infrastructure in the primary and processing sectors is limited. Producers and processors who wish to export to advanced economies need to have their products certified for quality and safety. Most primary-sector producers are required to comply with Global Good Agricultural Practices,[34] and most processors must obtain food safety management certifications like FSCC 22000. These international certification bodies are based outside of Honduras, and the nearest offices are in Costa Rica or Mexico. The lack of certification offices in Honduras adds to the operational costs of would-be exporters, who must cover the travel costs of certification agents arriving from abroad.

Inadequate branding and regulatory compliance have led to notifications and rejections of Honduran products, harming the country's image in international markets. In addition to posing serious health risks, food-safety issues can have negative reputational effects that can make a country less attractive as a trade partner. The US Food and Drug Administration reports that out of 144 food shipment lines occurring between January 2015 and June 2020, 86 were affected by misbranding (foodstuffs, soft drinks), 26 by pesticide residues (vegetables), 21 by unauthorized color additives (soft drinks), and 21 by unsanitary conditions (cheese, fruit jellies, seafood). However, the situation improved considerably after 2018, reflecting efforts by the Honduran authorities to improve compliance with international standards, but numerous issues are still being reported.[35] During the same period, Honduras received nine notifications from the European Union's Rapid Alert System for Food and Feed, three of which resulted in border rejections, while four others were considered serious cases. Two of the border rejections were due to compromised cold chains for seafood, and one involved the use of unauthorized chemicals in foodstuffs.[36]

Climate change

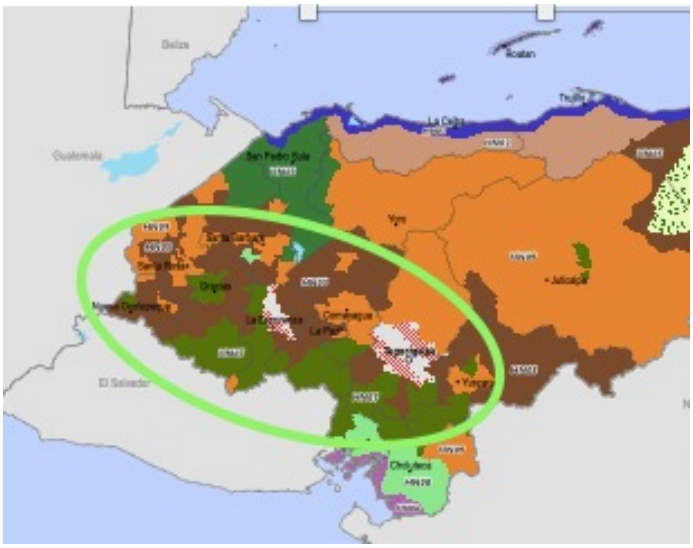
Climate change is a growing concern for the Honduran agriculture sector. Impacts from the changes in climate are observed across the country and include negative effects on hydropower production, significant effects on agricultural productivity and yields, particularly maize but also other agribusiness sectors such as shrimp production. It is expected that climate change will affect temperature and precipitation patterns—annual decreases up to 14 percent—with significant interannual changes; reductions in the southwest regions; an increase in droughts as well as floods; and a rising sea level. Honduras is highly vulnerable to extreme weather events, particularly heavy rains and drought. According to the Global Climate Risk Index,[37] Honduras was the country most severely affected by extreme weather events between 1996 and 2015, with average annual losses equivalent to 2.1 percent of GDP. Extreme weather affects a range of critical sectors, including transportation, telecommunications, health, education, and water and sanitation. Extreme weather is especially damaging in the country's dry corridor,[38] where poverty rates are highest. Furthermore, Honduras's mean annual temperature is projected to rise by 1.9°C within 30 years, with the largest increases expected in the southwest. In the northeast, climate change is expected to bring more prolonged, intense heat waves and drought, an increase in heavy rainfall and flooding, and more frequent hurricanes.

In recent decades, extreme weather events have had a major impact on Honduras. In 1998, Hurricane Mitch generated economic damage estimated around 81 percent of GDP. In 2015, a seasonal drought affected 1.3 million people, causing smallholder farmers to suffer an average loss of about 80 percent of agricultural production. In 2020, tropical cyclones Eta and Iota severely damaged key infrastructure, productive assets, land, and crops, with combined social and economic costs estimated at US$1.8 billion or 7.5 percent of 2019 GDP. Inadequate disaster preparedness and response mechanisms, limited financial protection against natural disasters, low capacity to recuperate lost assets, limited livelihood options, and a lack of basic support services undermine the agricultural sector's ability to cope with the impact of extreme weather events.[39]

Changes in crop suitability, increase of disease outbreaks, soil erosion, or complete loss of production are some of the outcomes of climate change. Climate change is expected to have negative effects on coffee production due to climate related diseases and increasing temperatures, lower agricultural productivity due to several effects, including water scarcity in some months and regions, increase in demand for water in the agriculture sector, increase in forest fires due to more frequent droughts, and lower cattle productivity.

According to CGIAR, a global food partnership focused on food security, corn, coffee and beans could suffer the most from climate change in Honduras.[40] Honduran coffee is highly vulnerable to climate change. In 2013, Roya del Cafeto (Hemileia vaxtatrix) disease affected 60 percent of coffee plants in Honduras. After that, much of the coffee park was renovated, eventually leading to higher yields. However, coffee production areas in Honduras have become drier and hotter in the past decade, increasing irrigation needs and pest vulnerability (map 4.2). Neighboring countries like Nicaragua are investing in Robusta coffee production, which is less vulnerable to climate change.

MAP 4.1 COFFEE, VEGETABLES, AND SUBSISTENCE GRAINS PRODUCED IN DRY CORRIDOR



Source: United States Agency for International Development (USAID)/Technical Unit for Food and Nutritional Safety (Unidad Técnica de Seguridad Alimentaria y Nutricional), "Honduras Livelihood Zone Map 2015," https://fews.net/central-america-and-caribbean/honduras/livelihood-zone-map/march-2015.

It is therefore imperative that climate-smart agriculture (CSA) practices, integrating agricultural development with climate responsiveness, are implemented in the sector. Climate change mitigation and resilience strategies for the government and private sector, including at the small and medium agricultural firm level, are nascent. Different adaptation strategies are needed for different crops and degrees of impact. However, some basic CSA practices can be implemented throughout the country, including no-burn, use of green manure, adoption of improved seed varieties, intercropping, and use of traditional agro-forestry methods, such as Quesungual. These practices can improve productivity and diversify income sources. Fighting deforestation is another practice that can be adopted, as it improves net carbon storage and reduces greenhouse gas emissions.[41]

For the coffee sector, CGIAR identifies a set of practices that should be adopted in Honduras.[42] Adequate varieties that meet new conditions should be carefully selected. Higher altitudes should be explored, without endangering forest systems. Shade and ground cover methods should be integrated, such as mulch, temporary shade, living edges, or windbreaks. In drought-affected areas, water-efficient methods should be introduced, including drip irrigation, water harvesting, and soil-enhancing polymers. Because the adoption of these technologies is expensive, takes time, and requires know-how, it is critical that continued financing and training are provided to sector players.

Opportunities and Recommendations

Honduras has the potential to diversify agricultural production beyond its traditional goods. Honduras has investment opportunities to increase the domestic production of imported agricultural goods, as well as opportunities to export new products to regional and global markets. Over the past decade, import demand has been increasing for a range of goods that could be produced locally.[43] These include fresh vegetables such as cabbages and other brassicas, lettuces, and herbs; staple grains; potatoes and other tubers; pumpkins and gourds; fruits such as grapefruit, watermelon, mangoes, mangosteens, papayas, avocados, and plantains; and meat, mainly poultry and small ruminants. Honduras has the potential to produce these items and others, including oriental vegetables, okra, jalapeno peppers, cocoa, cashews, crustaceans, flowers, and agro-forestry products, for both the domestic and export markets.

Honduras also has opportunities to increase value addition by improving product quality, engaging in additional processing, or developing new commercial uses for existing commodities. For instance, Honduras needs to rethink its coffee sector strategy to remain competitive and sustain livelihoods of small producers. The production of high-quality, single-origin and organic coffees to access high-end and niche markets is still relatively small in Honduras. Honduras could further improve the quality of its coffee exports by expanding its portfolio of specialty, organic, fair trade, and environmentally friendly coffees. Fruit producers could cultivate alternative varieties that generate higher margins in foreign markets. Greater processing of tilapia and other seafood items, including fresh and frozen seafood, could add value to a major export class. Increased processing capacity could also enable the production of milled grains, dehydrated or frozen fruits and vegetables, sauces and condiments, sugar derivates, and culturally specific items like local cheeses. Finally, Honduras can expand the commercial use of existing crops such as avocados by moving beyond fruit exports and using the leaves, branches, and pits, as well as the fruit, to produce condiments, cosmetics, or even energy.[44]

Government support can help investors leverage new opportunities in the agricultural sector. Under the National Agri-Food Development Program, the authorities are establishing private-public alliances with producers, processors, distributors, and service providers, as well as improving regulatory norms for the potato, onion, cassava, sweet potato, avocado, beekeeping, aquaculture (tilapia and shrimp), beans, cocoa, and oil palm value chains.[45] Under the Rural Competitiveness Program (COMRURAL), the government is enhancing rural productivity, incomes, and competitiveness and promoting agricultural exports. The World Bank Group–financed COMRURAL series (COMRURAL, COMRURAL AF, and COMRURAL II) has helped increase productivity and competitiveness among small-scale producer organizations by facilitating their engagement in productive alliances and linking them to domestic and international markets, while promoting financial inclusion. The COMRURAL series is also facilitating the delivery of technical and financial assistance to producers in the aquaculture, apiary, cocoa, coffee, livestock, fruit, livestock, staple grains, vegetables, and spices subsectors, as well as supporting the development of cultural products and rural tourism.[46] The Corredor Seco Food Security Project (PROSAUR) complements the COMRURAL series, focusing on the food and nutrition security of small farmers in Honduras's Dry Corridor.

Under the National Sustainable Rural and Urban Development Program, the government is providing capacity-building and financial assistance to rural savings banks, supporting small and medium farmers, bolstering food security, encouraging sustainable specialty coffee production, promoting the growth of rural enterprises, facilitating employment growth, increasing the availability of staple grains, and investing in renewable energy in rural areas.[47] The development of alternatives to thermal or hydro energy systems to support agribusiness development while achieving cost efficiency and increased resilience to climate change is critical. The Agrocrédito 8.8 Program has a fund of about US$120 million, from which BANHPROVI will distribute loans via financial intermediaries with annual interest rates of 8.7 percent, maturities of up to 10 years, and a three-year grace period.[48] INVEST-Honduras is supporting rural infrastructure projects in partnership with international development institutions.[49] Finally, the government is supporting the construction of new irrigation systems under the National Agricultural Irrigation Program.[50] Agriculture under irrigation is promoted to improve productivity and build climate resilience. Additional reforms designed to improve the efficiency of supply chains, enhance export competitiveness, and enable access to finance, could accelerate private investment and advance the government's objectives for the agricultural sector (tables 4.3 and 4.4).

TABLE 4.3 SUMMARY OF CHALLENGES, RECOMMENDATIONS, AND IMPLEMENTING AGENCIES IN THE AGRICULTURE AND AGRIBUSINESS SECTOR

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Firm consolidation and supply-chain efficiency			
Small-scale farming and dispersed production prevent the formation of economies of scale.	1. Improve and expand the productive alliances model. 2. Explore the possibility of expanding digital platforms to connect producers, off-takers, and end markets.	1. SAG	Short-term
	1. Support the creation of cooperatives and strengthen their commercial orientation. 2. Incentivize formalization by • Launching a public-private dialogue designed to inform a new social compact that would enhance the performance of the public sector while increasing private contributions to public revenue. • Developing worker-training and business-service programs, with special attention to vulnerable participants, and improving the regulation of microenterprises without subjecting them to taxation. • Establishing the necessary incentives and reform packages to encourage large or sophisticated informal businesses to formalize progressively.	1. SAG 2. SAG and SDE	Medium-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Export competitiveness			
Limited technical capacity weakens export competitiveness.	1. Provide improved market intelligence to farmers and build their agronomic capacity. 2. Provide training for farmers and MSMEs to gain bookkeeping and financial skills. 3. Provide training for agribusiness MSMEs in food-safety standards and import requirements of destination markets. 4. Support the adoption of irrigation systems, production models, and climate smart technologies that improve productivity and build climate resilience. 5. Explore the possibility of creating private partnerships to provide ICT-enabled extension services. 6. Unify investment-promotion efforts under one agency; publish up-to-date information for investors on the costs and availability of land and labor, as well as available incentives, local supply chains, government regulations, and procedures; gather market knowledge regarding potential investors; and participate in strategically relevant investment-attraction events. 7. Promote the upgrading of production, postharvest handling, and processing facilities to meet national and international safety and quality standards. 8. Streamline procedures for creating bonded (cold) storage capacity at ports and airports. 9. Create a more favorable environment for private laboratories and certification services.	1. SAG, DICTA, SEDUCA 2. SAG, SENASA, ARSA, ProHonduras 3. SAG, SENASA, ARSA, ProHonduras 4. SAG, SEDUCA, DGRD 5. SAG, SEDUCA 6. SAG, ProHonduras 7. SAG, SENASA, ARSA, ProHonduras. 8. SAG, SENASA, seaport/airport authorities 9. SAG, SENASA, ARSA, Pro Honduras	1–6. Short-term; 7–9. Medium-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Inadequate access to finance inhibits productivity growth.	1. Encourage private commercial banks and microfinance institutions to finance small rural producers in part by leading climate risk assessments, increasing understanding, defining a green taxonomy, and creating climate risk management frameworks. 2. Strengthen rural savings funds (cajas rurales) by providing financial assistance and capacity-building in areas such as digital transformation and by developing products such as value-chain financing and financing linked to climate-smart agriculture. 3. Encourage the private sector to finance production, postharvest handling, and processing infrastructure in compliance with international certification programs. 4. Support the development of tools to incentivize agricultural insurance; encourage private participation in agricultural insurance by addressing market and regulatory imperfections; and explore the possibility of offering public insurance for players that cannot be insured in the private market (for example, providing catastrophe reinsurance based on the models used in Mexico and Spain).	1. SAG, SDE, BCH, CNBS, BANHPROVI, private firms, 2. SAG, SDE, BCH, BANHPROVI, private firms 3. SAG, SENASA, ARSA, Pro-Honduras, SDE, BCH, CNBS 4. SAG, SDE, BCH, CNBS, AHIBA	1–2. Short-term; 3–4. Medium-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Weak governance institutions and regulatory systems undermine the efficiency of public spending and create regulatory distortions.	1. Evaluate and reform public expenditure policies for the agriculture sector and modernize the SAG. 2. Establish a long-term agriculture and agribusiness strategy and create a clearly defined state policy for the sector. 3. Assess the cost of governance challenges arising from inadequate coordination between government departments or between public agencies and other stakeholders, and create a strategy to improve coordination. 4. Improve the regulatory environment in the agricultural sector by accelerating the harmonization of national legislation with the RTCAs in areas including fertilizers and agricultural amendments (fertilizantes y enmiendas de uso agricola), certified seeds (semillas certificadas), and nutritional labeling (etiquetado nutricional). 5. Support the implementation phase of the Environmental and Social Risk Management Norm for financial institutions to build a climate-smart financing market. 6. Improve cross-border coordination and switch from a two-border control system to one or none.	1. Government of Honduras, SAG 2. Government of Honduras, SAG 3. Government of Honduras, SAG, all agencies dealing with agriculture not under SAG 4. SAG, Ministry of Foreign Affairs 5. CNBS, public and private financial institutions 6. Ministry of Foreign Affairs, Customs; SAG	1–5. Short-term; 6. Medium-term

Note: Short-term = 1–2 years; medium-term = 3–5 years. AHIBA = Honduran Association of Banking Institutions (Asociación Hondureña de Instituciones Bancarias); ARSA = Sanitary Regulation Agency (Agencia de Regulación Sanitaria); BANHPROVI = Honduran Bank for Production and Housing (Banco Hondureño de la Producción y la Vivienda) BCH = Central Bank of Honduras (Banco Central de Honduras); BCH = Central Bank of Honduras (Banco Central de Honduras); CNBS = National Commission on Banks and Insurance (Comisión Nacional de Bancos y Seguros); DGRD = General Directorate of Irrigation and Drainage (Dirección General de Riego y Drenaje); DICTA = Directorate of Agricultural Science and Technology (Dirección de Ciencia y Tecnología Agropecuaria); ICT = information and communication technology; MSMEs = micro, small, and medium enterprises; RTCA = Central American Technical Regulations (Reglamentos Técnicos Centroamericanos); SAG = Secretariat of Agriculture and Livestock (Secretaría de Agricultura y Ganadería); SDE = Secretariat of Economic Development (Secretaría de Desarrollo Económico); SEDUCA = Secretariat of Agriculture and Livestock Honduras (Servicio de Educación Agrícola, Capacitación y Desarrollo Agro-Empresarial); SENASA = National Directorate of Agricultural Health (Servicio Nacional de Sanidad Agropecuaria).

TABLE 4.4 CROSS-CUTTING REFORMS: AGRICULTURE

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Supply chains are fragmented and inefficient.	1. Complete land reforms, improve the quality of data in the land register, and digitize all agricultural land and cadastral data.	1. SAG, SDE	Medium-term
High operational costs undermine export competitiveness.	1. Improve the quality of agricultural statistics. 2. Invest in R&D capacity for crops and livestock to identify varieties that are suited to both the local ecosystem and export markets, as well as new production and postharvest handling methods. 3. Expand the public provision of extension services backed by export-market intelligence and ICT tools. 4. Upgrade laboratory capacity to meet ISO 17025 standards and expand the range of analyses offered. 5. Strengthen product quality, safety, and traceability legislation, especially in key sectors like dairy; improve compliance with HACCP norms. 6. Train the staff of quality and safety agencies in effective monitoring and control methods. 7. Invest in information platforms on quality and safety. 8. Undertake assessments of the costs and benefits of current policies, including (a) minimum prices for land transportation, (b) prohibiting mixed land transportation for imported agricultural goods, (c) mandatory importer registration, and (d) shipment-level import licenses. 9. Update agricultural input regulations and either eliminate the requirement to reauthorize products already authorized in Central America or establish a rapid, no-cost homologation procedure. 10. Streamline customs and border-clearance procedures to reduce the time and cost involved in exporting. 11. Invest in longer-term capacity development initiatives to create a new generation of R&D, extension services, and quality and safety professionals in the public sector.	1. SAG 2. SAG, DICTA, ProHonduras 3. SAG, DICTA, SEDUCA, ProHonduras 4. SAG, DICTA, SEDUCA, ProHonduras 5. SAG, SENASA, ARSA 6. SAG, SENASA, ARSA 7. SAG, SENASA, ARSA, SEDUCA 8. SAG, Consejo Nacional de Logística, IHHT 9. SAG, SENASA 10. SAG, SENASA, Customs, seaport and airport authorities 11. SAG, DICTA, SEDUCA, SENASA, ARSA, agricultural universities	1–10. Short-term; 11. Medium-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Infrastructure gaps increase costs and limit export opportunities.	1. Invest in road infrastructure and improve road access in rural areas. 2. Further expand irrigation infrastructure and provide extension services focusing on improved water management. 3. Explore PPP options for investing in postharvest infrastructure close to the sites of production. 4. Undertake an assessment of upgrade needs for IHMA storage facilities. 5. Invest in energy access and reliability in rural areas, especially renewable energy. 6. Invest in internet access and reliability in rural areas.	1. SAG, IHHT 2. SAG, DGRD 3. SAG 4. SAG 5. SAG, Ministry of Energy 6. SAG, CONATEL	1–4 Short-term; 5–6 Medium-term

Note: ARSA = Sanitary Regulation Agency (Agencia de Regulación Sanitaria); CONATEL = National Commission of Telecommunications (Comisión Nacional de Tele Comunicaciones); DGRD = General Directorate of Irrigation and Drainage (Dirección General de Riego y Drenaje); DICTA = Directorate of Agricultural Science and Technology (Dirección de Ciencia y Tecnología Agropecuaria); HACCP = Hazard Analysis and Critical Control Point; ICT = information and communication technology; IHHT = Instituto Hondureño del Transporte Terrestre; IHMA = Instituto Hondureño de Mercadeo Agrícola; PPP = public-private partnership; R&D = research and development; SAG = Secretariat of Agriculture and Livestock (Secretaría de Agricultura y Ganadería); SDE = Secretariat of Economic Development (Secretaría de Desarrollo Económico); SEDUCA = Secretariat of Agriculture and Livestock Honduras (Servicio de Educación Agrícola, Capacitación y Desarrollo Agro-Empresarial); SENASA = National Directorate of Agricultural Health (Servicio Nacional de Sanidad Agropecuaria).

4.2 LIGHT MANUFACTURING

Market Overview

Over the past several decades, the light manufacturing sector has become increasingly important to economic transformation and poverty reduction in Honduras. Honduras's light manufacturing sector emerged following the creation of the first free zone in Puerto Cortés in 1976 and the subsequent establishment of export-processing zones in the late 1980s. The sector is built on the maquila model, and it initially focused on garment assembly for the US market. Between 1995 and 2017, textile exports grew at an average rate of 6 percent per year, reaching US$3.4 billion and 30 percent of total exports by the end of the period. The sector's rapid growth made Honduras the eighth largest apparel exporter to the United States in 2018. Since the 1990s, the sector has been modernizing its productive structure and diversifying into electronics, particularly wire assemblies for the automotive industry. Maquilas currently account for over half the country's manufacturing sector and around 9 percent of GDP, providing about 167,000 direct[51] and 500,000 indirect jobs in textile production and 13,000 jobs in electronics. The sector has attracted significant FDI,[52] albeit largely in the form of reinvested retained earnings rather than new inflows. Recent reforms to the Law of Free Trade Zones are expected to spur an increase in FDI, which could generate about 15,000 new jobs. Some anticipated investments involve the production of more complex, higher-value-added goods, such as artificial fibers and car seats.

The light manufacturing sector has been among the few sources of new formal job growth, including for women, since the minimum wage increase in 2009. Between 1990 and 2006, the maquila industry substantially contributed to poverty reduction, offering wages 30 percent higher than those of other sectors, with higher-than-average rates of female employment and a smaller-than-average gender wage gap. Moreover, the maquila industry has contributed to increased gender equality by increasing female employment and labor earnings. A World Bank study found that between 1990 and 2006, maquila workers earned wages that were 30 percent higher than outside the industry. Maquila employers were less discriminatory with a 16 percentage point lower wage gap and higher levels of female employment.[53]

The light manufacturing sector benefits from preferential access to the US market and competitive lead times. The maquila industry operates under a free-trade model that exempts it from all export-related taxes, allows duty-free imports, and provides exemptions on income tax and municipal taxes for up to 25 years, providing long-term certainty around financial incentives. About 322 maquiladora companies operate in the special economic zones (SEZs) and industrial parks concentrated near Puerto Cortés, the largest and most efficient deep-water port in Central America (map 4.3). (See also box 4.1.) The port offers dedicated facilities for exports to clear US customs; it is certified by the Secure Freight Initiative; and it is the first port in Latin America to qualify under both the Mega Ports Initiative and the Container Security Initiative. Puerto Cortés is also certified by the US Custom-Trade Partnership Against Terrorism (C-TPAT), which improves its security levels and facilitates the clearance of export goods at US ports of entry. Transit times of 48 to 72 hours and efficient processing through a major port offer Honduran exporters a significant competitive advantage in the US market, especially compared to exporters in Asia, who face much longer travel times. Honduras is a member of CAFTA-DR, which has no termination date and therefore provides a degree of certainty to operators and investors regarding the long-term viability of investments in Honduras and the maintenance of its preferential ties to the largest consumer market in the world.

MAP 4.2 CROSS-CUTTING REFORMS: AGRICULTURE

Source: World Bank staff based on map from Asociación Hondureña de Maquiladores http://www.ahm-honduras.com/.

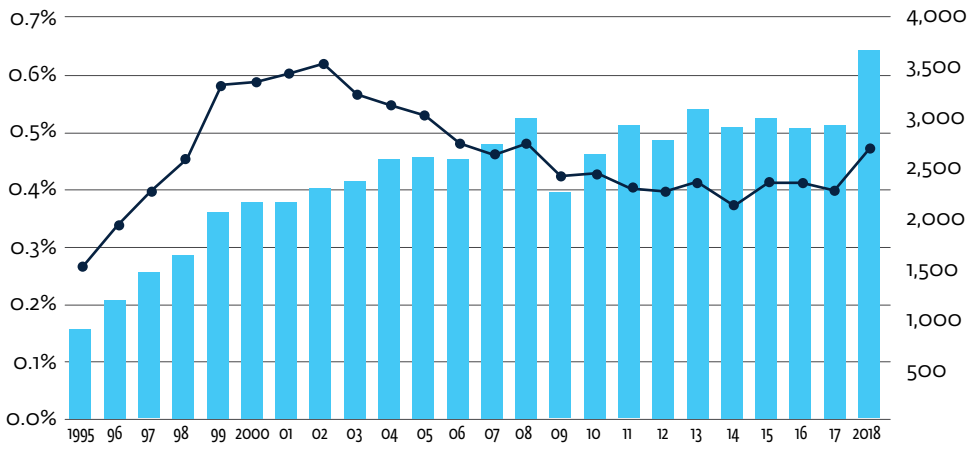
The maquila industry has invested in infrastructure and services for itself and its employees, compensating for the government's limited ability to provide public goods. The industry performs several functions that are nominally within the purview of the public sector. For example, high electricity prices resulting from the country's dysfunctional energy market have prompted many maquila firms to generate their own electricity using sources ranging from bunker or fuel oil to small-scale hydropower and biomass. To accommodate the industry's predominantly female workforce, the Honduran Maquila Association (Asociación Hondureña de Maquiladores; AHM) set up an in-home daycare program covering 9,000 children. The AHM also set up the Comprehensive Competitiveness Training Program in cooperation with the Inter-American Development Bank to help develop the workforce skills demanded by the private sector. Maquila workers are also the primary beneficiary of social housing programs organized through a public-private partnership in the context of the Honduras 20/20 strategy.

Honduran maquila workers are highly productive, which helps keep total production costs competitive. Labor costs in Honduras are broadly in line with those of peer countries, and Honduras remains competitive in low-cost, high-volume production. According to the US Department of Commerce, apparel from Honduras has the third-lowest cost per square meter equivalent (M^2E) among all US importers. In 2019, the unit cost for Honduran textiles currently stood at US$3.11 per M^2E, versus US$3.54 for Mexican textiles.[54]

While export complexity and value addition are both low, Honduras has a strong revealed competitive advantage in its export products. Export complexity in the light manufacturing sector increased modestly between 1995 and 2017, but complexity levels were persistently low among the sector's major goods, preventing Honduras from substantially narrowing the gap with more sophisticated producers. Honduras and other Central American countries compete in the production of staple apparel products, which are simple and respond to forecasted demand, as well as insulated wires and wire harnesses. Honduran manufacturers are attempting to move into more complex, higher-value-added products, such as technical textiles, sustainable fibers, and automotive parts and components. Three major projects that are currently in various stages of development will expand the country's capacity to produce synthetic fibers and garments as well as woven fabrics.

The textile and apparel subsector is crucial to the employment-creation objectives of Honduras 20/20.[55] The government aims to create 200,000 jobs by 2020 and 350,000 jobs by 2025 through product diversification into synthetic and woven apparel.[56] Textiles and apparel represent about 80 percent of the maquila industry's total production. According to the central bank's annual survey of maquilas, the industry grew by 8.2 percent, year-on-year (y/y), in 2018 and by 8.8 percent y/y in 2019, amounting to L 38,875.1 million to total output or around 9 percent of GDP. While the value of the country's textile and apparel exports has increased in the past two decades, Honduras's share of global exports has declined, on average, since the early 2000s (figure 4.4).

FIGURE 4.4 HONDURAS'S TEXTILE AND APPAREL EXPORTS AND SHARE OF GLOBAL TEXTILE AND APPAREL EXPORTS, 1995–2018



Source: Atlas of Economic Complexity (Center for International Development, Harvard University, https://atlas.cid.harvard.edu/) with export data from UN Comtrade.

Note: Textile and apparel correspond to codes 50 to 63 of the Harmonized System. World Customs Organization, Harmonized System Database, http://www.wcoomd.org/en/topics/nomenclature/instrument- and-tools/tools-to-assist-with-the-classification-in-the-hs/hs-online.aspx.

BOX 4.1 SPECIAL ECONOMIC ZONES IN HONDURAS

Honduras began processing goods for export during the 1960s, and the country established its first free trade zone in 1976. Exports based on the maquila model were initially limited to special economic zones (SEZs) located around the northern city of San Pedro Sula, which offered direct access to Puerto Cortés. The sector significantly expanded in the 1980s with the passage of a new law on export-processing zones, which attracted new investments in the textile and apparel sector and in automotive electrical harnesses. In 2013, Honduras introduced a new class of employment and economic development zones, which functioned as autonomous administrative enclaves designed to accelerate economic growth in surrounding communities. While all three models aim to attract investment by boosting competitiveness and productivity, they differ in important ways:

- **Free-trade zones can be single-enterprise units or industrial parks.** These zones focus on manufacturing, especially textiles and apparel, as well as international commerce and internet services. Manufacturing firms located in these zones must export at least 95 percent of their sales, while commerce firms must export more than 50 percent.
- **Export-processing zones are industrial parks for export-oriented firms.** Economic activities in these zones are limited to export-oriented manufacturing and complementary services. For the zone to be viable, firms that wish to locate there must demonstrate that they will create at least 5,000 jobs within five years. Firms in export-processing zones can sell goods domestically if such goods are not already being produced locally.
- **Employment and economic development zones are areas subject to special administrative jurisdiction.** These zones can host a range of economic activities in areas including finance, logistics, renewable energy, agroindustry, and tourism. Zone operators have significant control over the incentives offered. No size or occupancy requirements are imposed on employment and economic development zones.

As of 2019, there were 39 SEZs operating in Honduras, with 289 companies generating over 160,000 direct jobs. All zones provide preferential tax treatment and access to simplified trade regimes, and exporters can also participate in the temporary import regime, which was established in 1985 as an alternative exclusively for exporting firms in the manufacturing or agroindustry sectors (table B4.1.1).

BOX B4.1 SPECIAL ECONOMIC ZONES AND OTHER BENEFITS FOR EXPORTERS

	Free-trade zones	Export-processing zones	Employment and economic development zones	Temporary import regime
Tariffs	0%	0%	Not specified	0%
Corporate income tax	0% for 15 years; possible 10-year extension	Operator: 0%[a] for 20 years Users: 0% [a]	≤ 16%	0%[b] for 10 years
Individual income tax	Not specified	Regular rate	≤ 12%	Not specified
Value-added tax	0%	0%	≤ 5%	0%
Local taxes	Exempt	Operator: exempt for 10 years; Users: exempt	Not specified	Not specified

Source: World Bank staff based on relevant legislation.

Note: An entry of 0% indicates that the tax/tariff rate paid is of 0%; ≤ 16% of corporate income tax rate means that the rate charged should not exceed 16%. Unless specified otherwise, duration of the incentives is perpetual. Goods that are introduced to Honduras from any of these SEZs will pay the applicable taxes and tariffs.

a. For foreign enterprises, 0% if at country of origin there is no similar fiscal stimulus.

b. Company exports a "non-traditional" good to Central America and creates at least 25 direct jobs.

Apparel

Honduras's manufacturing value chain is dominated by the apparel subsector, which is marked by low levels of complexity and added value. After Mexico, Honduras is the region's second-largest apparel exporter to the United States. In 2019, apparel from Honduras accounted for about 3 percent of US apparel imports, with a total value of US$3 billion, reflecting a growth rate of 13 percent (y/y).[57] Among product categories, Honduras is the third-largest exporter of knitted apparel to the United States, and knitted apparel exports rose by 11 percent (y/y) to US$2.5 billion in 2019. Honduras's proximity to the United States and tariff advantages under the CAFTA-DR offer it a significant advantage relative to the other countries that are top five exporters worldwide: China, Vietnam, Indonesia, and Cambodia. The top garments exported from Honduras include T-shirts, socks, and sweaters. Knit T-shirts alone make up 16 percent of Honduras's total exports, exceeding coffee. Honduras is also a significant exporter of woven garments to the United States, though exports of woven garments are much smaller than exports of knitted garments. Honduras exported approximately US$500 million worth of women's garments to the United States in 2019, making it the 12th largest exporter to the United States in this product category. While knitted garments, especially cotton knits, continue to dominate apparel exports, investments in woven capacity have increased in recent years.

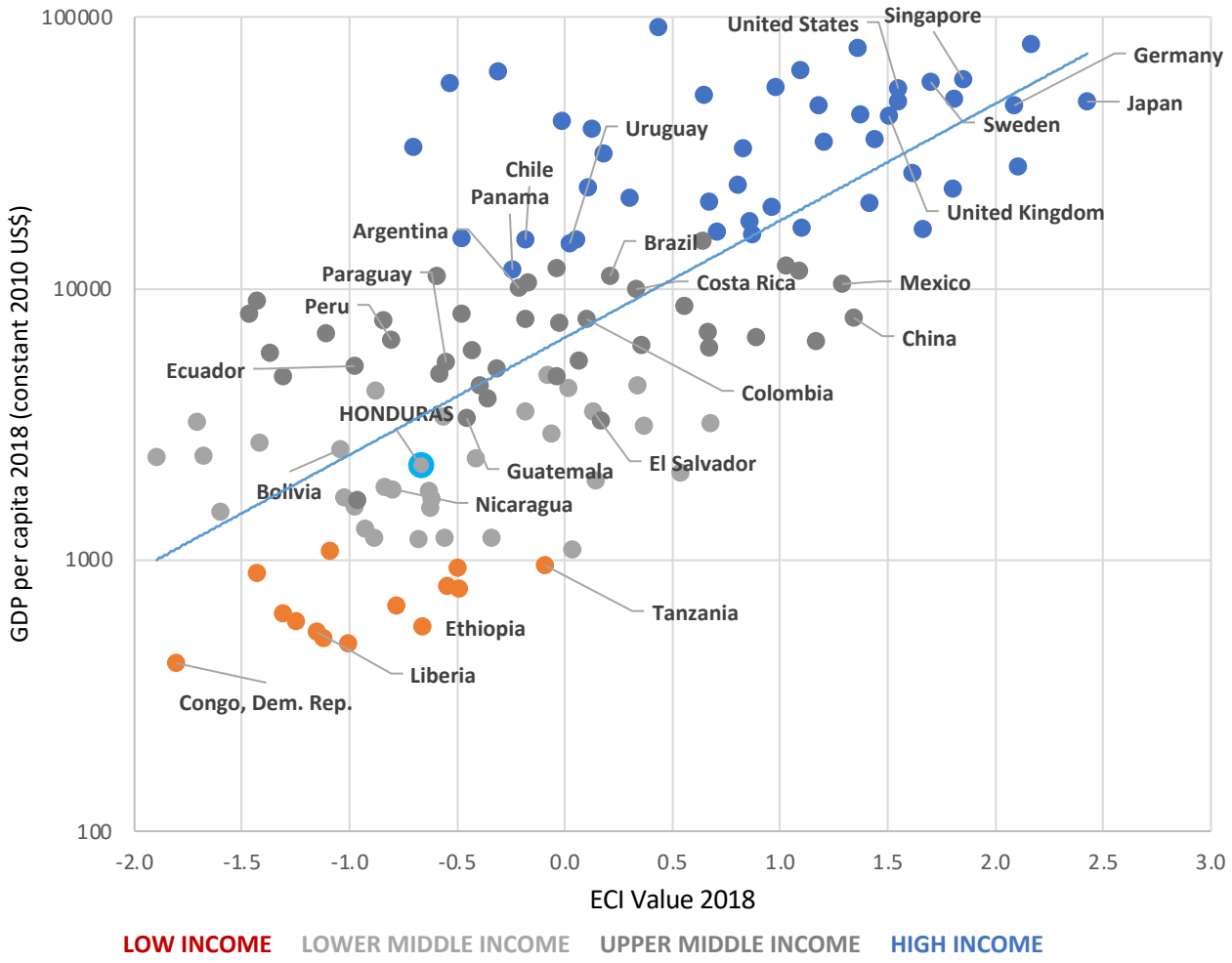
Textiles

Honduras is well positioned to build on its established base of production in cotton textiles. The country has developed its textile production capacity over the past several years, enabling it to increase its exports to regional markets such as El Salvador, Guatemala, and Nicaragua. According to AHM, 19 companies in Honduras produce fabrics for in-house use and regional export. However, Honduras remains a major importer of textile inputs. In 2019, the country was the largest importer of textile yarn from the United States at US$1.1 billion, representing 34 percent of total US yarn exports.[58] With easy access to cotton yarn and the ability to quickly turnaround finished garments for export to the United States, Honduras can further expand its cotton textile production capacity.

Honduras's capacity for woven fabrics is still relatively limited, and only a few producers of woven fabric operate in the region. Woven fabrics are more complex than knitted fabrics. While knitted fabrics are made from a single thread that is continuously looped, woven fabrics are made from two or more threads that are interlocked. Weaving looms are more sophisticated than knitting equipment, and woven textiles are more expensive to produce. Regional producers of woven textiles include El Salvador and Guatemala, but regional supply is small relative to regional demand, and an estimated 15 additional mills would be required to close the gap. With local supplies limited, woven fabrics are largely imported from China. Investments in woven textiles would help diversify Honduras's product mix and increase the economic complexity of its exports.

Honduras recently began importing artificial fibers such as polyesters, synthetics, and synthetic blends, which present a growth opportunity for the textile industry. The increased use of artificial fibers reflects shifts in demand and consumer preference, as well as the fact that synthetics-based apparel brings higher duty savings: a typical garment made of chief-value synthetics is subject to a 32 percent duty versus just 16 percent for cotton-based apparel. According to AHM data, imports of synthetic fibers have grown by about 36 percent in recent years. Synthetics are currently used only for knitted products for international sports and lifestyle brands. No factories in the region currently produce woven fabrics for outerwear or technical garments. This segment of the industry presents a growth opportunity Honduras, as domestic producers have established business relationships with major brands and retailers in this space.

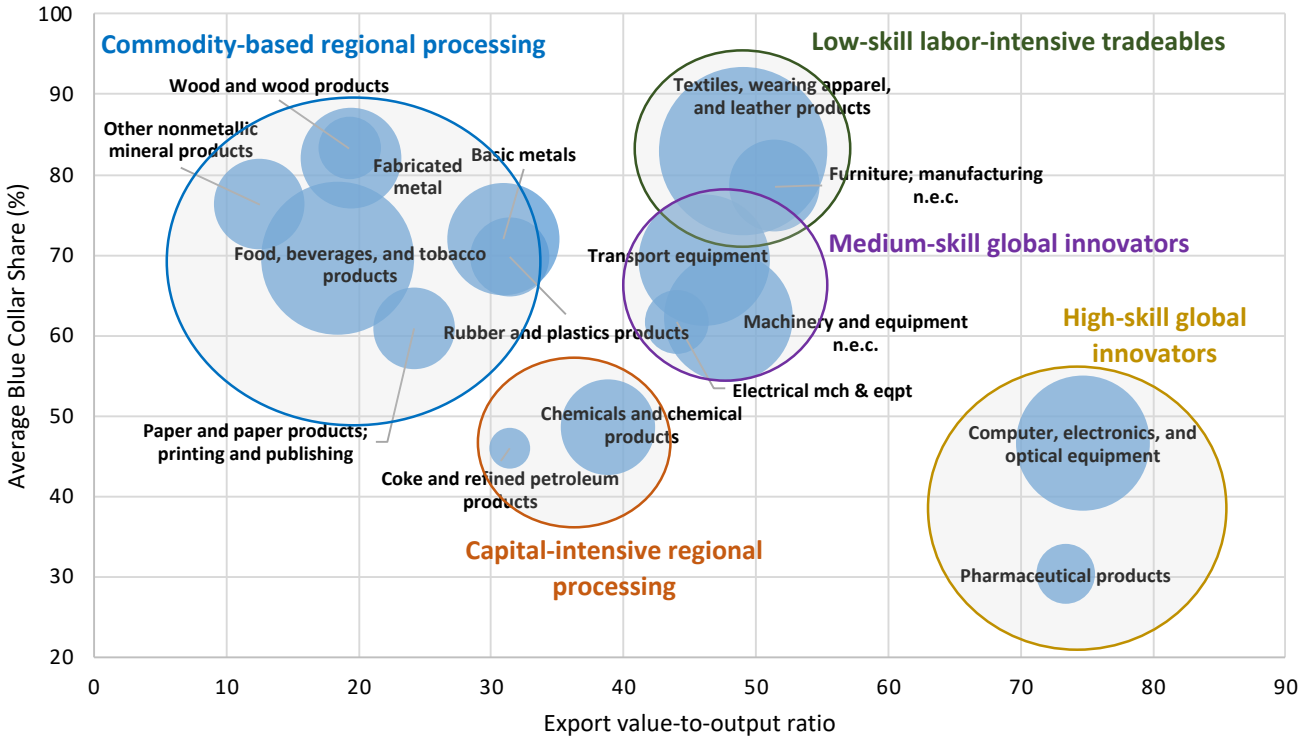
FIGURE 4.5 ECONOMIC COMPLEXITY AND GDP PER CAPITA, HONDURAS AND COMPARATORS



Source: World Bank, World Development Indicators, and the Center for International Development, Harvard University Atlas of Economic Complexity.

Note: GDP = gross domestic product.

FIGURE 4.6 MANUFACTURING SECTORS BY DEVELOPMENT CHARACTERISTICS



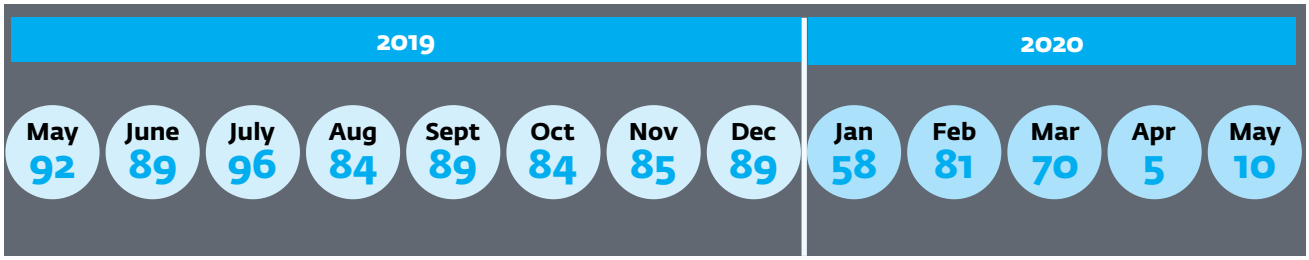
Source: World Bank staff based on Mary Hallward-Driemeier and Gaurav Nayyar, Trouble in the Making? The Future of Manufacturing-Led Development (Washington, DC: World Bank, 2018).

Note: GDP = gross domestic product; nec = not elsewhere classified.

The Impact of COVID-19

COVID has had a deeply negative economic impact on light manufacturing in Honduras. On the demand side, the downturn in the US consumer market has caused leading brands and retailers to cancel or delay orders from Honduran suppliers. Plunging demand and strict national lockdown measures prompted temporary factory closures in March 2020. As of August 2020, employment in the sector had fallen by about 18 percent, with job losses concentrated among women and low-skill workers. According to data from the central bank, maquila exports dropped by 41 percent in the first half of 2020, reflecting a nominal decline of US$896.6 million, of which apparel exports accounted for US$767.9 million. However, strong demand for personal protective equipment (PPE) boosted production to 76.6 percent of its 2019 average, by volume, in July.[59] Among the top 10 exporters to the United States, Honduras and El Salvador experienced the sharpest declines in exports, with shipments down 89 percent and 91 percent (y/y), respectively (table 4.5).

TABLE 4.5 HONDURAN APPAREL EXPORTS TO THE UNITED STATES, 2019–2020, MILLIONS M²E



Source: World Bank staff analysis based on "U.S. Imports of Textiles and Apparel," International Trade Administration, Office of Textiles and Apparel, https://otexa.trade.gov/scripts/tqads2.exe/catpage.

Note: M²E = square meter equivalent.

The pandemic's disruptive influence on global supply chains present an opportunity for Honduras, as US brands and retailers are accelerating the reshoring or nearshoring of production. Even before the pandemic, many firms were experimenting with nearshoring as part of a larger diversification strategy designed to decrease dependence on China. Honduras is well positioned to capitalize on these changing dynamics. In mid-2020, the chief executive officer of the American Apparel and Footwear Association stated, "We are going to see an evolution towards supply chains that are quicker, shorter, and more responsive. . . . We do think there is going to be a lot more production in the US, Mexico, and Central America."[60]

Production of PPE, especially masks and medical gowns, has mitigated the impact of COVID-19 on several textile factories. At the beginning of the pandemic, factories in Honduras fulfilled a government mandate to produce 9 million masks and 2.8 million gowns for domestic use. Exports of PPE, including 77 million masks, drove a rebound in maquila exports in July 2020. Given the country's experience producing disposable medical gowns, Honduras could explore opportunities to expand this product line and move into reusable garments. One company already reports that it has established a strategic partnership with a US supplier to produce reusable medical gowns. These medical gowns will be made from imported fabrics, as the necessary inputs are not available locally.

Key Barriers to Address

Poor public service provision raises operating costs and slows the expansion of light manufacturing. Much of Honduras lacks reliable and affordable infrastructure and essential public services. The light manufacturing industry is concentrated around export facilities and avoids using local transportation and logistics infrastructure, which prevents the expansion of export-oriented manufacturing within the country. Expensive, unreliable electricity is another key obstacle to the expansion of the maquila industry and especially its diversification into more complex products with higher added value. At an average of US$0.15 per kilowatt-hour, energy costs in Honduras are high by regional standards, which diminishes the competitiveness of garment manufacturers and energy-intensive textile mills. Frequent power outages compel firms to purchase expensive generators, furthering increasing costs and diminishing operational efficiency.

Some maquila companies have made their own investments in energy generation, which reduced electricity costs to an average of US$0.10 per kilowatt-hour. Firms based in industrial zones are increasingly developing their own electricity, security, transportation, and health services for workers to compensate for the inadequacy of public goods, which adds to their operating costs and deters foreign investment.

Regional customs inefficiencies slow international supply chains, reducing the advantages offered by Honduras's proximity to the US market. Despite the digitalization of customs procedures, maquila operators cite slow customs clearance in the region as an ongoing challenge. For example, a large factory in Honduras received an order to produce PPE using imported yarn from the United States. The fabric requirements exceeded the company's in-house capacity, so it produced some of the necessary fabric itself and subcontracted the remainder to seven other factories in the region. Those fabrics were then imported to Honduras, manufactured into PPE, and exported to the United States. Inefficient logistics and slow customs-clearance processes with neighboring countries greatly complicated this process, highlighting the challenges to regional integration in light manufacturing.

Limited local sourcing of raw materials constrains the industry's growth and diversification. Interviews with factory operators highlighted insufficient access to locally and regionally produced raw materials, other than cotton yarn, as a key growth challenge. Underinvestment in raw materials has led to an overreliance on imports, which limits the ability of Honduran producers to expand beyond basic cotton garments. The resulting lack of diversification leaves Honduras vulnerable to external supply shocks and foreign competition, particularly from countries that produce basic garments and have preferential access to the US market. The COVID-19 pandemic has exacerbated these constraints, and disruptions in shipments from China and other Asian countries in early 2020 delayed the arrival of critical inputs. Investing in backward linkages in the domestic and regional value chain could help insulate Honduras from future shocks and enable the country to better manage and diversify its product lines.

Increased labor skills will be necessary to support more complex, higher-value-added forms of production. The government does not offer training specific to the maquila sector, but the AHM operates the Procinco program to train maquila workers. Established in 2004, Procinco is funded through contributions from member companies. Its curriculum focuses on four major training areas: productivity, health and safety, administrative and human resources, and legislative and regulatory compliance. Beyond basic training for machine operators and other maquila employees, more advanced trainings are provided by individual factories. Most factories have indicated that 99 percent of their training is supplied in-house.

Investments in Honduras's education system will be necessary to expand the supply of training beyond what is offered by AHM. As Honduras moves up the value chain into more advanced manufacturing processes, its labor force will require training in customer relations, professional skills, and managerial and technical competencies. In Colombia, maquila companies work with a respected technical institution to offer training, and this model could be replicated in Honduras.

In addition, weak enforcement of labor regulations threatens the safety and working conditions of maquila employees and may also reduce competitiveness and increase costs due to noncompliance. While Honduran labor law closely mirrors ILO standards, the US Department of Labor has raised serious concerns regarding the quality of enforcement. Labor organizations allege that the Honduran Ministry of Labor fails to enforce labor laws in areas such as the right to form unions, the reinstatement of employees unjustly fired for union activities, the prohibition of child labor, the payment of minimum wages, limits on working hours, and occupational safety and health requirements.[61] To maintain unfettered access to US markets, the Honduran authorities must ensure that labor laws are reliably, consistently, and impartially enforced.

Access to finance at competitive terms is a significant challenge. While maquila companies generally have adequate access to finance, the average interest rate is 7.5 percent, far above the 3 percent average for regional competitors. Costly financing undermines the competitiveness of Honduran manufacturers. Expanded access to digital financial services could lower costs and facilitate the growth of smaller firms in manufacturing supply chains and clusters.

Opportunities and Recommendations

To achieve the targets of the Honduras 20/20 strategy, the authorities must address the challenges described above and create the necessary conditions to increase product complexity. Key priorities include reducing energy costs, improving the supply of basic infrastructure and services to operators in industrial parks, strengthening the business environment, and improving education and skills development. The Honduran textile and garment industry are well positioned to move beyond basic knitwear toward higher-value-added production. Honduran maquila workers are recognized for their efficiency, productivity, and work ethic, and much of the labor force already possesses the skills necessary to perform more advanced technical functions. While training in low-complexity production systems is adequate, the government and the private sector should work together to develop training in more complex operations.

Shifting consumer trends create an opportunity for Honduran producers to move from cotton to synthetic knits. Honduras can capitalize on rising demand for causal garments and the crossover "athleisure" market by boosting its capacity to produce synthetic apparel, which enjoys a larger tariff advantage than cotton-based apparel in the US market. However, an analysis of Honduras's current product mix also reveals further growth potential in garments the industry already produces, such as knitted T-shirts; men's and boy's shirts; socks; women's and girl's suits; and jerseys, pullovers, and cardigans. Honduras also has underexploited export potential in more marginal current products such as men's and boy's overcoats; sportswear and performance wear; and other polyester knitwear.

The limited supply of woven fabrics in the region highlights the opportunity for new investments in textiles mills. New mills would enable Honduras to fill the regional fabric gap in woven products. Meanwhile, diminished reliance on imports would enable Honduran producers to move more fully into woven garment production for the US market.

The development of eco-friendly solutions can be a source of competitive advantage. In the relatively capital-intensive textile subsector, adopting circular-economy solutions such as eco-industrial parks and resource-efficient production processes could help Honduras differentiate itself from its competitors. Brands and consumers that value sustainability increasingly demand garments produced through eco-friendly processes, and Honduran firms could become leaders in this market segment.

Honduras has opportunities to diversify to other markets beyond the United States. Honduras has free-trade agreements and other bilateral arrangements with over 40 countries. As Central America becomes more economically integrated, Honduras has the potential to increase fabric exports to El Salvador, Guatemala, Mexico, and Nicaragua. Other potential regional export markets include Colombia and Costa Rica. However, diversifying into the European market will be more difficult, as Europe currently makes up less than 5 percent of Honduran textile and garment exports, and Honduras does not have the preexisting economic ties or proximity advantage with European buyers that it enjoys with the United States and its regional neighbors.

Greater regional coordination will enhance regional trade and strengthen Central America as an economic bloc. Increased collaboration with neighboring countries, especially El Salvador and Guatemala, could yield efficiency gains through economies of scale. These opportunities go beyond the textile and apparel sector, and developing linkages with Guatemala in the auto-parts sector could offer an opportunity to increase vertical integration in the region and move beyond basic production.

As the US nearshoring process accelerates, and global supply chains shorten, Honduras is well placed to capture new buyers and strategic investors. Honduras can attract new FDI by creating additional "plug and play" industrial zones. Investments in raw material production, especially woven fabrics, would strengthen domestic value chains. E-commerce and direct-to-consumer marketing also offer significant growth potential, particularly in the context of a difficult US retail environment. Several factories in Honduras are already exploiting this distribution channel, albeit on a relatively small scale.

Table 4.6 lists recommendation actions to address challenges in the light manufacturing sector in Honduras.

TABLE 4.6 SUMMARY OF CHALLENGES, RECOMMENDATIONS, AND IMPLEMENTING AGENCIES IN LIGHT MANUFACTURING SECTOR

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Improving the Business Environment			
The lack of a strategic vision for light manufacturing weakens policy design.	1. Building on the Honduras 20/20 vision, develop a comprehensive strategy for light manufacturing that identifies areas for institutional capacity-building, addresses policy constraints, and fosters an organized collaborative relationship with the private sector.	1. Office of the President, SDE, ProHonduras	Short-term
Unreliable and expensive energy raises operating costs and diminishes competitiveness.	1. Identify policies to reduce energy costs and promote the adoption of efficient energy, water, and waste-management technologies. 2. Improve energy distribution and bring down the cost of electricity to improve the business environment and attract new investors, especially in the capital-intensive area of textile mills.	1–2. SEN, ENEE, IMF, World Bank Group, and donor community	Medium-term
Limited regional integration inhibits integration into global value chains.	1. Improve regional integration to better capitalize on proximity to the US market. 2. Support efforts to enhance regional integration, particularly via harmonized customs administration within the Northern Triangle to create more efficient regional value chains by reducing the time and cost involved in trading across borders.	1–2. SRE, SDE	Medium-term
Insufficient support for labor undermines human capital formation.	1. Improve the socioeconomic conditions of light manufacturing workers through a renewed focus on the quality of housing, transportation, food, and health care, especially in the main industrial parks, to ensure the long-term sustainability of the maquila industry.	1. AHM, SDE, maquila operators	Short-term
Enhancing productivity and value addition			
Limited sourcing of local raw material is a risk to the industry.	1. Encourage the development of vertical value chains to boost the competitiveness of the maquila sector. Foster a more conducive business operating environment and investment policies that enable the industry to increase its domestic backward linkages, especially to SMEs. 2. As the global textiles and apparel sector further consolidates and major US brands and retailers shorten their supply chains, create a more robust, vertical domestic value chain by strengthening linkages with SMEs to expand the economic impact of the sector beyond export-oriented firms.	1–2. AHM, maquila operators	Short-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
The production of PPE during the COVID-19 crisis has opened new production possibilities, but diversification must be sustained in a competitive global market.	1. Assist the textiles and apparel sector in exploiting PPE opportunities by encouraging investment in machinery and physical infrastructure to meet medical specifications and certifications. 2. Conduct a PPE cost-benefit analysis that (a) estimates current PPE demand in the United States and worldwide; (b) forecasts future demand, especially in the US market; (c) identifies the products, designs, machines, and raw materials that are most needed to develop this market in the medium-term; and (d) reviews the necessary manufacturing and certification processes.	1–2. AHM, maquila operators	Short-term
Increasing complexity			
More sophisticated labor skills will be necessary to move into higher-value-added forms of production.	1. Increase training capacity: Augment training available through AHM, to include more advanced technical training. 2. Training needs include specialized training for engineers, technician supervisors, chemical and dyeing engineers. As Honduras moves more fully into raw materials manufacturing, training will also be required on new machines, looms, etc., especially for wovens.	1–2. SDE, ProHonduras, AHM, maquila operators	Short-term
Limited FDI inflows slow the development of the maquila sector.	1. Strengthen investment promotion and foster new strategic partnerships to disseminate new technologies and access new segments of the global value chain by creating targeted investment missions, developing tailored investment "pitch decks," and exploring the possibility of creating a "one stop shop" for investors.	1. SDE, ProHonduras, AHM	Short-term
Limited sourcing of local raw materials increases dependence on global supply chains while reducing domestic value addition.	1. Utilize concessionary financing to promote investment in textiles mills and the production of raw materials, especially woven fabrics.	1. SDE, ProHonduras, AHM, maquila operators	Short-term

Note: Short-term = 1–2 years; medium-term = 3–5 years. AHM = Honduran Maquila Association (Asociación Hondureña de Maquiladores); ENEE = National Electricity Company (Empresa Nacional de Energía Eléctrica); FDI = foreign direct investment; IMF = International Monetary Fund; PPP = personal protective equipment; SDE = Secretariat of Economic Development (Secretaría de Desarrollo Económico); SEN = Secretariat of State in the Energy Office (Secretaría de Estado en el Despacho de Energía); SMEs = small and medium enterprises; SRE = Secretariat of Foreign Affairs of the Republic of Honduras (Secretaría de Relaciones Exteriores de Honduras).

4.3 BUSINESS-PROCESS OUTSOURCING

Market Overview

Business-process outsourcing (BPO) is one of the most dynamic and fastest-growing service sectors, both in Latin America and worldwide. BPO enables dedicated providers to supply operational support and perform other ancillary business processes for client firms, which are often based in another country. The two major types of BPO are back-office and front-office services (box 4.2). The global BPO sector grew by 13.6 percent (y/y) in 2019, reaching a total value of US$135.5 billion, and it is expected to expand by another 40 percent between 2020 and 2025. In recent years, Latin America has become a global leader in BPO, as measured by industry revenue (figure 4.7). While the BPO sectors of Central American countries are less developed than those of Brazil, Mexico, and Colombia, the 2019 AT Kearney Global Services Location Index (GSLI) ranked Panama and Costa Rica among the top 50 countries worldwide,[62] followed by the well-established BPO sectors in Guatemala and El Salvador. Emerging BPO destinations outside Latin America include Bulgaria, Romania, and the Arab Republic of Egypt.

The BPO sector in Honduras offers significant opportunities for economic growth and job creation. Honduras's relatively new BPO sector generated service exports of US$238 million in 2019, representing 17.2 percent of total services exports (figure 4.8). The sector is growing at an average rate of 8 to 10 percent per year,[63] and it employs about 20,000 workers,[64] the third-largest number of BPO workers in Central America. Large investment flows have boosted the growth of the BPO sector, especially FDI in the telecommunications industry, which has financed technological upgrades and network expansion. Mobile services companies increased their geographical coverage and diversified into cable and satellite television, as well as data transmission. The Honduran government prioritized the sector in its National Development Plan[65] owing to its rapid growth and employment potential, combined with Honduras's strong competitive advantages in labor costs, world-class BPO infrastructure, young and largely bilingual workforce, and strategic geographic location. The plan aims to increase the sector's exports to US$3.7 billion by 2025 and create 74,000 new BPO jobs between 2020 and 2025,[66] while diversifying into additional export markets such as, Canada, Colombia, and Mexico and into higher-value services such as application management and document management.

Twenty-four BPO firms are currently active in Honduras.[67] Most BPO firms operate call centers that provide customer service, telemarketing, and translation services, with a small share offering higher-value financial, administrative, accounting, and human resource services. Honduran BPO firms primarily support mobile phone services, the hotel and tourism industry, transportation and logistics, and agro-industry, with key clients based mostly in North America, followed by Europe.

BOX 4.2 BUSINESS-PROCESS OUTSOURCING SERVICES

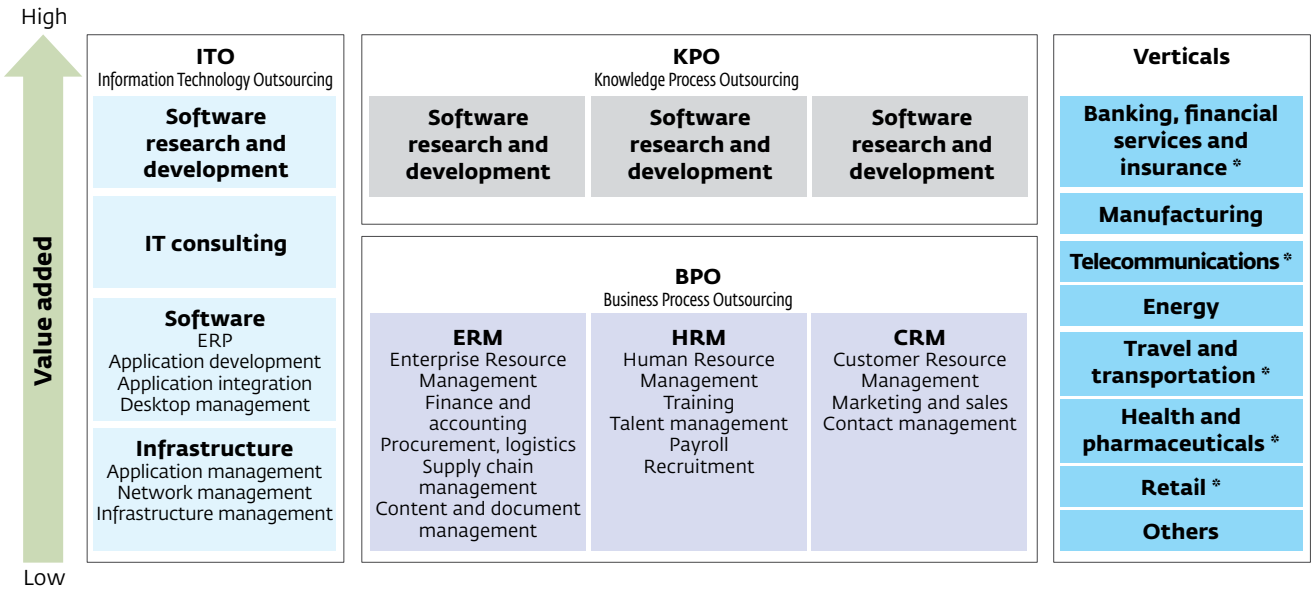
Business-process outsourcing (BPO) enables firms to augment their capabilities at a low cost by engaging a specialized firm in another country to carry out specific functions. In addition to traditional BPO services, some firms offer higher-value services such as knowledge-process outsourcing (KPO), information-technology outsourcing (ITO), and application service provision (ASP). Honduras's outsourcing sector focuses on traditional BPO services, especially call centers.

By specializing in functions that can be performed remotely, BPO providers can increase the operational efficiency of firms in a wide range of sectors. Human resources outsourcing is the largest BPO segment, accounting for 27.9 percent of the market's total value in 2017, according to the MarketLine.

Front-office BPO services include data entry, management, and analysis; surveys; accounting; and similar tasks. Back-office BPO encompasses customer relations (including call centers), email services, tech support, and other services. KPO involves information-related business activities, while ITO includes the remote provision of technological infrastructure and expertise. ASP typically involves managing subscriptions for software. While ASP is often provided in parallel with BPO or ITO, it is normally a fixed information utility rather than a type of infrastructure or business process.

Source: MarketLine, Global BPO Services, April 2018. Retrieved from https://store.marketline.com/report/ohmf3279--global-bpo-services-3.

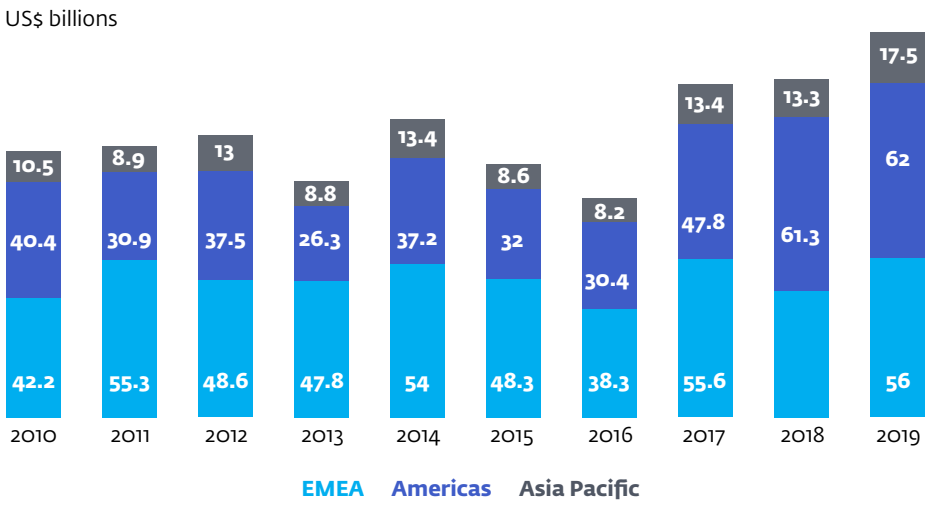
FIGURE 4.7 HIGH-LEVEL PROCESS OUTSOURCING INDUSTRY MAP



Sources: Gary Gereffi , Mario Castillo, and Karina Fernandez-Stark, "The Offshore Services Industry: A New Opportunity for Latin America" (Policy Brief IDB-PB-101,Washington, DC, Inter-American Development Bank, 2009), http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=35030707; Anna Abara and Yoon Heo, "Resilience and Recovery: The Philippine IT-BPO Industry during the Global Crisis," International Area Studies Review 16 no. 2 (2016): 160–83, https://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.876.4497&rep=rep1&type=pdf.

Note: Industry verticals identified with a (*) indicate the presence of Honduran BPO firms. BPO = business-process outsourcing; CRM = customer-resource management; ERM = enterprise-resource management; ERP = enterprise-resource planning; HRM = human-resources management; ITO = information-technology outsourcing; KPO = knowledge-process outsourcing.

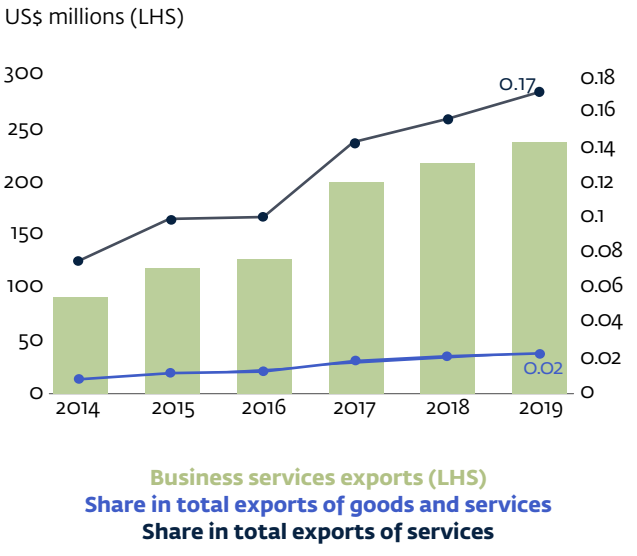
FIGURE 4.8 GLOBAL OUTSOURCING INDUSTRY REVENUE BY REGION, 2010–19



Source: Statista, Geographical distribution. Based on global, 2010 to 2019, https://www.statista.com/statistics/189795/global-outsourcing-industry-revenue-by-region/

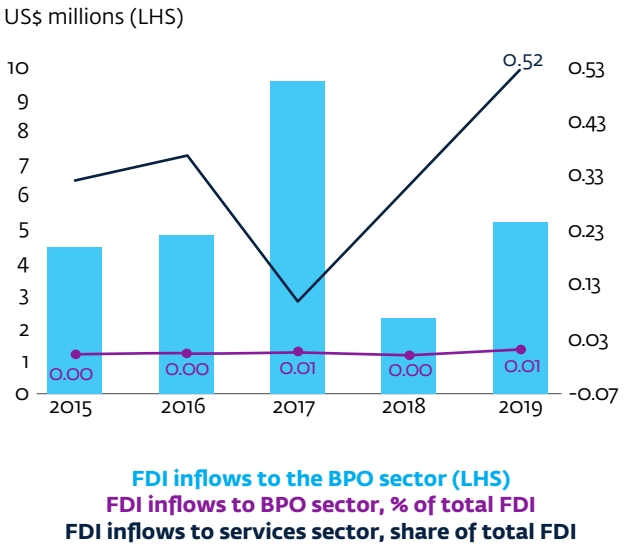
Note: EMEA = Europe, the Middle East, and Africa.

FIGURE 4.9 BUSINESS SERVICES EXPORTS, HONDURAS



Source: Business surveys and administrative tax and exchange register, the Central Bank of Honduras.

FIGURE 4.10 FDI INFLOWS TO THE BPO SECTOR, HONDURAS



Source: World Bank Staff calculations based on data from the Central Bank of Honduras.

Note: BPO = business-process outsourcing; FDI = foreign direct investment.

BPO centers are expanding their service offerings and capabilities. BPOs are concentrated in SEZs, including free-trade zones and industrial parks in San Pedro Sula and Tegucigalpa, and some are members of the AHM.[68] BPO firms based in special economic zones enjoy a preferential business regime and receive services provided by zone operators and firms, such as electricity and education. The largest special economic zone is the Altia Business Park, which was built in 2010 and is part of the AHM. Altia Business Park offers state-of-art facilities for BPO services, including office space, security, banks, a university campus, shared recreational facilities, a shopping center, and a hotel.[69] It houses more than 15 BPOs, which directly employ about 6,000 workers. The Altia complex aims for sustainability, with buildings that aspire to LEED (Leadership in Energy and Environmental Design) certification and private electricity generation using sources ranging from oil to hydroelectric. Altia provides "soft landing" services for call centers and other BPO operators, including support with the free-zone authorization process, recruiting services, legal services, communications, and building infrastructure. Grupo Karims, the developer behind Altia, has begun construction on a similar park in the free-trade zone in Tegucigalpa.

The government has adopted policies and laws to support the development of BPO exports. Major incentives include the authorized use of SEZs by BPO firms and access to favorable income tax and import tax regimes under the 2016 Law to Promote Call Centers and Business Services Outsourcing.[70] Honduras also reformed the Law of Free Zones in early 2020 to guarantee tax benefits over time, expedite compliance procedures, and ensure legal security. While the Law of Free Zones is very similar to the Law to Promote Call Centers and Business Services Outsourcing, most BPO companies prefer registering under the former because of its exemption from municipal taxes. However, there is no specific government strategy for promoting the BPO industry nor a joint strategy between the private and the public sector sectors. Moreover, there is no industry association for BPO to represent or act as a lobby for the BPO sector and support the dialogue between the public and the private sector.

Widespread English language skills and relatively lower labor costs make Honduras an attractive location for international BPO firms. Honduras has an English-speaking population of nearly 500,000, representing 6 percent of the total population.[71] Moreover, an estimated 97 percent of the population has a basic degree of familiarity with information and communication technology. Honduras has more than 700 schools and about 60,000 teachers offering English language instruction to 2.2 million students, with several schools delivering a curriculum focused on employment in the BPO sector. According to ProHonduras, each year the education system produces about 2,000 graduates who have English proficiency and are qualified to work in BPO. Many BPO firms regard the flexibility provided under Honduran labor law, which allows for hourly wage contracts as well as salaries, as a very attractive feature that helps keep costs low and adjustable to suit specific customer schedules or seasonal needs. Hourly wage rates in Honduras are close to the midpoint for Central America (table 4.7).

TABLE 4.7 AVERAGE MINIMUM WAGE IN CENTRAL AMERICA, US$

	Official minimum wage per hour	Monthly minimum wage based on 40-hour work week	Average monthly wages in the BPO sector (CPSD mission findings)
Nicaragua	0.76	181.17	285
El Salvador	1.25	253.60	300
Guatemala	1.49	366.50	350
Costa Rica	2.36	556.41	550–600
Honduras	**2.80**	**420.60**	**450**
Panama	2.81	528.00	600

Source: As of mid-2020, World Bank staff estimates based on data from the governments of Honduras, Nicaragua, El Salvador, Guatemala, and Costa Rica, as well as the Panamanian newspaper El Capital. See http://www.trabajo.gob.hn; http://legislacion.asamblea.gob.ni; http://www.mtps.gob.sv; https://www.mintrabajo.gob.gt; http://www.mtss.go.cr; https://elcapitalfinanciero.com.

Note: BPO = business-process outsourcing; CPSD = Country Private Sector Diagnostic.

The Impact of COVID-19 on the BPO Sector

Honduran BPO firms have largely adapted to remote work amid the COVID-19 pandemic. In interviews, representatives of nearly all BPO firms indicated that they had helped facilitate the transition to home-based work, including shifting call-center operations to the homes of staff and providing them with laptops or home workstations. The transition to remote work has allowed companies to reduce the costs associated with rent, security, and transportation to and from BPO offices, though some firms continue to provide transportation to essential workers who must commute to offices during the lockdown. Meanwhile, home-based workers spend less time commuting and experience reduced security risks. Moreover, Honduran BPO companies have found new outsourcing niches during the pandemic, including medical translation services for US clients.[72]

The pandemic has had a major impact on staffing and growth in the BPO industry. Employees falling ill with the virus, staff working entirely from home, delays in securing new contracts or extending existing ones, and tight restrictions on international travel all have affected BPO companies. Some firms report laying off part of their workforce.

As an increasing share of employees work from home, the lack of reliable internet access and frequent electricity outages in residential areas now pose serious risks to business continuity and service quality. Limited internet connectivity and unreliable electricity services are an especially serious challenge for workers located in small cities or rural areas outside San Pedro Sula, Tegucigalpa, and La Ceiba. Some companies have provided their employees with uninterruptable power supplies, but others continue to experience frequent service disruptions. Without the continued aggressive deployment of broadband throughout the country, the option of working from home will be limited to workers who live in or around the country's largest cities.

Honduras lacks regulations to provide guidance and support to firms during emergencies such as a pandemic, but the government has adapted the legal framework to facilitate the transition to remote work. The authorities eased the regulatory requirements for extending internet access and other communications services to support the provision of public health and education in remote, vulnerable, and underserved areas. The government also created a National Broadband Plan designed to strengthen the national telecommunications infrastructure and improve connectivity. The lockdown triggered discussions among call-center operators about the lack of regulation of BPOs' workers connecting to international customers from their homes via virtual private networks (VPNs), bypassing Hondutel or mobile carriers (appendix F).

Remote work has increased the need for robust cybersecurity measures. Technologies such as the use of virtual desktops and software-as-a-service applications can eliminate or reduce data loss, privacy violations, or other risks. However, adopting these technologies may require additional cooperation with vendors or contract adjustments. Though costly, mitigation efforts will tend to prove cost-effective given the magnitude of the risks involved.

Box 4.3 outlines challenges and opportunities that the COVID-19 pandemic has posed for the BPO sector in Honduras.

BOX 4.3 COVID-19 CHALLENGES AND OPPORTUNITIES IN THE BPO SECTOR

The COVID-19 pandemic has driven many changes in the business-process outsourcing (BPO) industry, ranging from executing disaster recovery plans to designing a continuous remote-work model that may yield permanent changes to BPO operations.

Challenges

- Lack of direct staff supervision
- Unreliable, low-capacity residential internet
- Unreliable residential power
- Lack of professional work environment
- Lack of direct customer interaction
- Greater regional and global competition

Opportunities

- Reduced facility costs
- Reduced direct operational expenses
- Faster response to changing customer demands
- Potentially greater access to different skills and competencies outside of San Pedro Sula
- Potential to be more competitive with regional and global BPO providers

During the early days of the COVID-19 lockdown, customers appeared tolerant and understanding of BPO service disruptions. This tolerance is waning within the outsourcing community, and all challenges must be mitigated or overcome through process changes, staff training, and investment in new equipment and resources.

Source: World Bank staff elaborations based on broad consultations with stakeholders in Honduras.

Key Barriers to Address

Weaknesses in telecommunications infrastructure, low rates of broadband penetration, burdensome regulatory processes, skills mismatches, and negative reputational effects inhibit growth of the Honduran BPO industry. BPO firms depend on high-performance, high-quality bandwidth, but internet access rates in Honduras are low by regional standards. While local telecommunication companies have diversified into cable and satellite services, improving the scale of internet access and data transmission, quality indicators have not substantially improved. Moreover, the national telecommunications company, Hondutel, does not promote public infrastructure sharing despite its mandate to set a higher standard for service-level agreements, invest in new infrastructure, and compete with the private sector on cost and quality. The complex, inconsistent, and slow registration process for BPO companies presents additional challenges to starting a business. Despite Honduras's relatively well-educated workforce, firms report having difficulty finding workers who can fulfill the requirements of highly skilled jobs. Finally, corruption and crime create adverse reputational effects that inhibit foreign investment in Honduras. These challenges slow the growth of the Honduran BPO sector and undermine its competitiveness.

Infrastructure

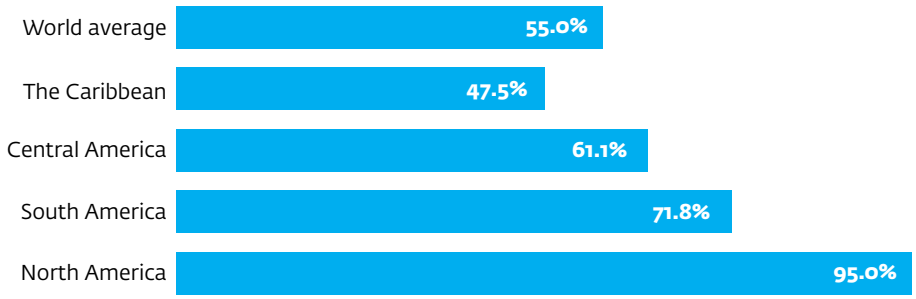
Limited telecommunication infrastructure is an especially acute constraint on the BPO sector. Telecommunications is an essential utility for BPO firms, which require high-performance connections and high-quality bandwidth. While Central America exceeds the world average in internet penetration, Honduras lags both the regional and global averages (figure 4.11 and table 4.8). The major cities of San Pedro Sula, Tegucigalpa, and La Ceiba have high rates of broadband penetration, but connectivity is limited in other areas of the country. Nationwide, only 2.66 percent of the population has access to fixed internet or telecommunications services, while 28.6 percent has access to mobile internet, primarily within the largest cities.[73] Moreover, Honduras's representative costs for fixed broadband access are above the regional average and those of other BPO exporters (figure 4.12 and table 4.9). Inadequate telecommunications infrastructure undermines the BPO sector's competitiveness and slows its growth.[74]

Honduras makes little use of the Internet Exchange Point (IXP), a cooperative agreement between the country's backbone internet service providers to interconnect and interchange internet traffic domestically rather than via international locations. An IXP is most valuable when internet content or traffic is both originated and accessed by domestic users. According to a representative from the Honduras IXP's Packet Clearing House, the IXP-HN, set up in 2015, is rarely used for domestic internet interchange, currently supports only three participants, and does not accept or facilitate new interconnections such as university systems or access networks. There is no incentive for the carriers to interconnect within the country.[75] Most data interchange likely occurs through a third party via the Network Access Point of the Americas in Miami, also known as MI1. While most home offices and applications used by BPO workers are now connected via international private lines or VPNs, some firms that primarily serve domestic customers, such as government agencies, banks, or home-based workers, may be better served by data interchange within the country.

The international telecommunications infrastructure that Honduras uses could be strengthened. Honduras is currently connected to the global internet via two submarine cables, Maya 1 and Arcos, which have capacities of 82 and 15 gigabits per second, respectively. These are generally considered the highest-quality networks in the region, and they provide near 99 percent redundancy for BPO operations. Hondutel also manages three submarine fiber-optic cable landing stations located at Puerto Cortéz, Puerto Trujillo, and Puerto Lempira.[76] All other telecommunication carriers connecting Honduran infrastructure to international resources must use the cables at these three landing stations. As most Honduran BPO firms serve a US customer base, they require access to multiple diverse cable connections to large hubs such as the MI1. Carriers and cable television operators connecting to resources within the Americas lease bandwidth capacity from Hondutel or other international carriers present at the cable landing stations. Carriers also provide satellite access to remote locations, and their capacity is adequate to connect most underserved or rural areas to the internet and other telecommunications services. Nevertheless, Honduras could benefit from improving the reliability of information technology, especially in remote rural areas.

Access to commercial-grade telecommunication infrastructure is often limited to those BPO companies operating in SEZs or large commercial areas. The large campuses supporting BPO firms and other high-tech industries have alternative communications providers at the metropolitan and smart-building level. For example, the real estate developer KATTAN provides its own fiber optic infrastructure within its properties, thus relying on larger commercial carriers to link BPO firms with international locations.

FIGURE 4.11 INTERNET PENETRATION RATES AMONG GLOBAL REGIONS, 2018



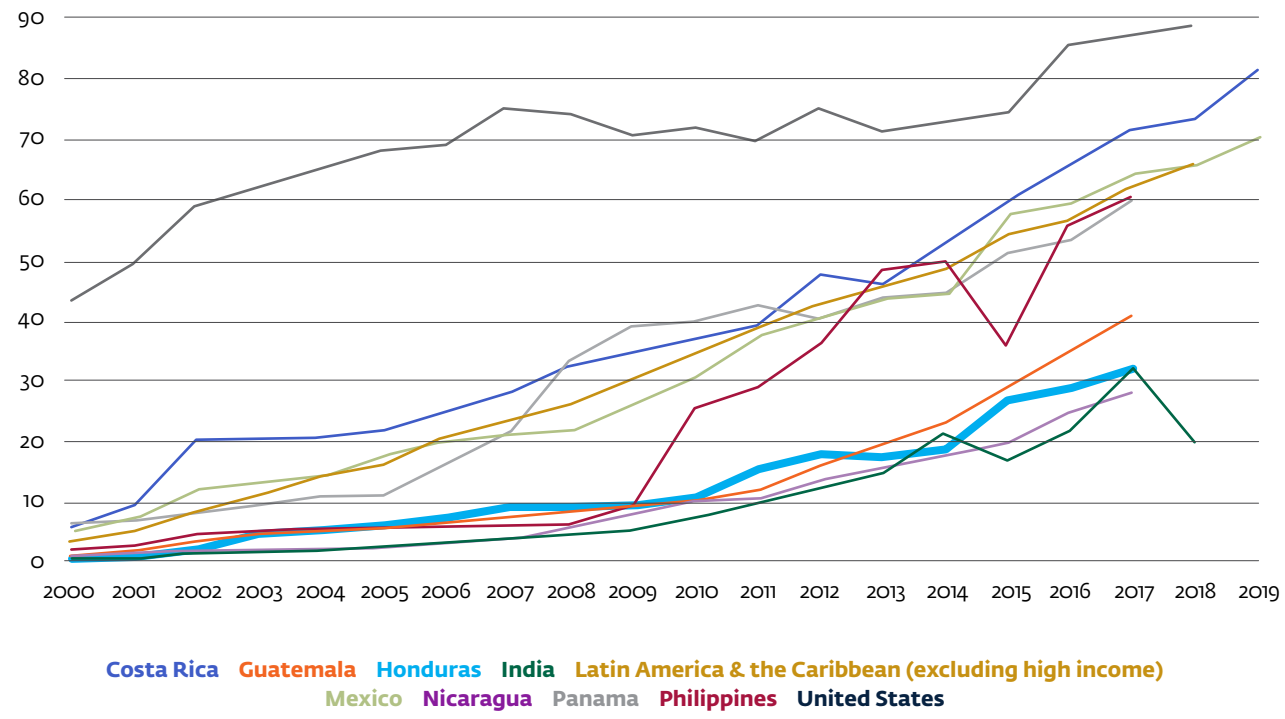
Source: Internet World Stats: Usage and Population Statistics, www.internetworldstats.com/stats2.htm.

TABLE 4.8 INTERNET PENETRATION IN CENTRAL AMERICA, 2019

	Population	Population, % of Central America	Internet users	Penetration (% of population)
	(2019 est.)		June 30, 2019	Penetration
Belize	390,231	0.20	200,020	51.30
Costa Rica	4,999,384	2.70	4,296,443	85.90
El Salvador	6,445,405	3.50	3,700,000	57.40
Guatemala	17,577,842	9.70	7,268,597	41.40
Honduras	**9,568,688**	**5.30**	**3,600,000**	**37.60**
Mexico	132,328,035	72.80	88,000,000	66.50
Nicagagua	6,351,157	3.50	2,700,000	42.50
Panama	4,226,197	2.10	2,899,892	68.60
Total	**181,886,939**	**100.00**	**112,708,598**	

Source: Internet World Stats: Usage and Population Statistics, www.internetworldstats.com/stats2.htm.

FIGURE 4.12 INTERNET USERS AS A SHARE OF THE POPULATION, HONDURAS AND COMPARATORS (%)



Source: World Development Indicators.

TABLE 4.9 REPRESENTATIVE FIXED BROADBAND INTERNET COSTS, SPEEDS AND DATA LIMITS, HONDURAS AND COMPARATORS

Fixed-broadband basket, 2019

	Residential monthly subscription	Speed	Cap per month
	US$	Mbit/s	GB
Brazil	10.92	2	Unlimited
Costa Rica	17.16	1	Unlimited
El Salvador	25	5	Unlimited
Guatemala	23.81	3	Unlimited
Honduras	**34**	**5**	**Unlimited**
India	5.16	8	Unlimited
Mexico	18.14	10	Unlimited
Nicaragua	32.19	1	Unlimited
Panama	31.95	10	Unlimited
Philippines	13.27	3	30
Spain	47.24	50	Unlimited
United States	43.54	100	1024

Source: Martin Schaaper, Measuring Digital Development: ICT Price Trends 2019 (Geneva: International Telecommunications Union, 2020), https://www.itu.int/en/ITU-D/Statistics/Documents/publications/prices2019/ITU_ICTpriceTrends_2019.

Note: Mbit/s = megabits per second. GB = gigabyte.

Most of the BPO firms serving clients in the United States use an extension of the US dialing plan, which increases service costs because of both performance issues and the additional consumption of internet bandwidth and other communications resources. Honduran firms appear to use expensive and limited telecommunications resources such as the MI1. BPO firms that use VPNs effectively contract leased lines from an international carrier to connect with a domestic telecommunications company such as Hondutel, Cable and Wireless, Tigo, or Claro. Using VPNs could increase latency, add additional potential points of failure, and reduce the overall bandwidth available to operator, thereby raising costs.

Regulatory Environment and Market Competition

The National Commission of Telecommunications (Comisión Nacional de Tele Comunicaciones; CONATEL) does not promote public infrastructure sharing with the private sector. Although Hondutel, a government entity that is a primary fixed-line provider within Honduras,[77] is explicitly authorized to share public infrastructure with private firms, it has proven reluctant to do so. As competition intensifies, Hondutel faces increasing challenges from private firms, and Hondutel representatives have expressed concerns regarding its ability to meet the higher standards set by service-level

agreements with its customers. This limits the innovation, utility, and service-level agreements available to users, which in turn could also discourage international client companies from establishing a business presence in Honduras. CONATEL does not appear to be providing incentives or a strategic plan with measurable objectives to improve the state of broadband or service utility. The regulatory environment should be improved in Honduras to further promote competition, obligate operators to share their infrastructure, and lower broadband prices.

A slow and complicated registration process for BPO firms appears to cause delays and increase business costs. Representatives of BPO companies describe the registration process as burdensome, confusing, and inconsistent. Local governments reportedly add additional registration fees, arbitrarily modify procedures, and create new requirements for BPOs operating domestically. To overcome the challenges of the registration process, BPO companies hire local legal, consulting, and accounting firms.

Educational services do not confer the skills demanded by the private sector necessary to compete in digital business world. BPO firms report that the education providers are not aggressively invested in technology-related skills such as telecommunications infrastructure and cybersecurity or key business competencies such as risk management and corporate governance. There are ample graduates with English language training; however, specific technical skills training is limited. Some education programs for technical skills are available through the National Institute of Professional Training (Instituto Nacional de Formación Profesional; INFOP) and the Central American Technological University (Universidad Tecnológica Centroamericana; UNITEC), which also have satellite campuses near SEZs and business districts. The United States Agency for International Development (USAID) helps young entrepreneurs in Honduras through the Young Leaders of the Americas Initiative. However, professional information technology (IT) training such as governance, IT risk management, and enterprise architecture are not available at local universities and are typically acquired overseas. Honduras's workforce may fall behind those of other countries that are aggressively investing in the skills necessary to compete in a highly automated digital business world. Some larger BPOs are offering internal training programs to close the skills gap.

Other challenges

An unreliable and expensive electricity supply poses risks to business continuity and increases operational costs. The BPO industry has adapted to the poor quality of public services by installing backup generators. For BPO companies, landlords, and real estate developers operating in SEZs or in some modern buildings, backup power is available through diesel generators.[78] Some landlords, such as KATTAN, generate their own energy in their real estate developments using a combination of solar panels and storage devices such as Tesla Batteries or other industrial power supplies. BPO firms such as IASSA and AVANZA[79] have invested in their own power-generation capacity. However, the unreliable public electricity supply is hindering work-from-home operations. The government has acknowledged the challenges facing the electricity sector, noting that unreliable power may inhibit the growth of the BPO industry.

Corruption is cited as a significant obstacle to investment in the BPO sector. BPO firms report corruption and difficult relationships with government officials as a routine element of doing business in Honduras. Businesses also frequently report corruption in the public administration and the judiciary.

Persistent security challenges discourage international investment. Even though the homicide rate has declined by nearly 50 percent since 2011,[80] Honduras is still high on the World Bank's Global Homicide Rate Scale, close to Belize, El Salvador, and Jamaica[81] International investors still perceive Honduras to be unsafe and a very risky space for investment. While many BPO firms are located in SEZs or modern campus facilities with high security, crime and violence pose serious risks to employees who must commute to work through dangerous areas. The annual cost of private security accounts for an estimated 10 percent of the country's GDP. Private-sector stakeholders continue to urge the government to take a more active role in improving the security situation and the country's image in the international community.

Opportunities and Recommendations

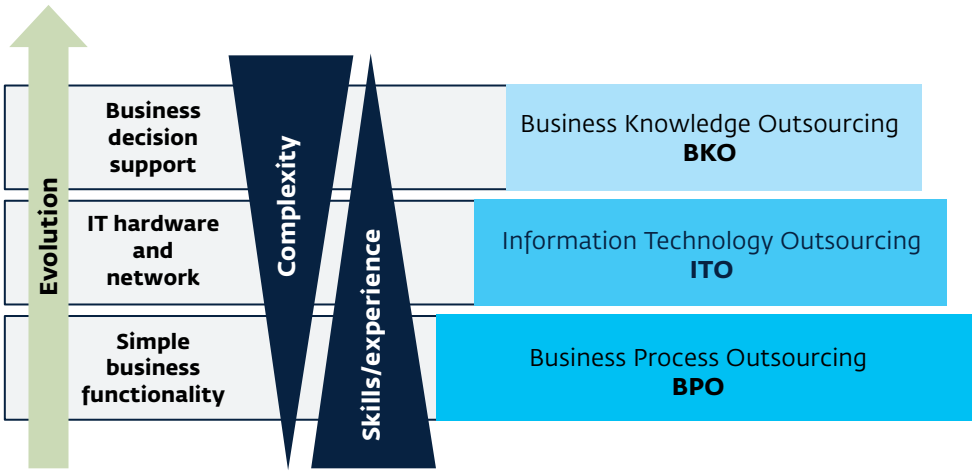
Honduras continues to be an attractive destination for international BPO, especially call centers. According to the 2012 Caribbean and Central America BPO and Contact Center Report,[82] business projections show that every 1,000 contract workers employed in the BPO sector generate between US$15 and US$20 million in export revenue. The BPO sector has considerable formal employment potential, especially for younger workers, who represent about one-third of the population and who tend to be most proficient at acquiring new technological competencies. However, to sustain its competitive edge in a rapidly evolving global economy, Honduras must invest in workforce skills. The Honduran BPO sector cannot compete on wages indefinitely, and the value of staff with greater digital and analytical skills is rising worldwide.

However, global competition, automation, and the increase of cyberthreats will compel BPO companies to adopt new business models and services. Over the coming decades, disruptive technologies such as robotic process automation are expected to assume many of the functions currently performed by BPO workers. Call center agents are at especially high risk of job losses due to process automation, as their functions are more easily automated than others. The automation of finance and accounting jobs could also result in indirect employment losses among providers of BPO services to these fields. Moreover, the increase of cyberthreats and the lack of a strong cybersecurity ecosystem in Honduras (from its regulatory framework to human resources) poses a possible threat to the BPO industry and its ability to compete. Labor markets that cannot adapt to meet the changing needs of businesses will become less attractive destinations for investment.[83] Call centers are an especially vulnerable BPO segment, and Honduras cannot afford to take their competitiveness for granted. To mitigate these risks, BPO firms will need to train their workers to perform more complex knowledge- and technology-intensive tasks.

The existing skills mismatch in the Honduran labor market could present opportunities to add new high-value services to the portfolios of BPO firms. Most BPOs recruit overqualified candidates with university and graduate degrees as entry-level call center agents because of a lack of sophisticated jobs in other industries, such as banking and health care.[84] This surplus of highly educated workers could enable BPO firms to create new business lines in knowledge-intensive areas. Some BPOs' staff onboarding process includes a career planning interview to determine the candidate's job objectives and professional ambitions.[85] These interviews give managers insight into what would motivate new hires to continue their professional development, enabling them to create new career paths and ultimately expand their range of professional services. BPO firms

report that Honduran staff are easily trained in new technologies and business practices. At present, the model of continuous learning and in-house professional development is not widely implemented in Honduras, where a majority of the BPO jobs have limited career potential, but it offers a valuable opportunity for the BPO industry to grow and innovate (figure 4.13).

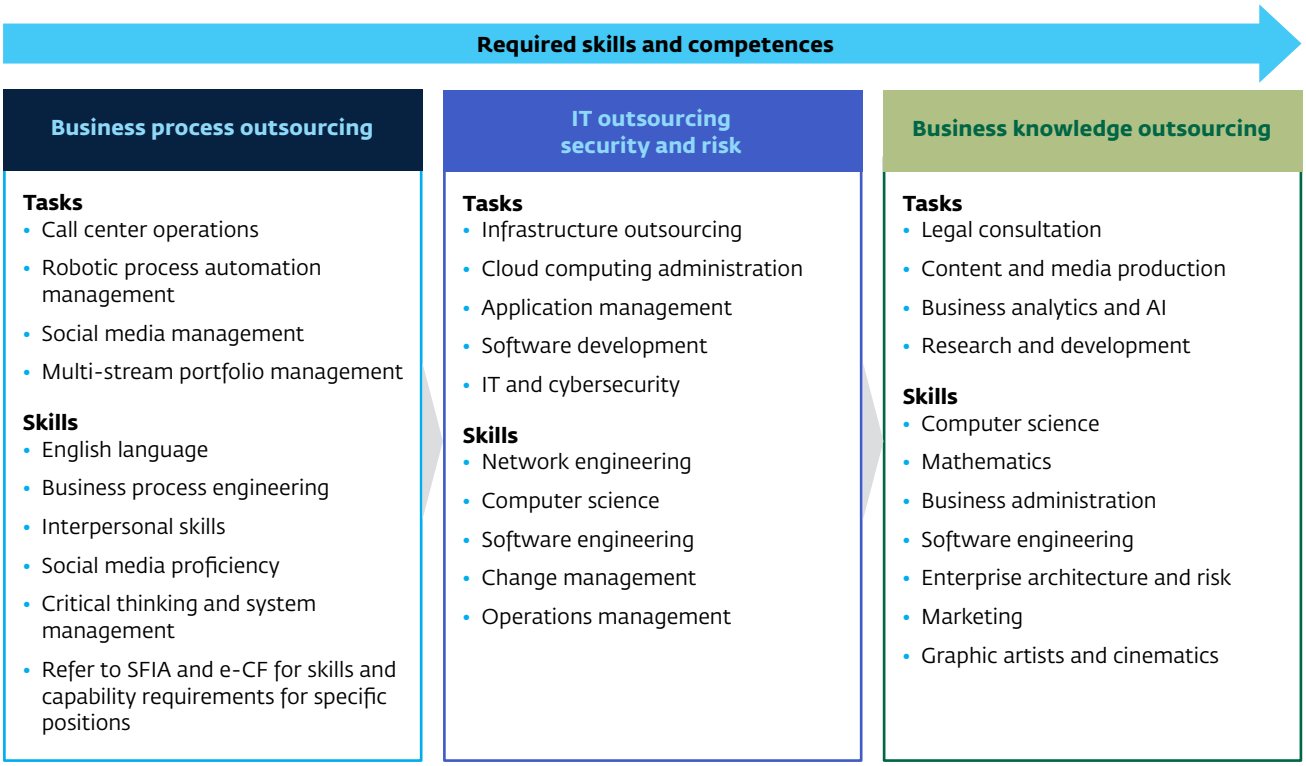
FIGURE 4.13 BPO INDUSTRY EVOLUTION AND SKILLS-DEVELOPMENT PLANNING



Source: World Bank staff based on Heiko Gewald and Jochen Franke, "IT-Outsourcing vs. Business Process Outsourcing Same Risky Business?" (PowerPoint presentation, E-Finance Lab, University of Frankfurt), http://www.wi-frankfurt.de/publikationenNeu/ITOutsourcingvsBusinessProce1127.pdf.

Over the longer term, the BPO industry must provide more value to its clients by developing the capacity to rapidly implement increasingly sophisticated outsourcing strategies. Currently, Honduras offers firms a low-cost pool of English-speaking call center operators, but it lacks the service capabilities of many Asian competitors.[86] As business processes evolve, BPO firms will need to meet rising customer expectations by cultivating a tech-savvy workforce with sophisticated knowledge and expertise. As global corporations increasingly outsource automated services, analytics, and visualization, BPO firms will need workers trained in coding, integrated information systems, and artificial intelligence, among other advanced competencies. While most current BPOs in Honduras focus on call centers and customer service, several companies[87] are transitioning into more complex and greater ITO and KPO services, including (a) inbound and outbound sales; (b) technical support; (c) logistics and freight management; (d) business intelligence; (e) social media content moderation; and (f) information management (figure 4.14).

FIGURE 4.14 SKILLS DEVELOPMENT IN THE BPO SECTOR



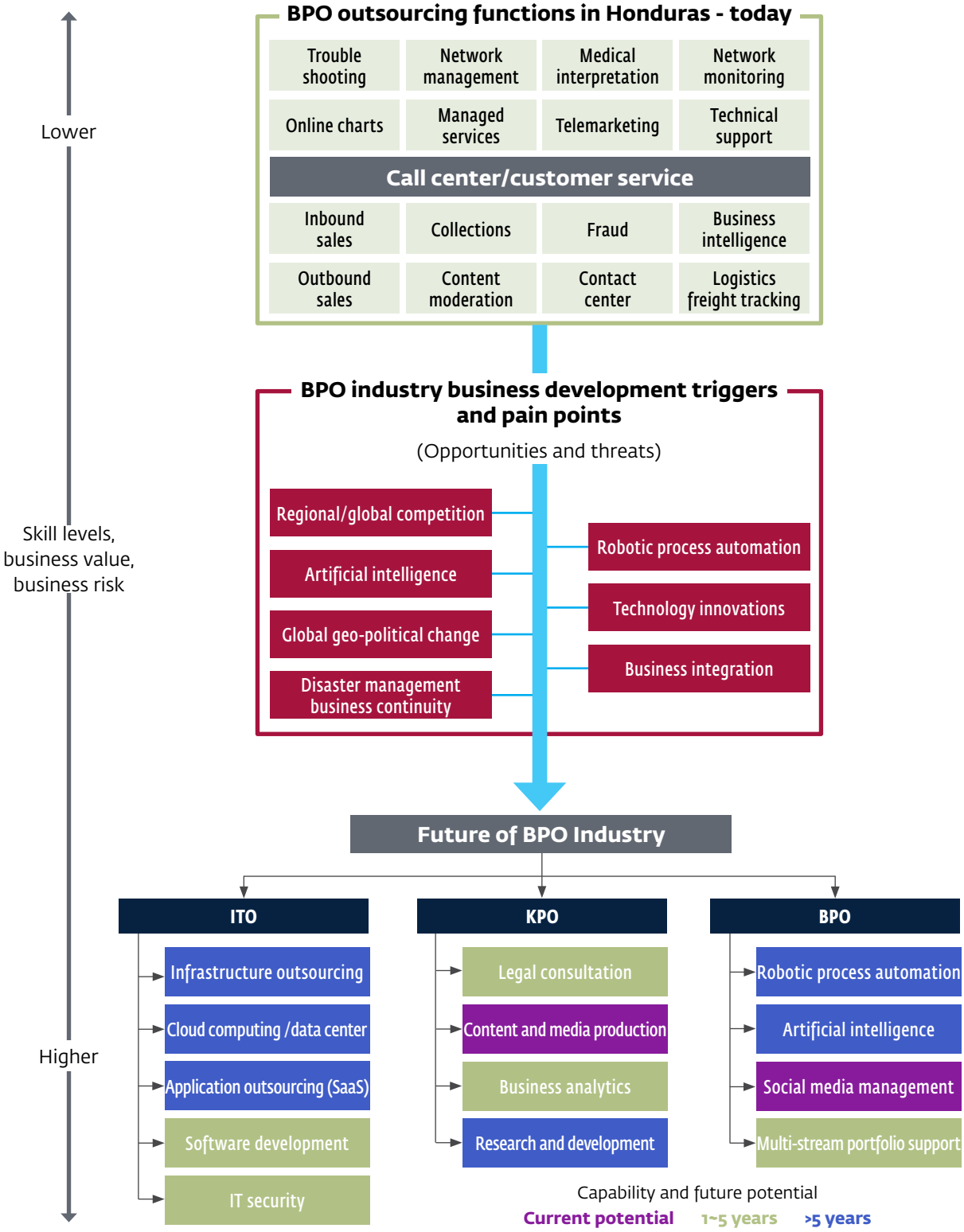
Source: World Bank Group staff based on K. Fernandez-Stark, P. Bamber, and G. Gereffi, "The Offshore Services Value Chain: Upgrading Trajectories in Developing Countries." International Journal of Technological Learning, Innovation and Development 4, no. 1/2/3 (2011): 206–34.

Note: BPO = business-process outsourcing; IT = information technology; SFIA = Skills Framework for the Information Age; e-CF = European e-Competence Framework.

The government can play an important role in fostering an innovative business environment. Collaboration between the public and private sectors can identify the skills, competencies, laws, and policies necessary to drive the growth of the BPO industry. For example, the Honduran government could partner with organizations such as the Association for Computing Machinery and the Institute of Electrical and Electronics Engineers Computer Society to implement the Computing Curricula 2020.[88] Subsidies or cash incentives to fund education services and procure training materials and technologies could further benefit the BPO industry's development. The government could support domestic start-ups by offering dedicated entrepreneurship training and creating technology incubators or training programs to address training gaps.[89] Finally, reverse trade missions could create additional incentives and market the Honduran BPO sector to foreign investors and potential clients by enabling SEZ operators, academic institutions, current BPO firms, and government officials to offer a more complete picture of the advantages Honduras has to offer.

Honduras has potential to present a robust value proposition to international companies by offering appealing incentives and programs. Given an appropriate enabling environment, BPO companies will be able to: (a) transition into higher-value services; (b) collaborate with the government and the academic community to develop a coordinated education plan; (c) incorporate new technology; and (d) create a BPO industry association to represent the sector's interests, both domestically and worldwide (figure 4.15).

FIGURE 4.15 THE TRANSFORMATION OF THE BPO SECTOR



Source: WBG staff, based on the interviews and surveys conducted during the Country Private Sector Diagnostic mission.

Note: BPO = business-process outsourcing; KPO = knowledge-process outsourcing; ITO = information-technology outsourcing; SaaS = software as a service.

The recommendations in table 4.10 could be considered when establishing new laws, incentives, development programs, and cooperation between the BPO sector and the government. 4.4 Digital Financial Services for MSMEs

TABLE 4.10 SUMMARY OF CHALLENGES, RECOMMENDATIONS, AND IMPLEMENTING AGENCIES IN THE BPO SECTOR

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Telecommunications infrastructure			
Insufficient bandwidth prevents the operation of large call centers (>500 operators) or call centers located outside of major industrial parks.	1. Enable CONATEL to promote the construction of fixed-line and cable distribution by streamlining the licensing and approval process, including the regulations associated with passing infrastructure through individual municipalities, and providing additional incentives to competitive carriers.	1, CONATEL, private tele-communications firms	Short-term
Undiversified telecommunications infrastructure and a lack of failsafe mechanism and redundancies heightens the risk that a single point of failure could cause a major service disruption.	1. Support CONATEL in developing a shared-infrastructure policy for long-distance and metro conduit access, and encourage the further sharing of electrical towers, telecommunications towers, and interconnection points to rapidly deploy high-performance broadband infrastructure, including via partnerships with ENEE and other utilities and service providers. Release state-owned telecommunications resources operated by Hondutel to expand shared-use infrastructure. 2. Establish the long-distance easements and rights of way needed to further extend high-bandwidth infrastructure throughout urban centers and in outlying residential areas. 3. Further promote the development of telecommunications infrastructure and encourage competition in underserved or low-performance areas and regions.	1. CONATEL, ENEE, other public utilities,private domestic and international tele-communications firms 2. Government of Honduras, ENEE or other utilities or public service providers 3. CONATEL, COPECO, private tele-communications firms	Medium-term
Poor telecommunications service quality and unreliable data networks inhibit remote-work arrangements.	1. Continue to develop and expand the National Broadband Strategy; require that CONATEL establish quality of service standards and a program to test telecommunications performance and quality; and create incentives to invest in areas that do not meet performance standards for subscriber bandwidth and quality. 2. Support the development of mobile coverage in rural areas by studying the feasibility of creating a wholesale open access network and introducing a third mobile operator.	1–2. CONATEL, Hondutel, private tele-communications firms	Short-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Bandwidth in urban areas is low due to the use of outdated ADSL infrastructure in areas that lack cable TV services with internet options (that is, CATV/DOCSIS).	1. Share telecommunications infrastructure operated by Hondutel, such as electrical towers, telecommunications towers, metro and long-distance conduit, and interconnection points, including via partnerships with ENEE and other utilities. 2. Better regulate wholesale tariffs to lower the retail cost of bandwidth and encourage the establishment of new ISPs and support the emergence of ISPs by stimulating investment in fixed-line infrastructure for high-speed broadband.	1. CONATEL, ENEE, private tele-communications firms 2. CONATEL, international tele-communications firms such as UFINET	Medium-term
Limited use of the domestic interconnection point (IXP-HN) likely increases latency, adds additional potential points of failure, reduces the available bandwidth, and raises costs due to both performance issues and the consumption of additional internet and communications resources; weak domestic service quality has negative implications for domestic service firms and remote workers.	1. Enable CONATEL to encourage internet and telecommunications network providers to utilize the IXP-HN free of charge.	1. CONATEL, private tele-communications firms, and ISPs	Short-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Hondutel controls access to submarine cable heads, reducing the flexibility of private operators to access submarine cable capacity and inhibiting their ability to provide end-to-end services without interventions or delays by Hondutel.	1. Authorize CONATEL to allow foreign and domestic international telecommunications networks to establish a presence in Hondutel-operated cable landing stations. 2. Allocate the additional sub-1 gigahertz spectrum to all market players and license a new entrant to increase competition and investment in the sector.	1–2. CONATEL, private tele-communications firms	Short-term
Routing interconnections via NOTA in Miami raises the risks of a single point of failure causing a major service disruption.	1. Promote investment in additional international fiber-optic links, including terrestrial and submarine cables, and encourage private telecommunications companies to build and operate gateways and cable landing stations.	1. COPECO, CONATEL, private tele-communications firms	Medium-term
Electricity quality and stability			
Frequent power outages compromise business continuity, increase costs, and weaken competitiveness.	1. Ensure that BPO companies backup power supplies provided by either the facility landlord or another BPO company. 2. Encourage firms to equip remote employees with backup power sufficient for at least two hours of computer and home internet service. 3. Mandate that telecommunications providers install infrastructure that will minimize or eliminate network outages due to blackouts. 4. Reform the energy sector to strengthen electricity generation, transmission, and distribution; minimize electricity losses; control costs; and reduce the frequency of power outages.	1–2. Government of Honduras, private BPO firms 3–4. Government of Honduras, ENEE, CNE	1–2. Short-term 3. Short-term 4. Medium-term
BPO registration			
Registration processes for BPO firms are complicated and time-consuming.	1. Simplify the registration process for BPO firms, and harmonize BPO registration with the requirement of the Law of Free Trade Zones.	1. Tax authority, CONATEL, AHM, ProHonduras, Chambers of Commerce, international agencies	Short-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
The AHM assists maquila companies with registering under the Free Trade Law, but no comparable organization supports the BPO industry.	1. Establish a BPO trade lobby and support organization along the lines of the AHM.	1. Private BPO firms	Short-term
Market risk and BPO sector growth			
Technological advances, including automation, may drive a gradual decline in the demand for call centers. The increase of cyberthreats poses a threat to the BPO industry and its ability to compete, due to the lack of a strong cybersecurity ecosystem in Honduras.	1. Review market trends to forecast the impact of automation on the BPO sector and define a strategy to maintain employment in a context of ongoing technological change. Develop a strong cybersecurity ecosystem in Honduras (from its regulatory framework to human resources).	1. Office of the President, ProHonduras, CONATEL, Ministry of Education, UNAH/Unitec/ INFOP, private BPO firms	Medium-term
Global demand is shifting toward more sophisticated BPO services (for example, ITO and KPO), and Honduras's BPO sector may not be prepared to participate in these markets (including due to lack of high-skilled technical workforce with high-value-added skills).	1. Assess the competitiveness of the domestic BPO sector in ITO and KPO services and develop a plan to either pivot away from BPO or work with private sector and academic community to begin developing the necessary skills and infrastructure to compete in global markets for more sophisticated BPO services.	1. Private BPO forms, ProHonduras, Government Innovation Office, Ministry of Education	Medium-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Honduras lags its regional and global peers in the growth of the BPO sector and has struggled to attract investment from international BPO companies.	1. Ensure that ProHonduras partners with agencies such as the American Chamber of Commerce to increase efforts to highlight the attractiveness of Honduras as a location for BPO, and coordinate with the World Bank and other multilateral institutions on post-COVID-19 trade missions to the United States or other countries to raise Honduras's profile in FDI source markets and BPO export destinations. Prepare BPO sector development strategy, potentially building on the Honduras 20/20 plan.	1. ProHonduras	Short-term
COVID-19 response			
COVID-19 restrictions have prevented employees from working in large call centers and other facilities, and not all BPO firms have a published operational continuity plan designed to ensure that they continue functioning in the event of a disruption or crisis.	1. Encourage BPO firms to implement remote-work arrangements whenever feasible; assist BPO staff to acquire the connectivity necessary for remote work; and develop new operational-continuity processes and skills standards.	1. Private BPO firms, AHM, COPECO	Short-term
The pandemic has hindered marketing efforts designed to attract new business to Honduras.	1. Consider adopting new marketing and sales models that support remote-work arrangements among BPO firms.	1. Private BPO firms, ProHonduras	Short-term
Companies have been forced to lay off staff due to pandemic-induced disruptions in their operations.	1. Accelerate the adoption of strategic broadband deployment plans by CONATEL and the government that would enable BPO companies to continue offering services via remote work.	1. Private BPO firms, COPECO, CONATEL, Government of Honduras	Medium-term

Note Short-term = 1–2 years; medium-term = 3–5 years. ADSL = asymmetric digital subscriber line; AHM = Honduran Maquila Association (Asociación Hondureña de Maquiladores); BPO = business-process outsourcing; CATV = cable television operators; CNE = The National Energy Commission (Comisión Nacional de Energía); CONATEL = National Commission of Telecommunications (Comisión Nacional de Tele Comunicaciones); COPECO = COPECO Permanent Contingency Commission (Comisión Permanente de Contingencias); DOCSIS = data over cable service interface; ENEE = National Electricity Company (Empresa Nacional de Energía Eléctrica); FDI = foreign direct investment; INFOP = National Professional Training Institute (Instituto Nacional de Formación Profesional); ISP = internet service provider; IXP-HN = Honduras internet exchange point; UHAN = The National Autonomous University (Universidad Nacional Autónoma de Honduras).

4.4 DIGITAL FINANCIAL SERVICES FOR MSMES

Market Overview

The Honduran financial sector is well capitalized, relatively profitable, and stable. The financial sector remains dominated by banks, and the banking industry is moderately concentrated, with 6 out of 15 total banks representing 80 percent of total domestic financial assets.[90] Banks are also the primary providers of digital financial services, along with one telecommunications operator. As of end-2019, the banking system maintained adequate capital buffers, with a 14.3 percent regulatory-capital-to-risk-weighted assets ratio exceeding the statutory minimum of 10 percent but below the levels of most regional peers.[91] Bank liquidity was also adequate, with a 24.8 percent ratio of liquid assets to total assets, and the share of nonperforming loans (NPLs) in total credit had reached a record low of just 2.1 percent. However, bank profitability, as measured by return on assets, was just 1.3 percent, at the lower end of the range for regional peers. The World Economic Forum's 2019 Global Competitiveness Report ranked Honduras 34th out of 141 countries in financial-sector stability, and the implementation of Basel III standards since 2008 has bolstered the regulatory framework. The banking regulator, the National Commission on Banks and Securities (Comisión Nacional de Bancos y Seguros; CNBS), has progressively implemented international standards for capital reserves, risk-based supervision, measures to combat money laundering and the financing of terrorism, reporting requirements, and corporate governance. The government has also been working to reform the payment system. In 2019, the authorities created the Fintech and Financial Innovation Committee, composed of representatives from the public and private sectors, to drive regulatory innovation in support of financial inclusion, with special attention to insurance and cybersecurity.

In international comparisons, Honduras's business climate performs well on measures of getting credit, reflecting recent advances in credit infrastructure. In 2020, 105 out of 1,000 adults in Honduras borrowed from commercial banks. This level sets it below Latin America and the Caribbean (217.9) and peer group countries including Guatemala (144.1).[92] Significant advances have been made in the last decade in the area of secured transactions, including the establishment of a centralized collateral registry in 2012 and the creation of out-of-court enforcement processes in 2008, as well as in the area of access to credit information, including measures to enhance the operations of the public credit bureau in 2010 and the assurance of a guaranteed right for borrowers to inspect their own data in 2008.[93] In 2019, private bureau coverage encompassed 48.9 percent of adults versus a regional average of 47.6 percent and public credit registry coverage stood at 17.3 percent, above the regional average of 14.6 percent.[94]

Despite the liquidity of the banking system and the consistent growth of credit, many households remain excluded from the formal financial sector. According to the 2017 Global Findex (latest available data as of 2020), the share of adults holding an account at a formal financial institution rose from 31 percent in 2014 to 45 percent in 2017 but remained below the regional average of 54 percent.[95] Significant disparities persist across socioeconomic and demographic groups. In 2017, the gap in bancarization rates between households in the top 60 percent of the income distribution and households in the bottom 40 percent stood at 20 percent, while the gap between men and women stood at 9 percent. Just 17 percent of adults report having a debit card, and 6 percent report using mobile-money services. As of 2017, 15 percent of adults had a savings account at a formal financial institution—close to the regional average—while 12 percent had received a loan from a financial institution. The number of bank branches, offices, agents, ATMs, and other access points has been rising over the last few years, driven by the growth of agent banking.

Relatively few MSMEs use formal financial services. Honduran firms cite access to finance as one of the top 10 obstacles to doing business,[96] with MSMEs primarily relying on internal capital to fund business development. Firms of all sizes rarely use formal financial services to fund their operations, and only 37.4 percent of firms in Honduras have investments financed by a bank.[97] Among MSMEs, credit analysis is a complex and costly process. At end-2019, the MSME loan portfolio was estimated at about US$2 billion (L 50,700 billion), or 12 percent of the total loan portfolio (table 4.11). The government provides support to MSMEs through over 30 programs, yet many firms cannot access these funds due to high levels of risk and informality. The National Association of Small and Medium Enterprises reports that most lending is based on credit history, formal financial statements, and collateral guarantees. The Honduran Association of Banking Institutions highlights the need to expand the range of acceptable collateral and offer partial guarantees to unlock long-term financing for MSMEs.[98] High informality rates are also a significant constraint on financial access, and many informal entrepreneurs finance business development through personal credit cards, which have low approval thresholds and high interest rates, frequently resulting in overindebtedness. Credit constraints slow the growth of MSMEs, undermining their competitiveness and limiting opportunities to expand their business operations.

Credit has grown consistently in recent years, but capital markets remain shallow. Honduras's domestic deposit and loan rates are relatively high by regional standards. The ratio of total deposits to GDP rose from 43 percent in 2014 to 50 percent in 2017 and has consistently exceeded the Central American average of 34 percent (excluding Panama). Domestic credit to the private sector rose from 48 percent of GDP in 2011 to 62 percent in 2019, placing Honduras broadly in line with most regional peers.[99] However, the 2019 World Economic Forum Global Competitiveness Report ranked Honduras 87th out of 141 countries on indicators of financial-sector depth.[100] Due to the predominance of government securities, local markets provide limited opportunities for banks and investors. Insurance penetration is low, and insurance-company assets equal just 3 percent of GDP. Leasing and factoring services are underdeveloped, and the financial technology (fintech) ecosystem for MSME financing is nascent. The cooperative sector composes over 1,000 institutions[101] and represents about 5 percent of financial-system assets.

TABLE 4.11 ESTIMATED MSME LOAN PORTFOLIO

a. Total estimated loan portfolios, by lending institution type

End of 2019	#	Total Assets			Loan Portfolio		
		L, millions	US$ millions	%	L, millions	US$ millions	%
Commercial banks	15	610,659	24,925	91	375,387	15,322	89
Financial companies	10	13,896	567	2	10,251	418	2
OPDF	5	4,442	181	1	3,554	145	2
Cooperatives	88	43,545	1,777	6	32,491	1,326	8
Total		**672,542**	**27,451**	**100**	**421,682**	**17,212**	**100**

b. MSME loan portfolio estimates, by lending institution type

MSME Loan Portfolio Estimates	L, millions	US$ millions
Banks and financial companies	10,238	418
OPDF	422	99
Cooperatives	32,491	1,326
Other creditors	5,500	224
Total	**50,651**	**2,067**

Source: World Bank Group staff based on data from CNBS (Comisión Nacional de Bancos y Seguros), "Reporte Anual de Inclusión Financiera en Honduras," July 2020, https://www.cnbs.gob.hn/blog/2020/07/20/reporte-anual-de-inclusion-financiera-en-honduras-2020/; and Red de Microfinancieras de Honduras (Redmicroh).

Note: L = Honduran lempira; OPDF = Private Organizations for Financial Development (Organizaciónes Privadas de Desarrollo Financiera).

The public development bank is reforming its institutional strategy to improve operational efficiency, reach underserved consumers and MSMEs, and develop new financial products. The Honduran Bank for Production and Housing (Banco Hondureño para la Producción y la Vivienda; BANHPROVI) was founded in 2005 as a second-tier credit institution, but since 2018 it has provided first-tier banking services, and it is now one of the most important public agencies supporting MSMEs. BANHPROVI promotes financial inclusion by focusing on reaching the smallest enterprises, especially in areas that are not well served by private institutions. BANHPROVI provides direct and second-tier lending at subsidized interest rates for MSME development, agriculture and livestock production, the purchase or construction of first homes, and microenterprises. It is one of the few banks that offers leasing, factoring, and other moveable-asset-based lending products, term investments, and revolving lines of credit. BANHPROVI offers loans with preferred rates for food production and to promote financial inclusion, but its funds are not fully utilized because of applicants' high-risk ratings. In recent years, BANHPROVI has prioritized improvements in operational efficiency, including upgrading the core banking system, accelerating the disbursement processes, and building staff capacity. BANHPROVI has been actively expanding its second-tier lending and credit guarantees to cooperatives and microfinance institutions, which doubled their share in second-tier lending from 6 percent in 2018 to 12 percent in 2019. BANHPROVI has also expanding its branch network, developed new digital financial services (DFS), and is leading efforts to digitize government-to-person (G2P) transfers.

Other public financial institutions offer loans and financial services to MSMEs, especially those in rural areas. The government introduced rural savings and credit cooperatives (cooperativas de ahorro y credito; CACs) in 2014 to provide financial services in areas with limited access to commercial banks. In these areas, farmer groups often sell products collectively to large traders or processors, making some of the CACs de facto agriculture cooperatives. The government's productivity- and competitiveness-focused initiative, COMRURAL, has prioritized expanding credit access for agricultural MSMEs to foment innovation and growth, augmented by support to organized small-scale rural producers.

Financial institutions could reduce the cost of borrowing for MSMEs by adopting technologies that support emerging financial-sector business models and that promote the growth of DFS and its ecosystem. The uptake of digital financial services is low, and just 37 percent of adults surveyed in 2017 reported making or receiving a digital payment (for example, via card or mobile phone) in the past year.[102] Moreover, digital platforms have not yet been leveraged for major payment categories such as G2P payments, remittances, or wages. Although the largest banks are creating digital channels and applications, improving their infrastructure, and digitizing their processes, the impact of fintech on MSME financial products remains limited, as this segment is not a high priority for major commercial banks, which instead focus on affluent and already-banked clients, especially in major cities. Moreover, MSMEs often lack the information necessary to obtain bank loans, such as a history of audited financial statements, and the risks arising from information asymmetry and weakly secured transactions frequently surpass banks' risk appetite. DFS could provide a cost-efficient solution for reaching the MSME segment due to their lower infrastructure and transaction costs and the use of big-data applications (for example, analyses of transactional and behavioral information) can mitigate information asymmetry among borrowers who lack traditional credit histories.

The government is implementing programs to foster the growth of e-government services and digital transactions, which would catalyze the national ecosystem for digital financial services. The introduction of fintech payment and lending systems among MSMEs and rural enterprises can have a transformational impact. Harnessing widespread remittance inflows through DFS can serve as the basis to develop and distribute new financial products for the underserved. Digitalization of remittances facilitates traceability and data generation, which could also result in the creation of data scoring to provide MSMEs with access to credit opportunities within the financial sector. While remittances totaled 21.5 percent of GDP in the Honduras in 2019,[103] only 11 percent of Hondurans reported using formal financial accounts to receive remittances. In this context, the government is developing a digital identification system and plans to disburse national G2P payments via e-wallet accounts at BANHPROVI. Since 2019, a government-led Fintech and Technological Innovations Committee has acted as an official focal point for financial institutions, fintech firms, and regulators.[104] Promoting digital innovation as a driver of financial inclusion, through development of DFS and its ecosystem in Honduras, stands to affect lower-income households and MSMEs.

Financial-sector authorities have taken steps to create a regulatory framework for DFS. A DFS ecosystem includes financial institutions, payment providers, telecommunications firms, fintech firms, and other companies that provide financial services, technological innovations, or infrastructure and support services. The regulatory framework for DFS must establish rules and requirements for digital payment systems and the digitization of core banking services, especially lending. The Honduran government regulates DFS through (a) a 2016 law governing digital payment providers known as the INDEL, which was approved by the CNBS and (b) financial-sector regulations on opening "basic" bank accounts and conducting low-value transactions.

The government has prioritized easing the process for opening basic bank accounts to promote financial inclusion and encourage the use of e-wallets and other DFS. A 2015 CNBS resolution-enabled banks,[105] financial companies, credit and saving cooperatives, and private development finance organizations (organizaciónes privadas de desarrollo financiera, OPDFs) to offer basic bank accounts. At end-2019, the three commercial banks that report basic account information to the CNBS—Banrural, Banco de los Trabajadores, and Banco de Occidente—had opened a total of 80,202 basic accounts with a total balance of US$880,000. The services offered by basic accounts include deposits, inquiries, and withdrawals through the institution's access points, as well as payments for public services, direct deposit of salaries, G2P payments, remittances, and national and international transfers. Currently, basic accounts are primarily used to receive conditional cash transfers from the government under programs such as Bono Vida Mejor and Credito Solidario.

Existing DFS solutions for MSMEs in Honduras include the following:

- **Noncash merchant payments.** In addition to enabling digital payments for goods and services, this solution expands access to credit for MSMEs by recording transaction data that can be used to assess a merchant's creditworthiness. Prerequisites for digital payment uptake include (a) user services, such as accounts, credit and debit cards, and e-wallets; (b) merchant services, such as digital payment accounts and platforms; and (c) payment infrastructure, such as ATMs and other access points. At present, e-wallet uptake is relatively low, with just under one million users at end-2019.[106] The cooperatives that currently supply the bulk of direct MSME financing are not providing e-wallet solutions, and the few other DFS providers are largely in the early stages of their development.
- **Alternative financial data, advanced analytics, and underwriting process automation.** This solution includes three categories of innovation: (a) marketplace lending, in which credit is provided to MSMEs through online platforms that match lenders with borrowers; (b) balance-sheet lending, in which fintech firms originate loans directly and maintain their own loan portfolios on their balance sheets; and (c) credit-scoring platforms, which provide credit scores and matching services to banks. A few fintech firms are currently offering these services in Honduras.
- **Value-chain lenders.** These solutions either allow MSMEs to sell receivable accounts to third-party financial institutions more efficiently or facilitate access to distribution financing for MSMEs that purchase supplies or inputs from large firms. Under this model, the data generated by the MSMEs can be useful for potential lenders. Existing value-chain lending is primarily provided by large private firms directly, without passing through the formal financial system.
- **Nonfinancial services for MSMEs.** These solutions can provide MSMEs with virtual support for preparing business plans or managing business operations. A few fintech firms offer nonfinancial services in Honduras, though their range of subject areas is limited.

Smaller banks, microfinance institutions, and cooperatives that focus on MSMEs are aware of the potential offered by DFS. Some have started investing in DFS innovations, and medium-size banks like Banco Popular and Banhcafe have attended the IFC's digital strategy acceleration program, DigiLab Finance.[107] However, the CACs and OPDFs have made little progress toward greater DFS provision, as they have limited resources to invest in new technologies.

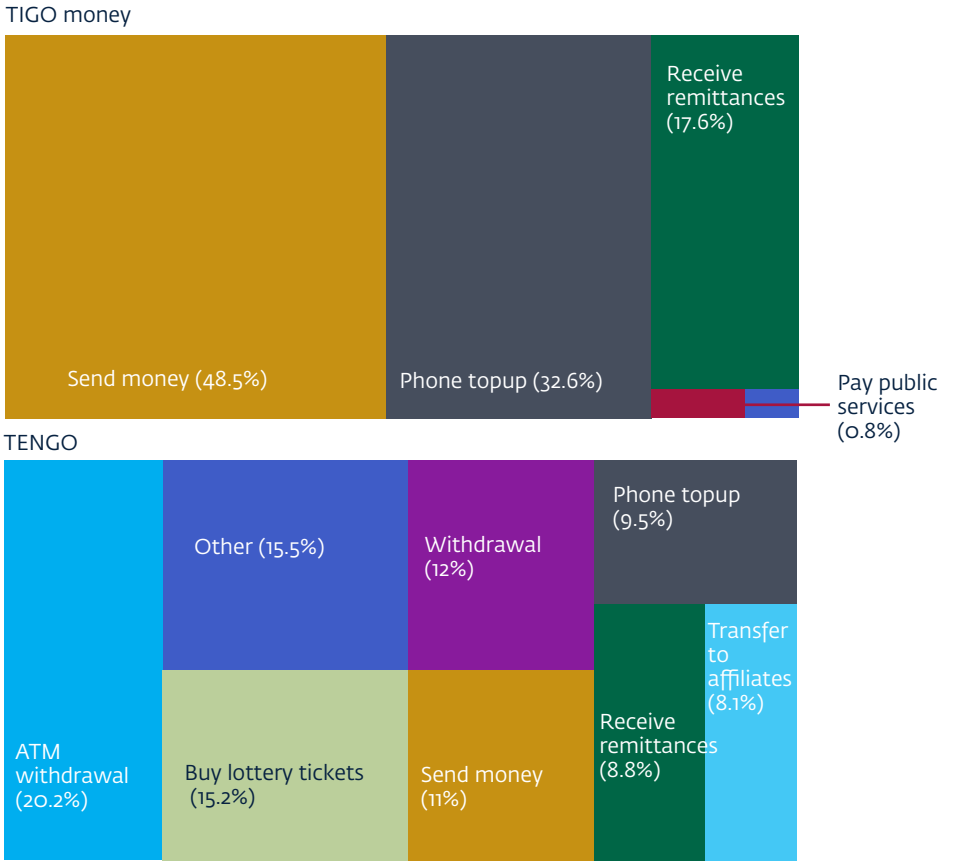
The OPDFs are nonprofit financial institutions established to support MSMEs. Honduras's five OPDFs operate 265 offices throughout the country. At end-2019, the ODPFs reported a total of 223,774 clients with at least one deposit account and 103,859 clients with at least one loan, 82 percent of which were microloans. Meanwhile, the country's 319 CACs reported nearly 1.5 million affiliates, of which 1.1 million are part of the 14 largest cooperatives and represent 72 percent of all savings and credit accounts. The CACs offer productivity-oriented microloans, and their total lending portfolio amounted to US$1,326 million, representing 8 percent of the financial system. The CACs with the most clients and largest portfolios are ELGA, OCOTEPEQUE, Educadores de Honduras, Sagrada Familia, CHOROTEGA, and TAULABÉ.

The Honduran Microfinance Network (Red de Microfinancieras de Honduras, REDMICROH) is a private association of 24 banks, financial companies, and OPDFs, which together play a significant role in microfinance. REDMICROH operates in 17 of the 18 states in Honduras. Its loan portfolio totals US$338 million, and the network serves 217,000 clients, of whom 57 percent are women and 53 percent reside in rural areas. Recognizing the importance of digitization, REDMICROH has hired consultants to assist its members with their digital strategies. REDMICROH launched a project to provide core banking services via microfinance institutions as early as 2015, but the project was halted.

Fintech Firms and Innovators

The fintech sector in Honduras is underdeveloped relative to those of other countries in the region. In much of Latin America, fintech has been integral in accelerating innovation and providing DFS to MSMEs. Most fintech firms operate payment services, but this subsector has experienced little growth in Honduras. Some of the larger fintech firms offer e-wallets, which are mainly focused on individual consumers, and merchant acceptance remains a challenge. The two main e-wallet services, Tigo Money and Tengo, had more than one million combined users at end-2019 (figure 4.16).[108] Other fintech firms in Honduras are small, and no marketplace lenders or balance-sheet lenders are currently operating in the country (table 4.12).

FIGURE 4.16 TIGO MONEY AND TENGO TRANSACTIONS BY TYPE



Source: World Bank Group staff based on data from National Commission on Banks and Insurance (Comisión Nacional de Bancos y Seguros; CNBS), various, 2020.

TABLE 4.12 FINTECH SERVICES IN HONDURAS

Tigo Money operates an e-wallet system based on e-money bank accounts licensed under the e-money issuer law (INDEL Law). At end-2019, Tigo Money had 833,944 clients and transactions totaling L 7.06 billion (US$282 million). Tigo Money has an exclusive partnership agreement with BanPais, which manages the e-money accounts and enables Tigo Money users to access to its network of ATMs and branches.
Tengo is an e-wallet service provider created in 2017. Tengo has its own agent network of 1,500 service points (Tengo Puntos). It is part of Ficohsa and operates through basic bank accounts created under Ficohsa's banking license. At end-2019, Tengo had 158,304 clients with transactions totaling L 550.5 million (US$22 million).
Kequeres offers rapid payment and transfer services via mobile devices
Pixelpay allows merchants to accept online payments.
Noncash platform enables credit-and debit-card payments through a smartphone app and payments through a QR code.
Smartaxis Central is a platform that allows taxi companies to accept card payments
Ephamoney is a digital account that allows mobile deposits, withdraws, transfers, and payments
Todomovil is a technology enabler for financial institutions that was established in 2012 through a partnership with Wizzit, a South African mobile-banking service provider.
Hugo Pay is an e-wallet provided to users of Hugo (food delivery application active in Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua,) developed with Visa. Users can transfer funds person-to-person, either nationally or internationally, and use QR code payment functionality.
Subelatinoamerica offers e-commerce solutions for entrepreneurs.
Clinpays allows MSMEs to receive instant payments via WhatsApp, social networks, email, or any other messaging platform, or via a dedicated website, mobile app, or physical access points.

Source: CPSD mission discussions (August 2020).

Note: QR code = quick response code.

Some fintech firms provide nonfinancial services for MSMEs, but their scope is narrow. Cloudbiz and FacturaHN provide cloud-based billing and inventory software for small businesses. The only fintech firm that uses alternative financial data appears to be Omnipago, which is used to finance the purchase of smartphones. Omnipago has recently partnered with the US tech start-up PayJoy to launch Omicredit, which creates a credit history to inform smartphone financing.

The Impact of COVID-19

The COVID-19 crisis is imposing significant financial stress on households and MSMEs. According to the Honduran Council of Private Firms (Consejo Hondureno de la Empresa Privada; COHEP), the most affected sectors involve nonessential consumer goods and services, such as furniture production, light manufacturing, and tourism. Formal firms reported a major contraction in sales and revenues between 2019 and 2020, and the number of firms that filed value-added tax (VAT) returns fell sharply.[109] Small firms were among the most affected, especially those in the service sector, which has been subject to strict containment measures. As of August 2020, about 1,500 firms had not resumed tax reporting despite a phased reopening. The impact on informal firms is inherently difficult to estimate but likely even more severe. One proxy to this estimation is the complementary increase in remittances. In 2020, personal remittances totaled 24 percent of GDP, representing a steady climb from 2019 (21.5 percent) and prior years since 2012.[110] Increased remittances during the pandemic are in part attributable to a shift from cash and informal channels to digital transfers and formal channels.[111]

The extent of liquidity stress in the banking sector remains uncertain. Cashflow disruptions among firms and rising demand for cash by the public likely tightened funding and liquidity conditions for banks. In addition, market participants may refrain from lending to each other, causing disruptions in the interbank market. The Honduran Association of Banking Institutions (Asociación Hondureña de Instituciones Bancarias; AHIBA) has projected that deposit withdrawals may be significantly higher than those observed during previous crises. In interviews, AHIBA representatives expressed confidence in the ability of the banking sector and the government to handle liquidity stress even in a worse-case scenario but emphasized that the situation remains unpredictable.

Deteriorating asset quality is likely to significantly impact the capital positions, profitability, and lending activity of Honduran banks. While the sector entered the COVID-19 crisis with low NPL ratios and adequate capital buffers, depressed economic activity and a sharp deterioration in asset quality may now threaten banks' capital positions, and increased provisioning could contribute to a further decline in bank profits. The duration and intensity of the crisis and its long-term economic implications are unknown.

Faced with bleak economic prospects, banks are likely to become very conservative in their lending operations. A cautious approach to lending could cause a credit crunch even if liquidity remains ample, which would limit the role of private banks in supporting the recovery of the real sector. The financial sector could prepare improved response mechanisms for managing bankruptcy, insolvency, and distressed assets.

The government has taken measures to reduce financial pressure on households and MSMEs and to protect employment, maintain liquidity, and address credit-risk vulnerabilities. Financial-sector authorities have enacted regulatory forbearance measures to provide temporary debt-service relief to companies and individuals whose incomes have been affected by the crisis, without altering credit classifications—and thereby limiting the need for additional provisioning by banks. Such measures, particularly if extended, risk concealing the real extent of asset deterioration. The government had also announced a three-month moratorium on the service of bank loans financed by BANHPROVI, representing about 5 percent of total bank credit to the private sector. Moreover, the government has allowed deferrals of income tax, social contributions, and some VAT payments; extended tax credits to help companies maintain pre-crisis employment levels; created new unemployment benefits; and frozen the prices of goods in the basic consumption basket.

The authorities are implementing a new digital agenda, which has been influenced by the COVID-19 pandemic. The president created a new Office of Presidential Priorities and Public Innovation to define and implement the agenda, which includes a digital-transformation strategy for the public sector, as well as e-government policies and programs, a national digital ID, and digital payment systems. The government is also in the process of launching an e-wallet for G2P transfers. In the context of the COVID-19 pandemic, the government has prioritized efforts to increase touchless digital transactions, which could encourage the uptake of DFS. While a government e-wallet would support the growth of cashless transactions, it could give rise to a conflict of interest with second-tier clients of financial institutions by creating overlapping customer bases and access to customers' e-wallet transactions.

The authorities temporarily increased the limits on basic account transactions to encourage the use of DFS during the pandemic. In April 2020, the CNBS issued a temporary permit for regulated financial institutions and OPDFs to increase the maximum monthly balance of basic accounts and e-money accounts to L 15,000 (US$612) and the maximum monthly transaction limit to L 30,000 (US$1,225) until October 31, 2020.[112] These institutions are also required to design and implement new channels to increase the use of basic accounts, especially through expanded ATM and agent networks, and to review the costs and commissions associated with agent networks and electronic transfers.

The government has also created a special postcrisis recovery program focusing on MSMEs. In May 2020, the Central American Bank for Economic Integration approved a US$300 million loan to finance the program, and an initial tranche of US$100 million has been signed. The funds are to be deployed by BANHPROVI as loans issued through regulated financial institutions, with 65–90 percent of the credit earmarked for MSMEs. BANHPROVI is also deploying an additional L 5,625 million (US$230 million) to finance loans to MSMEs and other firms affected by the pandemic. In June 2020, the Inter-American Development Bank approved a US$20 million loan to finance working capital for MSMEs facing liquidity challenges. The funds will support BANHPROVI's efforts to provide advance payments and rediscounting lines, as well as guarantees to financial intermediaries designed to benefit about one thousand MSMEs in the tourism sector, which has been severely impacted by the crisis.

Key Barriers to Address

Capacity Constraints among smaller institutions

Limited resources prevent uptake of DFS among smaller financial institutions, including small and medium-size banks. These institutions often lack the necessary capital, human resources, or institutional capacity to adopt innovative digital products or form partnerships with fintech firms. Institutions that serve MSMEs, such as OPDFs, rural CACs, and microlenders, frequently struggle to digitize their own internal systems and processes, which limits their ability to offer DFS. To provide DFS, these institutions must form partnerships with banks or other digitized institutions, such as e-wallet providers. Several Interbank Processing Center (Centro de Procesamiento Interbancario; CEPROBAN) member banks have extended automated clearing house (ACH) access to CACs and other nonbank financial institutions, and additional banks may follow suit. Some banks have even suggested they would do so free of charge to build the DFS ecosystem and increase the number of access points.

Smaller financial institutions also have limited access to financial infrastructure controlled by banks, which constrains their ability to provide DFS. Smaller institutions are typically unable to offer e-wallets, credit or debit cards, electronic payment services via point-of-sales devices, ATMs and agent networks, or real-time transfers unless they partner with a larger bank. Although Banco de los Trabajadores has partnered with several CACs to issue debit cards and provide access to ATMs and transfer infrastructure, this partnership has not expanded the supply of DFS or encouraged the modernization of CACs.

Competition and regulation

Regulation is a major obstacle to the formation and expansion of new financial institutions. The financial regulatory framework is among the most stringent in Latin America and is not conducive to the creation of fintech firms. Stakeholder interviews have revealed the widespread perception that the financial sector is controlled by the banks, which have established high entry barriers, such as minimum capital requirements, to shield themselves from would-be competitors. The insolvency and bankruptcy regulatory environment is not conducive to innovative response mechanisms for dealing with distressed assets. The international experience shows that fintech firms are often initially perceived as a threat to traditional financial institutions, especially banks, and this appears to be the case in Honduras.

The Honduran financial market is not prepared for the emergence of alternative lenders. Although there is an unsatisfied demand for credit, DFS providers face significant barriers to entry. DFS providers must rely on incumbents for back-end processing of payments and identity verification, which increases the cost of services. Limited digital literacy and connectivity among much of the population weakens demand for DFS. Access to data is a challenge, both for traditional credit information and the alternative data provided by fintech innovations. The concentration of the banking sector increases the difficulty of obtaining the necessary market share for DFS services to be financially viable. Obtaining the necessary licenses is an onerous process, and the government imposes cloud-computing restrictions on DFS.

Government programs and direct financing to MSMEs may create market distortions even if they are designed to address the deficit in MSME lending. BANHPROVI faces a possible conflict of interest between its first-tier commercial activities and second-tier clients. BANHPROVI intends to maintain a small portfolio in commercial banking after the launch of its e-wallet, but its second-tier clients do not want to lose business to BANHPROVI, and if customers choose to use the e-wallet, BANHPROVI would have access to their transaction history. While BANHPROVI's objectives are to promote financial inclusion and the expansion of DFS, these goals conflict with those of financial institutions competing for the same clients.

Few institutions are both willing and able to provide financial services in rural areas. While BANHPROVI will launch an e-wallet and G2P payment service, the CACs are the institutions best positioned to serve rural MSMEs. Enabling the CACs to provide DFS will require a catalyst, such as access to ACH transfers or the establishment of a new person-to-person transfer mechanism. In addition to the government and rural CACs, some private agricultural and agribusiness firms have a stake in how their value chains and customers utilize financial services and have expressed interest in supporting improvements in financial access. Along with financial access, these firms could introduce climate smart agriculture approaches to smallholder farmers, to increase climate resilience for rural MSMEs. These firms could be leveraged to support the growth of DFS in rural areas.

Climate change

The financial sector has begun to develop the basis for climate finance, but significant implementation work is required. The Bankers Association—AHIBA and CNBS joined the Sustainable Baking Network in 2015. CNBS identifies Honduras as a country with great diversity of natural resources, and due to its geographic location, it is vulnerable to climate change. This in turn represents a risk for the populations that subsist and live in areas where the most important agricultural activities that contribute to the economy are developed.[113]

The banking and insurance regulator approved prudential environmental and social (E&S) regulation, and banks are aligned in support of implementation. The Honduras Sustainable Banking Initiative (SBI) began with AHIBA in 2018 with support from IFC, the Netherlands Development Bank (FMO) and Norfund. In addition to wide sector engagement and capacity building of member banks, the project supported drafting of regulation to require all banks to apply an environmental and social management system based on categorization of projects by E&S risks, which was released by the regulator (CNBS) in June 2020.[114] Addressing the legal, policy, institutional, and operational constraints of adopting climate and environmental, social and governance (ESG) standards and risk management practices has been placed on the regional agenda by Honduran government leadership. Drawing from the SBI experience, the Honduran presidency of the Central American Council of Superintendents for Banks, Insurance and Other Financial Institutions (Consejo Centroamericano de Superintendentes de Bancos, de Seguros, y de Otras Instituciones Financieras), is leading exploration of preparation and execution of an action plan for climate and ESG standards and regulation and support of sustainable financing. Development of a green taxonomy is an element of the proposed action plan.

In light of Honduras's vulnerability to climate risk, and the priority placed by public and private actors on climate risk management, work in assessment, mitigation, and resilience are recommended. The Central Bank and regulators may introduce climate risk assessments and stress testing guidelines in the financial sector. Work to support private sector actors, such as banks, insurance companies, and other financial institutions, in understanding climate risk and opportunities, adaptation strategies, and disaster risk management, will be timely as E&S prudential regulation implementation is required. Carbon accounting, climate risk assessment, climate risk management and disclosure, as well as green financing and finance-linked climate-smart agriculture (CSA) products—of particular interest and impact for MSMEs—are ripe opportunities for the coming years.

Gender gap in access to finance

Women are disadvantaged in access to credit, including by higher costs, and rural individuals and MSMEs are even more so. The share of loans granted to women has increased faster than the share granted to men—in 2019, 36.5 percent of the loans granted by financial institutions went to women, representing an annual growth rate of 10.6 percent, compared to an 8.3 percent growth rate for men.[115] Commercial banks have the lowest share of loans to women (36.3 percent), followed by financial companies (37.8 percent) and OPDFs (40.8 percent).[116] Average rates on commercial loans are 5.5 percentage points higher for women (40.1 percent) than for men (34.5 percent), although the gap (3.7) is lower for microcredit (women: 40 percent; men: 36.3 percent).[117] Such higher interest rates act as a disincentive to seeking credit. The access to finance gap exists even though women are more likely than men to repay loans, as reflected in the delinquency index, which as of end-2019 was 3.6 percent for women, 0.6 percentage points lower than for men. Women's superior repayment rates have persisted for years (2015–19).[118] Despite such differentiation, state banks do not consider rural women's access to credit to be a priority, meaning women are largely limited to seeking microcredit through rural savings banks and other mechanisms.[119] Honduras would be well served to seek greater understanding of gender discrepancies in lending and other financial services, including as they may affect DFS to MSMEs.

Infrastructure

Mobile infrastructure is an important component of DFS, but Honduras's infrastructure remains limited.[120] Telecommunications firms have indicated a desire to move into LTE and 4G, but the necessary upgrades have not been rolled out. Data from the National Telecommunications Commission (Comisión Nacional de Telecomunicaciones; CONATEL) indicate that 3G internet connectivity is available in 96 percent of municipalities. During the third quarter of 2019, just under 7 million mobile telephone lines were active in the country, enough lines for 77 percent of the population, and 2.7 million of these lines were mobile internet subscribers.[121]

Smartphone access is constrained by low data connectivity, high prices, and limited digital literacy. Telecommunications firms have not provided email and data services at affordable prices, which reduces the uptake of these services and inhibits the provision of DFS. Internet prices in Honduras are among the highest in the region, with an average monthly price of US$60, surpassed only by Belize.[122] Stakeholder interviews suggest that a lack of smartphone usage skills is an important barrier to increasing demand for DFS for both MSMEs and individuals.

Opportunities and Recommendations

Representatives of AHIBA have indicated that most banks recognize the importance of incentivizing DFS as an alternative to checks and cash payments. However, the Honduran fintech ecosystem is characterized by a small number of players, with limited competition and inadequate infrastructure. In this context, it is important to support the entry of new players and allow them to access the country's financial infrastructure at a reasonable cost. The financial sector should create awareness of DFS and support MSMEs in designing and implementing digital transformation strategies. Financial firms should strive to develop new mechanisms to finance the implementation of these strategies, and government should partner with private firms to offer financial education and digital literacy programs. The government's digital identification program should be the centerpiece of a broader digital transformation agenda directly linked to the provision of DFS.

Improving access to DFS among MSMEs will require coordinated efforts among multiple public and private sector players. Building a robust payment ecosystem for merchants and individuals will be necessary to enable the growth of DFS, and leveraging value-chain data can help create new products that suit the unique needs of MSMEs. It is also important to develop a real-time, low-cost system for digital payments, either through the central bank or in partnership with CEPROBAN. Experience in the region (see appendix H and appendix I) has shown such encouragement of electronic payments merchant acceptance—including breaking up monopolies and lowering merchant discount and interest rates through regulation—has had the desired effect of democratizing payments systems.

Reforms to several aspects of the legal framework could improve DFS access among MSMEs. Creating factoring regulations could facilitate the emergence of new players. Although factoring products are typically offered by banks, a regulation guaranteeing the enforceability of receivables and payables could help new fintech firms enter this market. Such a reform would also create space for public or private financial institutions to offer value-chain financing to MSMEs or to create payment platforms for such transactions. In addition to this current lack of a conducive regulatory framework, the small volume of transactions also represents an obstacle to successful value-chain financing platform development. In addition, the central bank could promote the expansion of real-time, low-value payment services offered at a reasonable cost. Finally, a regulation authorizing remote account opening could enable entrepreneurs to more easily open accounts.

Specific reforms to the INDEL Law could improve the functionality of e-wallets and encourage the entry of innovative firms. These include reducing the minimum capital requirements for establishing an e-money provider, increasing the maximum monthly balance limits and transaction values, incorporating payment aggregators and payment gateways into the financial sector, and more clearly specifying the interoperability requirements of financial regulation. In line with the regional experience with DFS, Honduran banks could become new e-money providers. Indeed, BANHPROVI and Banco de Occidente are already in the process of launching e-wallets with the support of Todo Movil, a fintech enabler.

Greater access to cloud computing would accelerate the transformation of the financial industry. The CNBS should look for ways to integrate cloud computing into the regulatory framework and allow public and private institutions to access cloud services. Some institutions from the financial sector are using cloud computing for data processing and data storage. However, the service falls outside the legal framework, forcing private companies to incur extra expense for physical in-country data centers. The regulation of cloud computing should enable banks to transition to modern infrastructure and expand their range of client services.

An open banking regulation could help level the playing field, enabling the entry of new firms and encouraging their integration into the financial ecosystem. Robust data protections are essential to promote open banking. Open banking should be regarded as a catalyst of digital transformation and incorporated into the government's financial inclusion agenda. Large banks should be encouraged to leverage corporate clients as anchor firms for value-chain financing, which offers the advantage of well-developed distribution channels and national scope and could be supported by development of private or public digital supply chain financing platform solutions. In addition, small- and medium-size financial institutions should receive equitable access to the financial infrastructure currently managed by banks. A full list of recommendations to address the challenges in the DSS is in table 4.13.

TABLE 4.13 CHALLENGES, RECOMMENDATIONS, AND IMPLEMENTING AGENCIES IN THE DIGITAL SERVICES SECTOR

Digital financial services for MSMEs

Challenges	Recommendations	Implementing agencies	Short- or medium-term
Financial access among MSMEs			
MSMEs lack access to appropriate financial products, including payments and credit.	1. Leverage value-chain data and partnerships with private financial institutions and corporations to develop new lending products and digital platform solutionsin order to capture remittance inflows. 2. Increase the flexibility of the INDEL Law; facilitate the creation of real-time, low-value payment systems; strengthen the Factoring Law; and support the development of digital identification. 3. Examine climate risk assessments and stress testing guidelines and work to support private sector actors: banks, insurance companies, and other financial institutions in climate risk management and climate financing, such as finance-linked CSA products.	1. Private financial institutions and corporations, including 2. BCH, Office of Presidential Priorities and Public Innovation, all digital agenda supporters 3. Central bank and regulators, international development institutions	Short-term

Challenges	Recommendations	Implementing agencies	Short- or medium-term
The fintech ecosystem			
The presence of few fintech firms in Honduras slows technological innovation.	1. Provide fintech firms with access to low-cost financial infrastructure, especially payment systems. 2. Expand fintech regulation beyond the INDEL Law while increasing its flexibility. 3. Promote open banking to allow access to financial-system data.	1–3. BCH, CEPROBAN	Short-term
MSMEs access to large banks			
Large banks are not motivated to serve MSMEs.	1. Employ new technologies that enable banks to target new customers, create payment platforms to reduce cash-outs, and leverage large corporate clients as anchor firms in value-chain financing.	1. Private banks	Short-term
Challenges of small and medium-sized financial institutions			
Smaller financial institutions have difficulty accessing infrastructure utilization at a reasonable cost.	1. Support digitalization among financial institutions. 2. Provide smaller institutions with access to bank-managed financial infrastructure (ACH-Pronto, POS/card infrastructure, ATMs) at a reasonable cost.	1–2. IFC Digilab, BCH, CEPROBAN	Short-term

Note: Short-term = 1–2 years. ACH = automated clearing house; BCH = Central Bank of Honduras (Banco Central de Honduras); CEPROBAN = Interbank Processing Center (Centro de Procesamiento Interbancario); CSA = climate-smart agriculture; fintech = financial technology; MSMEs = micro, small, and medium enterprises; POS = point of sale.

1. Economies grow by diversifying into more complex products. According to research conducted by Harvard University's Growth Lab, strategic diversification balances proximity within the product space, opportunity gain, and product complexity. A country's ability to begin producing a new good or service is conditioned by its mix of existing products, and proximity within the product space measures the relative ease with which the capabilities necessary to make one product can be leveraged to make other products. Because productive capabilities are adaptable, diversifying into high-complexity products creates more opportunities for continued diversification—a process known as opportunity gain. Product complexity measures the knowledge and skills required to make a product: creating more complex products requires more sophisticated human capital, but it can also increase productive knowledge and workforce skills through learning-by-doing.
2. Nearby distance: A country's ability to enter into a new product, measured from 0 to 1. A "nearby" product (closer to 0) requires related capabilities to existing products, offering a greater likelihood of success. Opportunity gain for future diversification: higher values hold more linkages to other high-complexity products, opening more opportunities for continued diversification. Product complexity: Measures the amount of diversity of know-how required to make a product.
3. Active labor market and youth employment programs use training, public works, and job search assistance to increase employment opportunities and to help give people the skills needed to find jobs.
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62. Arjun Sethi and Vidisha Suman, "Digital Resonance: The New Factor Influencing Location Attractiveness—2019 Kearney Global Services Location Index," Kearney, https://www.kearney.com/documents/20152/4977724/Digital+resonance+the+new+factor+influencing+location+attractiveness.pdf/7a39643a-dc22-87f5-936b-5e734999f57d?t=1581025251793. See Appending F for the ratings.
63. Kleymer Baquedano, "Call Centers Generated 13,000 Jobs This Year," La Prensa, December 2, 2018, www.laprensa.hn/sanpedro/1238728-410/call-centers-generaron-13000-puestos-trabajo-ano-2018-san-pedro-sula.
64. UK Department for International Trade, UK Foreign and Commonwealth Office, and UK Foreign, Commonwealth and Development Office, Overseas Business Risk—Honduras. www.gov.uk/government/publications/overseas- business-risk-honduras/overseas-business-risk-honduras. The aggregate numbers are estimates.
65. Further analysis of these sectors is complicated by a lack of reliable data for the past five years.
66. See Honduras 20/20. This figure is significant for Honduras but small relative to the number of BPO workers employed in countries such as the United States (~3.3m), India (~1.1m), and the Philippines (~670,000).
67. Firms based in the Altia Business Park include KM2, Startek, San Services, Partner Hero, Apex, Zero Variance, Convergys, Serve5ive, Allied Global, Alorica, and Grupo Levanter; in the rest of the country, Collective Solution, Myron, and LL Contact Center.
68. Most SEZs are near Puerto Cortés or the commercial center of San Pedro Sula.
69. Developed by Grupo Karim, the Altia Business Park is the largest industrial park located in San Pedro Sula's free-trade zone. Altia Park is part of a larger development called the Altia Smart City, which offers telecommunications infrastructure through partnerships with Cable and Wireless Global Communications, self-sufficiency in energy, shopping malls, a Marriot Hotel, a park and recreation center, private security, and an extension of Central American Technological University (Universidad Tecnológica Centroamericana) for continuing education among workers. Grupo Karim also developed a similar business park in Tegucigalpa, but most BPO operations are in San Pedro Sula. See AHM Call Centers, http://www.ahm-honduras.com/?page_id=965.
70. The government included call centers and BPOs as a valid SEZ activity in 2010. The Temporary Import Law allows imports of materials, parts, capital equipment (except vehicles), and IT equipment exempt from surcharges and customs duties if the equipment is used solely within the SEZ. See AHM's website, http://www.ahm-honduras.com; U.S. Department of State, 2019 Investment Climate Statements: Honduras; and Agreement #41-2020: Regulation of the Law of Free Zones.
71. Honduras's three Bay Islands are former British colonies, and their populations are largely composed of native English speakers. In addition, decades of large-scale labor migration to and from the United States have bolstered the English language skills of the Honduran workforce. However, the National Institute of Statistics has no empirical data on the country's English-speaking population, the lack of which inhibits strategic planning in the education sector.
72. ProHonduras (https://sde.gob.hn/prohonduras/) and Workloop (https://theworkloop.com/). Medical translation includes videoconferencing support, telephone support, and patient assistance.
73. UNCTAD Statistics.

74. According to the International Telecommunications Union, "fixed broadband has had a significant impact on the world economy during the last seven years (2010–2017). An increase of 1 per cent in fixed broadband penetration yields an increase in 0.08 per cent in GDP. Secondly, according to the mobile broadband model, an increase of 1 per cent in mobile broadband penetration yields an increase in 0.15 per cent in GDP." Raul Katz and Fernando Callorda, "The Economic Contribution of Broadband, Digitization, and ICT Regulation" (International Telecommunications Union [ITU] Publications, Geneva, 2018), https://www.itu.int/en/ITU-D/Regulatory-Market/Documents/FINAL_1d_18-00513_Broadband-and-Digital-Transformation-E.pdf.
75. If, for example, access networks (local internet service providers; ISPs) had direct access to the IXP, then they would be able to reduce their traffic to one of the carriers and subsequently reduce their fees to the transit internet networks. Currently, access ISPs are simply resellers of larger network or carrier capacity, and the carriers prefer to be the sole (default) transit providers. This arrangement complicates the access networks to connect to the IXP. This is a common practice for Tier 1 or incumbent carriers in countries with underdeveloped regulations framework for a telecommunications sector.
76. Telegeography, Submarine Cable Map, www.submarinecablemap.com/#/.
77. Other carriers, such as Claro and Tigo, provide mobile services. UFINET is a wholesale carrier that only provides service to carriers and some ISPs.
78. With a few exceptions where BPO clients operate onsite data centers (for example, IBM), power requirements in BPO call centers is generally low compared to other infrastructure such as that supporting the garment or textile industry.
79. These firms operate Caribbean Call Centers and Caribbean Innovation Technology (CITECH), respectively.
80. The measured declines may be partially skewed by a change in the methodology of evaluating homicides. Sources: United Nations Office on Drugs and Crime, "Victims of Intentional Homicide: 2018," https://dataunodc.un.org/content/homicide-rate-option-2, based on data from the United Nations Crime Trends Survey (UN-CTS); UNAH/IUDPAS—Honduras Violence Observatory.
81. World Bank Databank, UN Office on Drugs and Crime's International Homicide Statistics database, 2018.
82. Zagada Institute, "Caribbean & Central America (CCA) BPO & Contact Center Report 2012: Leading the 'Core Nearshore' Momentum". (Zagada Institute, Coral Gables, FL, December 2011), http://www.zagada.com/pdf/CCA2012-LeadingtheCoreNearshoreMomentum_sponsors_final.pdf.
83. According to Sethi and Suman, "Not surprisingly, digital resonance is led by the world's most advanced economies. These advanced economies with higher-skilled labor forces are generally more costly for employers, but the growing emphasis of digital skills is starting to level the playing field as automation begins to make a dent in the traditional cost arbitrage calculations." Sethi and Suman, "Digital Resonance."
84. In some of the larger BPO firms, such as Teleperformance, 50 to 60 percent of their employees have bachelor's degrees and 30 percent hold a master's or other postgraduate degree. Several BPOs firm representatives indicated that overqualified staff often take low-skilled jobs as call center agents or other entry-level positions. Having a degree or special skills does not guarantee a higher salary or a more senior position in Honduran BPOs.
85. Discussion with Workloop BPO, an outsourcing company based in Miami, Florida.
86. For example, India, Malaysia, and the Philippines are major players in high-value BPO subsectors such as ITO and KPO services.
87. This study did not consult with all BPO companies in Honduras, therefore cannot conclude on the exact number of companies operating in the KPO and ITO space.
88. Computing Curricula 2020—Paradigms for Computing Curricula is an initiative launched jointly by several professional computing societies to summarize and synthesize the current state of curricular guidelines for academic programs that grant baccalaureate degrees in computing. The project aims not only to reflect the state of the art in computing education and practice, but also to provide insights into the future of the field of computing education for the 2020s and beyond. The participating societies engaged a task force of individuals representing organizations from academia, industry, and government. Association for Computing Machinery (ACM) and Institute of Electrical and Electronics Engineers (IEEE) Computer Society, "Computing Curricula 2020—CC2020: Paradigms for Global Computing Education" (Computing Curricula Series Report, April 2020), https://www.acm.org/binaries/content/assets/education/curricula-recommendations/cc2020.pdf.
89. Training programs have been successfully implemented in other countries. For example, Mexico, through its PROSOFT program certified more than 100,000 people in international standards certifications in four years See World Bank, "Moving Toward a Knowledge-Based Economy: Improving Competitiveness in Mexico's Information Technology Industry" (Result Brief, World Bank, Washington, DC, November 1, 2017), https://www.worldbank.org/en/results/2017/11/01/moving-toward-a-knowledge-based- economy-improving-competitiveness-in-mexicos-information-technology-industry.
90. BCH, Banco Central de Honduras), Informe de Estabilidad Financiera (IEF), (Tegucigalpa, Honduras: BCH, June 2020), https://www.bch.hn/estadisticos/EF/LIBINFORMEEF/IF%20Junio%202020.pdf.
91. World Bank Data, "Financial Soundness Indicators: Bank Capital to Assets Ratio," 2020, Data.worldbank.org.
92. World Bank DataBank, "World Development Indicators: Borrowers from Commercial Banks," 2020, Databank.worldbank.org.
93. During a December 2019 mission, the Women's Business Development Organization (Organización de Desarrollo Empresarial Femenino) reported that the credit bureau does not include nonbank financial institutions.
94. World Bank Data: Private credit bureau coverage and public credit registry coverage, 2019, Data.worldbank.org.
95. The latest available demand-side data are for 2019.

96. According to the World Economic Forum, access to financing was the eighth most serious challenge to doing business, behind tax rates, crime and theft, inefficient government bureaucracy, and corruption. Klaus Schwab, ed., The Global Competitiveness Report 2017–2018 (Geneva: World Economic Forum, 2017), www3.weforum.org/docs/GCR2017- 2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf.
97. World Bank Enterprise Survey, Honduras (latest available data as of 2019).
98. Cofinza provides guarantees and collateralizes guarantees with futures.
99. According to TheGlobalEconomy.com, in a well-developed financial system, banking credit to the private sector should equal at least 70 percent of GDP. The Global Economy, Honduras Bank Credit to the Private Sector, www.theglobaleconomy.com/Honduras/Bank_credit_to_the_private_sector/.
100. Schwab, The Global Competitiveness Report 2019.
101. CNBS (Comisión Nacional de Bancos y Seguros), "Reporte Anual de Inclusión Financiera en Honduras," July 2020, https://www.cnbs.gob.hn/blog/2020/07/20/reporte-anual-de-inclusion-financiera-en-honduras-2020/.
102. Asli Demirguc-Kunt, Global Findex Database 2017.
103. Personal Remittances, received (%GDP), World Bank Data Bank, https://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS. Online May 27, 2021.
104. In 2019, the committee identified, collected data and registered existing fintech firms and reviewed the legal framework for regulators that inhibit the development of fintech initiatives.
105. CNBS (Comisión Nacional de Bancos y Seguros), "Circular CNBS No. 011/2015," February 5, 2015, http://www.cnbs.gob.hn/files/CIRCULARES/CNBS2015/C011-2015.pdf.
106. This estimate includes 824,012 TIGO users and 158,304 Tengo (Ficohsa) users.
107. DigiLab Finance supports financial institutions in developing a structured digital transformation through a hands-on acceleration program.
108. CNBS, (Comisión Nacional de Bancos y Seguros), "Reporte Anual de Inclusión Financiera en Honduras," July 2020, https://www.cnbs.gob.hn/blog/2020/07/20/reporte-anual-de-inclusion-financiera-en-honduras-2020/
109. Pierre Bachas, Anne Brockmeyer, and Camille Semelet, "The Impact of COVID-19 on Formal Firms in Honduras: Evidence from Monthly Tax Returns" (Washington, DC: World Bank, 2021), https://openknowledge.worldbank.org/handle/10986/35093.
110. Personal Remittances, received (% GDP), World Bank Data Bank: https://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS. Online May 27, 2021.
111. Dilip Ratha et al., "Resilience: COVID-19 Crisis through a Migration Lens" (Migration and Development Brief 34, World Bank and Global Knowledge Partnership on Migration and Development [KNOMAD], Washington, DC, May 2021), https://www.knomad.org/sites/default/files/2021-05/Migration%20and%20Development%20Brief%2034_1.pdf.
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113. CNBS, Comisión Nacional de Bancos y Seguros), "Se dio a conocer la experiencia de Honduras como primer país Centroamericano con una regulación prudencial de Banca Sostenible," January 18, 2021, https://www.cnbs.gob.hn/blog/2021/01/19/se-dio-a-conocer-la-experiencia-de-honduras-como-primer-pais-centroamericano- con-una-regulacion-prudencial-de-banca-sostenible/.
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116. CNBS, "Report on the Gender Gap."
117. CNBS, "Report on the Gender Gap."
118. CNBS, "Reporte Anual de Inclusión Financiera."
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APPENDICES

APPENDIX A
DEFINITION OF PEER COUNTRIES

The CPSD uses the same definition of peer countries as in Systematic Country Diagnostics (SCD) 2015.[1] The analysis features six comparable groups of peers: Central American countries, Latin American peers, lower-middle-income countries, the world, structural peers, and aspirational peers. In the case of the former two, both groups were prepared using the WBG's "Find your friends" tool, which is mainly based on the World Economic Outlook database.

Structural Peers

Under this classification, countries with similar characteristics to Honduras were identified using the following criteria for the period 2001–13:

- Lower-middle-income countries
- Population between 3.0 and 15.0 million
- Not land-locked
- Not fragile state
- Manufacturing share higher than 10 percent

This classification delivers the following countries: El Salvador, Georgia, Moldova, Nicaragua, and Senegal.

Aspirational Peers

This classification aggregates countries that may be used as good examples of development for Honduras using the following criteria for the period 2001–13:

- Lower-middle-income and upper-middle-income countries
- GDP per capita growth higher than 3.0 percent
- Inflation below 5.0 percent
- Credit risk rating better than B+
- Population below 35 million

This classification delivers the following countries: Armenia, Chile, Latvia, Lithuania, Morocco, Panama, and Peru.

1. Marco Antonio Hernandez Ore, Liliana D. Sousa, and J. Humberto Lopez, "Honduras: Unlocking Economic Potential for Greater Opportunities" (Systematic Country Diagnostic, World Bank, Washington, DC, 2015), https://elibrary.worldbank.org/doi/pdf/10.1596/23119.

APPENDIX B
KEY POLICY RESPONSES TO COVID-19

Fiscal policy

Activated Fiscal Responsibility Law's escape clause

Non-Financial Public Sector Fiscal Deficit Limit raised for 2020-2022

Authorized new borrowing of US$2.5 billion (10 percent of GDP) for 2020-2021

Increased spending to support the healthcare system

Transfers or forbearance to individuals:

- unemployment benefits to formal workers
- cash transfers of 2,000 lempiras per month to informal workers
- distribution of food supplies and other basic items to over 1 million poor households

Transfers or forbearance to business and firms:

- tax exemption extension for companies in Free Trade Zones, broadened to other income-related taxes (including VAT exemptions for medical supplies)
- reduced advance payments in corporate income tax to provide cash flow relief to companies
- a one-off income tax credit (10 percent of salary expenses) for companies maintaining pre-crisis employment levels.
- deferred income taxes and social contribution payments

Reallocated non-priority spending to finance emergency expenditure

Monetary policy

- Policy rate cut to 3 percent
- Legal Reserve requirements reduction for deposits on national currency from 12 to 9 percent
- Temporary mandatory investments in lempiras to incentivize new credits backed by the guarantee funds
- The policy bank BANHPROVI provided roughly 1 percent of GDP in guarantees for lending to small and medium sized enterprises (SMEs) and other firms.
- Finance loans to SME and other sectors
- Loans restructuring scheme for SMEs and micro loans
- Temporary debt service suspension was provided to liquidity constraint companies and individuals whose incomes were being affected by the pandemic

Policies affecting the sectors

Agribusiness
Government streamlining credits and credits lines available to farmers and agriproducers through BAHNPROVI and setting up programs to promote the cultivation of basic grains to ensure food security

Textile and apparel
Government mandating production of 9 million masks and 2.8 million gowns (PPE)

Digital financial services for MSMEs
Temporary permit applicable to regulated financial institutions and OPDFs increasing the transactional limits of basic accounts and e-money accounts until October 31, 2020. Maximum monthly balance of L 15,000 (US$12) and maximum transaction limit of L 30,000 (US$1,225) per month

Business-process outsourcing
Government relaxing processes needed to extend service to underserved and vulnerable areas, with an emphasis on providing telecommunications, and creating electronic mechanisms to strengthen telecommunications infrastructure (CONATEL's Resolution #11/2015)

Other

- Increasing the coverage and amount of electricity subsidies
- Fostering low-income housing
- CNBS suspending debt service until end-June 2020 for affected sectors: MSMEs, transportation, tourism, agriculture, and maquila
- Not suspending fixed and mobile telephony, mobile, and residential internet services
- Speeding up the process of incorporating ICT tools in trade procedures

Source: World Bank staff based on information provided by Central Bank of Honduras and Ministry of Finance (SEFIN).

Note: Most of the information presented is as of December 2020. BANHPROVI = Honduran Bank for Production and Housing (Banco Hondureño de la Producción y la Vivienda); CNBS = National Banking and Insurance Commission (Comisión Nacional de Bancos y Seguros); CONATEL = National Commission of Telecommunications (Comisión Nacional de Tele Comunicaciones); GDP = gross domestic product; ICT = information and communication technology; MSMEs = micro, small, and medium enterprises; PPE = personal protective equipment; OPDF = Private Development Finance Organizations (Organizaciónes, Privadas de Desarrollo Financiera); SMEs = small and medium enterprises; VAT = value added tax.

APPENDIX C
DEFINITIONS OF MSMES

MSMEs in Honduras are defined by the MSME Sector Law Decree 135-2008 based on the number of employees and level of revenues (table C.1). The banks do not make a distinction between small and medium enterprises and consider micro enterprises those with a credit lower than US$50,000.

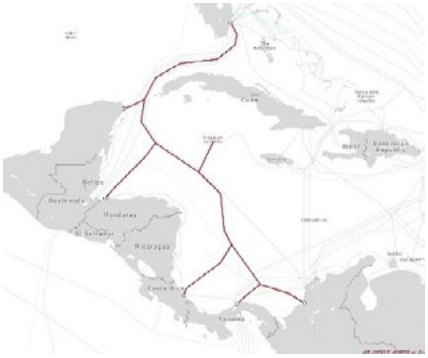
TABLE C.1 DEFINITION OF MSMES BASED ON MULTIPLE CRITERIA

Type of Enterprise	Number of Employees	Monthly Revenues (US$)	Amount of Credit (US$)
Micro	1–10	<200	<50,000
Small	11–50	200–400	
Medium	51–150	400–1000	50,000–500,000

Source: World Bank Group staff based on data from MSME Sector Law and commercial banks.

APPENDIX D
KEY SUBMARINE CABLE LANDING POINTS IN HONDURAS

Maya-1 Submarine Cable



Aurora Submarine Cable

ARCOS Submarine Cable

Source: Telegeography_Global Bandwidth Research Service_Submarine maps. www.submarinecablemap.com/#/.

APPENDIX E
BUSINESS-PROCESS OUTSOURCING LAW VERSUS FREE TRADE LAW

TABLE E.1 DIFFERENCES BETWEEN BPO LAW AND FREE TRADE LAW

Name of Regulation	Executive Agreement #008-2016: Regulation of the Law for the Promotion of Call Attention Centers and the Provision of Business Services	Agreement #41-2020: Regulation of the Law of Free Trade Zones
Goal	To create employment opportunities and promote national and foreign investment through the establishment of a special legal regime that allows the operation and functioning of the sector, stimulating the national economy and ensuring economic benefits especially for the country's unemployed youth.	Provides facilities to the industry, trade, and export and re-export of goods and services through national and foreign companies using a special regulation for the development of their activities. Fiscal incentives are intended to stimulate and strengthen the competitiveness of companies, improve export value chains, and increase the country's productivity to obtain a greater generation of employment and foreign exchange by promoting and attracting national and foreign investment. These tax incentives are granted to all companies that operate under the regime, which extends to the entire national territory.
Beneficiaries	Any natural or legal person, national or foreign, under the definition of the Law for the Promotion of Call Attention Centers and the Provision of Business Services.	Every user and user operator company that requests incorporation into the regime must allocate no less 50 percent of its production to export or re-export, with the exception of service companies, which will use their production or activity to supply productive processes or the supply of services to other companies benefiting from the regime or services that can be offered electronically using wire or wireless means for companies outside the national territory.

Name of Regulation	Executive Agreement #008-2016: Regulation of the Law for the Promotion of Call Attention Centers and the Provision of Business Services	Agreement #41-2020: Regulation of the Law of Free Trade Zones
Benefits and incentives	Exemption from the payment of customs taxes; charges; surcharges; consular fees; and internal, consumption, and other taxes that are imposed on the importation of equipment, tools, spare parts, accessories, furniture and office equipment, and other goods, that have direct or indirect relationship with the operations and execution of the incentivized activity.	The introduction of merchandise to the Free Trade Zone of Puerto Cortés is exempt from the payment of customs duties, charges, surcharges, consular fees, internal taxes, consumption and other taxes, and charges that are directly or indirectly related to import and export customs operations.
	Exemption of the income tax exclusively for the income from the incentivized activity, during the period that they carry out their operations in the free zone, counted from the beginning of operations.	The profits obtained in their operations in the Free Trade Zone by the companies established there are exempted from the payment of income tax.
		Sales and productions that take place within the free zone and the properties and commercial and industrial establishments of the same, are exempt from the payment of taxes and municipal contributions. The exemption from the payment of municipal taxes and contributions contained in this law exempts compliance with the formal and material obligations derived from sale taxes, except for the formal and material obligations derived from the neighborhood tax.
	Income from salaries and other personal income of the people who work in call service centers and business services outsourcing, will be subject to the payment of income tax in accordance with the law on the matter.	Income from salaries and other similar personal income of the people who work in the Puerto Cortés Free Trade Zone, will pay the income tax in accordance with the law on the matter.
Supervision and regulation	Surveillance and control of the customs and fiscal regime will be supervising by the DEI, and the technical-regulatory aspects will be overseen by CONATEL.	Secretary of State in the SDE and Customs Administration
Control	SDE and CONATEL in the case of call centers	SDE and Customs Administration

Note: companies covered by other special regimes that want to enjoy the benefits of the Free Zone Law, must renounce the benefits of the previous regime.

Source: The Executive Agreement #008-2016 was retrieved from https://www.poderjudicial.gob.hn/CEDIJ/Leyes/Documents/Reglamento%20Ley%20Fomento%20Centros%20Atencion%20Llamadas%20y%20Tercerizacion%20Servi%20Empresariales.pdf. The Agreement #41-2020 was retrieved from https://www.tsc.gob.hn/web/leyes/Acuerdo-41-2020.pdf.

Note: BPO = business-process outsourcing; CONATEL = National Commission of Telecommunications (Comisión Nacional de Tele Comunicaciones); DEI = Executive Directorate of Income; SDE = Secretariat of Economic Development (Secretaría de Desarrollo Económico)

APPENDIX F
COVID-19 AND BUSINESS-PROCESS OUTSOURCING INTERNATIONAL COMMUNICATIONS MODELS

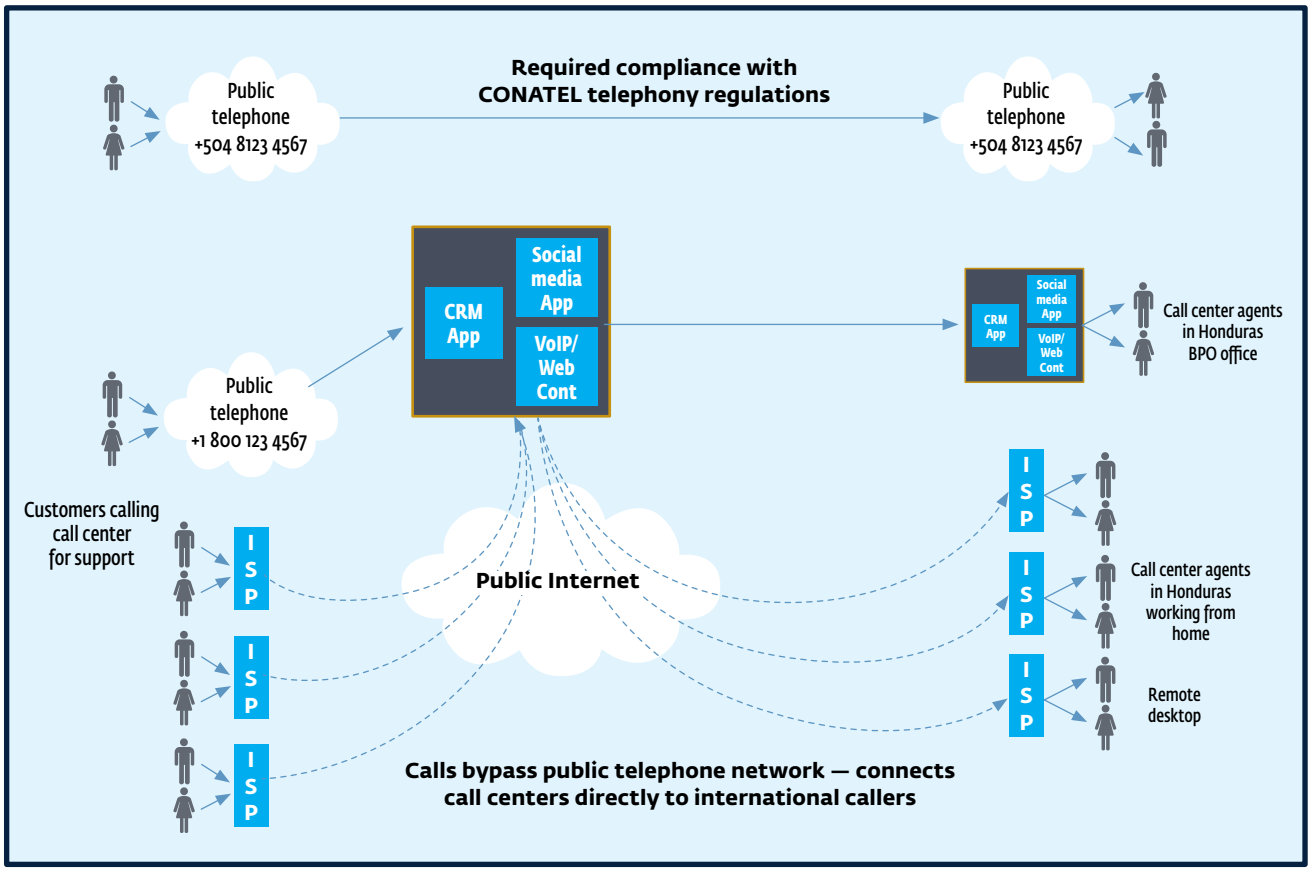
The Permanent Contingency Commission (Comisión Permanente de Contingencias; COPECO) has developed the SINAGER Law,[1] which "constitutes a legal framework aimed at the country having and developing the ability to prevent and reduce the risks of potential disasters, in addition, to prepare, respond and recover from the real damages caused by the natural phenomena that impact us or by those generated by human activities."[2] In the case of the COVID-19 pandemic, the national shutdown and curfew were implemented very quickly without an advance warning or specific guidance for the business community. In addition, to ensure compliance, a business-process outsourcing (BPO) company registered under the Free Trade Law requires a compliance inspector onsite to ensure no infractions of the customs laws or taxation occur on premise. This was impossible to audit during remote work and has required emergency compromises for items such as company laptop computers, printers, or other information technology equipment that were brought to individual homes or residences for use during the crisis.

With the COVID-19 stay-at-home response to call center operations, there was some confusion and discussion on the legality of workers connecting to international call center calls from their homes. Normally during voice communications between a customer, for example in the United States, and a Honduras-based BPO, the call would never touch the Honduras public switched telephone network or mobile networks. The national telecommunications commissions (CONATEL), an advisory, coordinating, and executing body of telecommunication services in Honduras, noted that home-based work for call center agents will allow telephone calls from the United States or other locations to pass through the internet with the same consideration as if the agents were in the call center facility, as per CONATEL resolution #11/2015. Under CONATEL's Resolution #11/2015: "It is provided that the final application of call centers does not constitute telephone calls. However, if in the origin or reception of voice and data communications from call centers they use numbering resources from the National Numbering Plan of Honduras, these must be processed by the Public Switched Telephone Network or the Public Telephone Networks of the operators/sub-operators authorized by CONATEL in the international long distance telephone service."

The American Chamber of Commerce is offering training to small and medium enterprises on how to use e-commerce, virtual meetings, and other utilities that might help them deal with COVID-19. However, according to the Association of Technology and Communications Companies of Honduras (ASEMTECH), which aims to improve the access and use of technology, most programs designed to support innovation within the country are on hold due to COVID-19. While this may delay some innovations in supporting the BPO industry, it is a condition that is beyond the control of ASEMTECH and the BPO industry.

While this reality is not specifically addressed by CONATEL in their COVID-specific decree #24-2020, there have not been any operational or legal disruptions based on the communication model shown in figure E.1. This may become an issue when COVID-19 begins to fade, and stay-at-home or work-at-home business models persist as an alternative to working in physical call centers, or if a company needs to implement a continuity plan based on facility or other operational disruption.

FIGURE F.1 BPO INTERNATIONAL COMMUNICATIONS MODELS



Source: World Bank Staff based on the Country Private Sector Diagnostic (CPSD) mission consultations.

Note: BPO = business-process outsourcing; CONATEL = National Commission of Telecommunications (Comisión Nacional de Tele Comunicaciones); CRM = customer resource management; ISP = internet service provider

1. This risk and disaster response law are supported by World Bank loan P172567.
2. COPECO Honduras, SINAGER Law, 2020: http://www.copeco.gob.hn/?q=ley-sinager.

APPENDIX G
KEARNEY GLOBAL SERVICES LOCATION INDEX COUNTRY RANKINGS

FIGURE G.1 GSLI OVERALL COUNTRY RANKINGS

Rank	Δ	Country	Financial attractiveness	People skills and availability	Business environment	Digital resonance	
1	-	India	2.82	2.23	1.14	0.87	7.06
2	-	China	1.88	2.25	1.38	0.97	6.49
3	-	Malaysia	2.60	1.15	1.64	0.76	6.15
4	-	Indonesia	2.84	1.26	1.27	0.65	6.02
5	1	Vietnam	2.82	1.17	1.33	0.56	5.88
6	16	United States	0.40	2.34	1.89	1.21	5.83
7	1	Thailand	2.62	1.16	1.41	0.62	5.81
8	11	United Kingdom	0.85	1.84	1.95	1.14	5.79
9	(4)	Brazil	2.27	1.66	1.34	0.52	5.78
10	(3)	Philippines	2.76	1.31	1.11	0.59	5.78
11	2	Mexico	2.36	1.31	1.48	0.56	5.71
12	13	Estonia	2.13	0.78	1.81	0.92	5.64
13	(3)	Colombia	2.50	1.16	1.42	0.53	5.60
14	-	Egypt	2.90	1.08	1.01	0.58	5.56
15	2	Germany	0.76	1.86	1.91	1.02	5.55
16	13	Lithuania	2.46	0.72	1.63	0.70	5.52
17	(2)	Bulgaria	2.47	0.73	1.61	0.61	5.42
18	5	Russia	2.25	1.23	1.23	0.68	5.39
19	1	Peru	2.61	0.98	1.35	0.43	5.37
20	4	Ukraine	2.90	0.87	1.01	0.58	5.36
21	7	Latvia	2.33	0.74	1.67	0.62	5.36
22	(13)	Chile	1.97	1.12	1.72	0.54	5.35
23	9	United Arab Emirates	2.09	0.76	1.78	0.72	5.35
24	(12)	Poland	2.05	1.11	1.56	0.63	5.35
25	(14)	Sri Lanka	2.94	0.85	1.08	0.46	5.34
26	10	Portugal	1.66	1.15	1.70	0.83	5.33
27	19	Canada	0.65	1.66	1.91	1.05	5.27
28	(10)	Romania	2.29	0.92	1.46	0.58	5.25
29	6	Argentina	2.21	1.28	1.26	0.49	5.25
30	4	Mauritius	2.30	0.75	1.60	0.59	5.24
31	(5)	Hungary	2.22	0.85	1.56	0.60	5.24
32	(11)	Bangladesh	2.90	1.01	0.89	0.43	5.22
33	(17)	Czech Republic	1.95	0.93	1.68	0.64	5.21
34	13	Singapore	0.75	1.33	2.06	1.04	5.18
35	6	Slovakia	2.04	0.78	1.69	0.62	5.12
36	(9)	Morocco	2.52	0.78	1.36	0.47	5.12
37	(7)	Pakistan	2.85	1.08	0.68	0.48	5.09
38	2	Panama	2.30	0.65	1.54	0.59	5.07
39	(2)	Turkey	1.96	1.28	1.22	0.59	5.06
40	4	Uruguay	2.18	0.74	1.52	0.60	5.04
41	1	France	0.56	1.72	1.81	0.93	5.02
42	3	Spain	1.00	1.51	1.61	0.88	5.00
43	(5)	Kenya	2.46	0.76	1.12	0.63	4.98
44	(13)	Costa Rica	2.16	0.79	1.42	0.55	4.91
45	(12)	Ghana	2.57	0.73	1.07	0.47	4.84
46	(7)	Trinidad and Tobago	2.16	0.79	1.39	0.44	4.79
47	2	Ireland	0.57	1.37	1.86	0.92	4.72
48	-	New Zealand	0.93	0.91	1.96	0.76	4.56
49	(6)	South Africa	1.91	0.83	1.29	0.53	4.55
50	-	Israel	0.74	1.03	1.58	1.05	4.39

Financial attractiveness | People skills and availability | Business environment | Digital resonance

Source: Arjun Sethi and Vidisha Suman, "Digital Resonance: The New Factor Influencing Location Attractiveness—2019 Kearney Global Services Location Index," Kearney. www.es.kearney.com/digital-transformation/gsli/2019-full-report.

Note: GSLI = Global Services Location Index.

The A.T. Kearney Global Services Location Index (GSLI) Study in 2019 considered four main criteria: (a) financial attractiveness; (b) people, skills, and availability; (c) business environment; and (d) digital resonance (table F.1).

TABLE G.1 GLOBAL SERVICES DIGITAL LOCATION INDEX

Financial attractiveness (35%)	People skills and availability (25%)	Business Environment (25%)	Digital resonance (15%)
Compensation costs	ITO/BPO experience and skills	Country environment	Digital skills
Infrastructure costs	Labor force availability	Country infrastructure	Legal and cybersecurity
Tax and regulatory costs	Educational skills	Cultural adaptability	Corporate activity
	Language skills	Security of intellectual property	Outputs

Source: Arjun Sethi and Vidisha Suman, "Digital Resonance: The New Factor Influencing Location Attractiveness—2019 Kearney Global Services Location Index," Kearney. www.es.kearney.com/digital-transformation/gsli/2019-full-report.

Note: BPO = business-process outsourcing; ITO = information-technology outsourcing

APPENDIX H
KEY PUBLIC SECTOR STAKEHOLDERS IN THE DIGITAL FINANCIAL SERVICES SECTOR

A. The Central Bank of Honduras (Banco Central de Honduras; BCH) is in charge of formulating and directing the monetary, exchange and credit policy for the country and issuing corresponding regulations. The BCH is responsible for ensuring the proper functioning and stability of the country's financial and payment systems. It is currently working on fully digitizing its check clearing system using electronic images that require advanced e-signatures, as well as working on promoting digital payments. The BCH owns and operates the Real Time Gross Settlement System, implemented in 2013 for transactions above US$20,000.

B. The National Banking and Insurance Commission (Comisión Nacional de Banca y Seguros; CNBS) is in charge of supervising the Honduran financial system and ensuring its stability and solvency as well as its regulation and control. It has also become very involved with the digitization process and the use of mobile technologies as a way to increase financial inclusion. In 2016, the CNBS approved the e-money issuer law (INDEL Law) and in February 2019, it created the Fintech Committee and Technological Innovations, through the government's Official Daily Gazette Resolution No. 119/02-21-2019, to promote regulatory and supervisory innovation, with a proactive approach considering technological initiatives oriented to financial deepening and financial user protection. This committee has become the point of contact between supervised financial institutions, financial technology (fintech) companies, and regulators. Some of the activities carried out during 2019 were (a) reviewing the regulatory framework to identify regulatory aspects that prevent the development and innovation of fintech initiatives; (b) identifying, collecting data, and registering existing fintechs; and (c) sharing knowledge to learn from other countries in the region (Digital Collection System [CoDI] of Banco de México, open banking, and the experiences of Colombian fintechs).

C. CNBS and BCH participate in the **Financial Innovation Round Table of Honduras** with banks and fintechs, with the objective of improving the ecosystem of payments and transfers, alternative financing, and cross-cutting technologies, and promoting innovation and financial digital transformation for Honduras as an important driver for inclusion in the financial system, especially to increase access to formal financial products and services that improve quality of life for lower income brackets.

D. **The National Supervisory Council of Cooperatives** (Consejo Nacional Supervisor de Cooperativas) is a state-owned institution, supervised by the CNBS and in charge of the application of legislation governing cooperatives, that acts as the control authority of the cooperative entities. The council is in charge of supervising the cooperative sector and conducting risk analysis related to corporate governance, as well as operational and portfolio risks. It also verifies fulfillment of anti-money-laundering compliance rules and conducts an annual analysis of those considered most at risk.

E. The state-owned **Honduran Bank for Production and Housing** (Banco Hondureño de la Producción y la Vivienda; BANHPROVI) is one of the most important stakeholders that supports micro, small, and medium enterprises (MSMEs). It was established in 2005 as a second-tier credit institution independent from the central bank. Since 2018, BANHPROVI also initiated commercial banking services to increase financial inclusion in the country by focusing on serving the bottom of the pyramid and geographic areas that are not currently served or are underserved by private institutions. BANHPROVI needs to manage the possible conflict between their first-tier commercial activities and their second-tier clients. BANHPROVI is in the process of launching an e-wallet with the first objective of conducting electronic government-to-people (G2P) transfers. Second-tier clients are concerned about the use of BANHPROVI´s wallet, since BANHPROVI would have access to their customer's transactional activity.

F. The **National Service for Entrepreneurship and Small Businesses** (Servicio Nacional de Emprendimiento y Pequeños Negocios; SENPRENDE) is the institution providing formalization services for MSMEs, as well as technical and financial assistance. SENPRENDE has specific programs oriented to increasing digitalization in the MSME sector, for example, in April 2020, together with the Organization of American States and Kolau, a marketing platform for small and medium enterprises (SMEs) that partnered with Google and launched a plan to allow entrepreneurs and MSMEs to register their companies on the internet completely free and in less than 15 minutes, and thus gain access to the benefits of electronic commerce. In its first phase, the program expects to benefit about 15,000 entrepreneurs.

G. The **Office of Presidential Priorities and Public Innovation** was created by the prime minister during the COVID-19 pandemic, to define and implement the government digital agenda that includes a digital transformation strategy for the public sector, as well as policies and programs for e-government initiatives. At the moment, the focus is on public policy, where digital identification (ID) and digital money are considered the two main pillars of the digital strategy.

H. The **National Register of People** (Registro Nacional de las Personas) has become a key player in the digital transformation of the Honduran population revamping the ID system to become digital. The register has updated its registry infrastructure and has hired international tech companies such as Oracle, to migrate data into cloud, and Idemia, as an expert in identity programs, to enable a secure and trusted environment for citizens to perform their daily activities. The first phase is to provide the population with a new ID card, and a quick response (QR) code instead of a physical ID. Having a revamped ID system might make it possible to open accounts remotely and therefore increase the number of people with a transactional account to facilitate electronic payments. Building transactional data is a relevant step to assess creditworthiness for lending.

I. The **National Telecommunications Commission** (Comisión Nacional de Telecomunicaciones; CONATEL) is of high importance to the sector, since connectivity access at an affordable cost is one of the foundational pillars for the provision of digital financial services. CONATEL was involved in the process to authorize Tigo Money to operate as an electronic money issuer.

APPENDIX I
SELECT REAL-TIME, LOW-VALUE PAYMENTS INITIATIVES—EXPERIENCES IN THE REGION

In global markets, there is a mix between closed-loop initiatives led by the private sector or by consortia, such as Venmo (US PayPal), Zelle (US banks), Bizum (Spanish banks), WeChat and Alipay, and public initiatives such as Faster Payments (United Kingdom), and Giro (Hungary). In Latin America there are different initiatives to also embrace real-time, low-value payments in an effort to democratize payments:

Mexico. By mandate of the Central Bank of Mexico (Banxico), since the end of 2017, real-time payments have been available 24/7 through its interbank electronic payment system (SPEI), originally established in 2004. The adoption among consumers was low as users needed the full 18-digit account number or the beneficiary's debit card number, so the user experience is clunky and unappealing. To promote the use of SPEI, Banxico developed its Digital Collection System, CoDi, which incorporates quick response (QR) codes with the aim of equipping merchants with a low-cost mechanism so that they can accept electronic payments (instead of using a point-of-service terminal) and sell products over the internet. One of the main challenges for Banxico is encouraging banks to support this solution. Many banks have already developed their own closed-loop systems for person to person (P2P) payments, mobile wallets, and QR code platforms with a better user experience.

Colombia. ACH Colombia, a company owned by financial institutions, in 2005 built the payment button service PSE (Electronic Service Provider), a centralized system that allows businesses to offer their customers online payments and purchases by accessing their bank accounts. In 2007, ACH Directo (Real-time Interbank Transfers) services was created. In 2016 the e-money issuer law was approved. Since then, several closed-loop wallets have emerged, but they are not interoperable. ACH Colombia implemented "ACH in real time," an initiative to enable low-value payments from bank accounts more widely and in real time. Since 2019, ACH has offered its Transfiya product to send, receive, and request money in seconds, using only the mobile phone number and without additional apps, thus facilitating interoperability between wallets and promoting low-amount payments in real time. It allows users to make up to five daily transfers, for a maximum amount of COL$250,000 (US$65) per transfer. The institutions that have already connected to ACH are Banco AV Villas, Caja Social, Coopcentral, Daviplata, Davivienda, Itaú, Movii, Nequi, and Serfianza. For those small institutions that are not able to launch their own e-wallet, and to be an inclusive project, ACH is also providing an e-wallet-as-a-service to those institutions with limited resources.

Peru. In Peru, banks came together in 2017 to combat the lack of competition in cards (Visanet was the sole acquirer of Visa in Peru) and the dominance of cash. Banks built an interoperable money transfer system, Bim, also an interoperable mobile wallet. Bim, which had the backing of most banks, made it possible to do P2P payments, mobile recharges, bill pay, and other interoperable services. However, Bim was created for financial inclusion purposes for the unbanked population, limiting its growth, and it reached a user base of only 700,000. Banks decided to create their own P2P closed-loop wallets for their clients. For example, the Central Bank of Brazil launched Yape, which is already incorporating QR codes. This motivated the competitors—BBVA, Interbank, and Scotiabank, which also launched their own e-wallets—to merge into a single interoperable wallet called Plin.

Brazil. The Central Bank of Brazil (BCB) was one of the first in the region to promote payment interoperability. Initial discussions in 2010 focused on the interoperability of payment processors and has evolved toward bank transfers and real-time payments. In 2017, the BCB started to work with banks and financial technology (fintech) companies to promote an instant payment system. The system was launched in November 2020 to make P2P, person-to-business, business-to-business, person-to-government, business-to-government, government-to-person, and government-to-business transactions. The instant payment system aims to speed up payments, with immediate availability of final funds to the payee, lowering costs, increasing safety, and, ultimately, improving customer experience. The Brazilian instant payment (IP) ecosystem is composed of (a) the open participation scheme run by the BCB; (b) the Instant Payments System (SPI) operated and managed by the BCB, that is the centralized and sole settlement infrastructure of the Brazilian IP ecosystem that will settle the transactions on a real-time and gross basis, without generating financial exposure among participants, available 24/7; and (c) the payment service providers. The provision of this service still needs regulation by the Central Bank, based on art. 6 of Law 12865, of October 9, 2013.

APPENDIX J
SELECT WAYS TO ENCOURAGE NEW PLAYERS IN MERCHANT PAYMENT ACCEPTANCE ACTIVITY

There are three ways regulators can encourage electronic payments merchant acceptance:

1. Increase competition and avoid monopolies:

- In Argentina, in 2017, the Commission for the Defense of Competition forced the banks to sell Prisma, which held an exclusive Visa license, and to free up competition in the acquisition market.
- In Chile, Transbank, also owned by the banks, was forced to be sold.
- In Peru, the two single-brand acquisition networks, Visanet (Visa processor) and PMP (Mastercard processor) were forced to become multi-acquisition brands.
- In Brazil, regulations removed exclusivity for acquiring and opened the market for new players in 2010, and today there are almost 20 acquirers offering all card stamps, including private label ones. The result was a sustained drop in the merchant discount, in addition to consumers being able to opt for differentiated products adapted to business needs.

2. Regulate the merchant discount rate and interest.

In Chile, the 3 percent merchant discount rate charged to merchants has gone down in five years to 1.8 percent. In Argentina it has dropped by half to 0.8 percent, which is still far above Europe, which has a rate of 0.2 percent. In Peru, the merchant discount rate has not been affected. This means that as income on the issuing side is reduced, banks decide to reach out to more businesses.

3. Develop a financial technology law to encourage new payment players, including the following:

- An obligation to give free points-of-sale terminals to accept debit card payments to businesses
- The creation of new subacquirers or aggregators facilitating the connectivity to existing processors under nondiscriminatory conditions. These subacquirers do not need to be payment-card industry compliant with Mastercard and Visa (creating payment-card industry compliant costs of US$15 to $20 million) and are exempt from conducting know-your-customer checks (for example, Prisma with Ferrata).
- Tax advantage of aggregators versus acquirers. Acquirers withhold taxes (value added tax) while subacquirers do not.

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