



**DIRECTORATE-GENERAL FOR EXTERNAL POLICIES
DIRECTORATE B
- POLICY DEPARTMENT -**

NOTE

**ON THE POLITICAL AND ECONOMIC SITUATION
IN HONDURAS AND ITS RELATIONS
WITH THE EUROPEAN UNION**

Abstract:

Honduras is one of the poorest countries in the Western Hemisphere. Its economy, mainly dominated by agricultural exports, was devastated by Hurricane Mitch in 1998. Damage to the infrastructure was a major obstacle to economic growth; however Honduras did receive international financial support which encouraged the government to pursue its programmes focused on regaining stability.

In March 2006, the legal proceedings for the entry into force of the Central American-Dominican Republic-US Free Trade Agreement (CAFTA-DR) were completed, with the creation of Institute for External Trade. The Vienna Summit, which took place in May this year, represented a milestone for bilateral relations between the EU and Latin America. The EU is in favour of launching negotiations for the Association Agreement between the EU and Central America which includes the establishment of a Free Trade Area.

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I. POLITICAL SITUATION

1. Introduction

1.1 Geographical Location

Honduras is a Central American State¹. Its history, culture and economy are very closely connected to those of Guatemala, El Salvador, Nicaragua and Costa Rica, its neighbours on the isthmus. These countries, along with Panama and Belize (formerly British Honduras), form a strip of land the same size as France (540 000 km²) which, in 1950, had a population of 8 million inhabitants. Fifty years on, the population has risen to 33 million.

Honduras, which covers an area of 112 090 km and is situated between the Caribbean Sea and the Pacific Ocean, shares borders with Guatemala to the west, El Salvador to the south and Nicaragua to the east, and has a population of around 6.5 million. Its capital is Tegucigalpa.

1.2 Historical Background

The countries of Central America were subject to Spanish colonial domination from the 16th century until 1821, the year of their independence. 1824 saw the creation of the Central American Federation, comprising Guatemala, Honduras, El Salvador, Nicaragua and Costa Rica. Fifteen years later (1839), the Federation fell victim to regional nationalism and foreign interests and collapsed. The second 'post-independence' period that followed was marked by consolidation of the nation states, integration of the region into the global economy (thanks to the production of coffee and bananas) and the growing influence of a 'coffee plantation' oligarchy that was very dependent on foreign capital and foreign markets.

Central America was especially hard-hit by the crisis of 1929, which resulted in a fall in the price of raw materials and the shrinkage of export markets, with no alternative manufacturing sector, and rapid disinvestment by the United States. This crisis was exacerbated by frequent military intervention by Washington, which foreshadowed the long reign of the 'Depression dictators': Maximiliano Hernández in El Salvador, Tiburcio Carias in Honduras, the Somoza dynasty in Nicaragua and Jorge Ubico in Guatemala.

In the 1960s, the rise in coffee prices and the formation of the Central American Common Market (CACM) presented an opportunity to attempt limited reforms. Twenty years later, the adverse international economic climate (slump in the prices of traditional Central American exports, increase in foreign debt, etc) led to devaluation, inflation, unemployment, and consequently major social unrest. The oligarchies of the isthmus,

¹ See Annex I

who feared what had happened in Cuba, delegated political power to the military. Conflicts broke out in almost every state in Central America. The *Contadora* Group, which was formed in 1983 by Mexico, Venezuela, Panama and Colombia, was to play a decisive role in negotiating settlements to the conflicts, based on respect for the independence of the countries concerned. The activities of this group, which received the support of Argentina, Brazil, Peru and Uruguay, led to the signing on 7 August 1987 of the peace agreement known as *Esquipulas II*, which signalled a clear sidelining of US diplomacy and the adoption of a more independent attitude by the signatory Central American countries.

Peace has returned to Central America, but the region has been bled white. 100.000 to 150 000 people died in Guatemala, 75.000 in El Salvador and 100.000 (in the conflicts) in Nicaragua. In addition, over two million people were forced to abandon their homes in the 1980s, and almost half of these displaced people have left the region. However, at the peace talks, which were the result of political compromise, the socio-economic factors that lay at the origin of the conflicts were sacrificed. Despite spectacular progress at institutional level, the establishing of the rule of law and the emergence of a democratic culture, the continuing degeneration of the economic and social situation makes any hope of political stabilisation improbable. A long period of civil war ended the military dictatorships, but an alternative development model has yet to be found. The crisis has ended where it started, leaving unanswered the question of how to end social injustice.

Since 1839, violent clashes between the Conservative National Party (PN) and the Liberal Party (PL) has dominated political life, which was punctuated by dictatorships, including that of Tiburcio Carias (1932-1949), for many years. Reform attempts failed as a result of regional fragmentation and major communication difficulties.

2 Recent History

At the beginning of the 20th century, the Honduran economy began to develop around the US companies who monopolised the land and banana production. The United Fruit Company (UFCO) gradually increased its hold over other sectors, to the point where it had almost complete control over economic and political life. Indeed, UFCO and its partner, United Brands, assembled and dismantled governments to suit their own interests. The United States also sent its marines into the country in 1903, 1905, 1919 and 1924 to 'restore order'.

The army, which had long been known for having a progressive wing in its ranks, burst onto the Honduran political stage in 1956, two years after the country's largest strike on the banana plantations. The military organised elections in 1958, which were won by a liberal, Ramón Villeda Morales. He drafted a labour code, a social security law and, most importantly, agricultural reforms. A violent coup in 1963 ousted the elected President, who was accused of 'communism'. The military's influence on Honduran politics continued until 1980, when parliamentary elections were held. To the surprise of many, the Liberal Party, which represented the interests of the business and industrial moderate

middle classes, but was also supported by large numbers of workers and impoverished peasants, won a majority in the new parliamentary assembly, to the detriment of the National Party, which continued however to control all the state apparatus. The 1981 presidential elections also saw a victory for the PL candidate, Roberto Suazo. These elections marked the end of nine years of military government and lent politics a certain legitimacy. A new Constitution, the 16th since independence, entered into force on 20 January 1982.

Honduras, which spans Central America and cuts Nicaragua off from the other two countries in which military movements emerged, became the linchpin of US strategy. The protective influence of the United States and its omnipresent troops continued to dominate political life in Honduras, which, unlike its neighbours, Guatemala, El Salvador and Nicaragua, has never known the threat of guerrillas.

The civilian-military power struggle began with the election of President Carlos Alberto Reina, the former President of the Interamerican Human Rights Court, on 28 November 1993. With a comfortable Liberal Party majority in the National Congress, Mr Reina announced his intention to eradicate corruption, reform the judicial system and reduce the army's power. The President's efforts, which had the backing of the international community and particularly the United States, were crowned with success. On the social level, however, he failed spectacularly. According to the United Nations Development Programme (UNDP), 71% of Hondurans were living below the poverty line in 1997 and 55% of them were destitute. The situation has become all the more critical with the country's difficulty in getting back on track following Hurricane Mitch, which devastated Honduras in 1998, causing 11.000 deaths, destroying 700.000 homes and dealing a severe blow to the agricultural sector. The attempts by President Carlos Flores to modernise the economy and improve the circumstances of the most deprived members of the population have been a mitigated success.

3. Internal Policies

3.1 Institutional framework

Honduras is a constitutional republic which is divided into 18 departments. In spite of the separation of powers, the executive clearly dominates and the Parliament has one chamber. The National Congress is made up of 128 members, who are elected by universal suffrage for a four-year period. The Supreme Court of Justice consists of nine judges, elected by the National Congress for a four-year term.

Since 1982 politics have been dominated by two parties, the National Party and the Liberal Party, right wing and centre right, respectively. There are three other minor parties in Honduras, namely the *Partido de Innovación y Unidad-Social Democracia (PINU)*, *Unificación Democrática* and *Democracia Cristiana*. These parties are very small compared to the other two; they occupy very few seats in congress and generally obtain very little votes in the presidential elections (in the November 2005 elections they

received only 5% of the votes all together).

The organism in charge of supervising the elections is the *Tribunal Supremo Electoral*. It has been accused in the past of lack of transparency and efficiency.

3.2 2001 Elections

After two consecutive terms under a Liberal Party Administration, Honduras saw the victory of Ricardo Maduro (*Partido Nacional*) on 25 November 2001. He defeated his opponent by 8 percentage points, which is quite a major difference by Honduran standards.

The transition to democracy has been relatively successful in Honduras, particularly compared with other countries in Central America. The 2001 elections, which took place without major problems, helped to consolidate Honduras' democratic tradition, although it could be argued that there was little to choose between the two candidates at a policy level. While Ricardo Maduro has performed competently, he has not convincingly managed to get to grips with some of the major issues from his election campaign, particularly fighting rising levels of crime and violence. This has led to increasing discontent and falling approval ratings throughout his mandate.

Forty-four per cent of the rural population in Honduras have no land or not enough land to provide them with sufficient income and food. The Agrarian Reform is written into the Constitution: under current legislation, land not fulfilling its social purpose must be expropriated and transferred to landless rural families as part of the Agrarian Reform. However, these transfers are not always straightforward. In the summer of 2003, several peasants were murdered.

Maduro pledged to crack down crime by taking a zero tolerance approach, with unconvincing success to the extent that his government was accused of being corrupt and too radical in the fight against *maras* (criminal youths). Economic growth did flourish however.

Over the past decades politicians, as well as members of the executive, legislative and judicial branches, have been accused of being involved in drug trafficking. Recent reforms have shown the government's effort to regain credibility vis-à-vis the people.

Ricardo Maduro is now free of the immunity he once benefited from for being head of state. This "lifting off of immunity" is spreading across South America, where many governments and individuals have been accused of corruption over the decades but where it has been very difficult to take them to court to face a trial. Unfortunately, in Central America, many of the powerful people still benefit from immunity. This has been, therefore, a major step towards transparency and democracy in Honduras.

During Maduro's mandate there was a tragic accident in a prison in San Pedro Sula, in the

north of the country. A fire killed 104 young men, most of them in jail for belonging to some gang. In the government's fight against terrorism (the two main Mara gangs, *Mara Salvatrucha* and *Mara 18*, are considered almost terrorist organizations), it was possible to imprison suspects to a ten year sentence just because they had a gang tattoo. This policy has caused an emigration movement to the United States. These radical measures have been criticised by NGOs as being anti-democratic.

3.3 2005 Elections

a) Candidates

The last presidential election took place on 27 November 2005.

The *Partido Nacional* was represented by Porfirio "Pepe" Lobo, a former member of the Communist party who had been trained in the Soviet Union. He then studied business administration in Miami. He is in favour of the death penalty for crimes such as sexual assault, kidnapping and murder. Lobo supports hardline anti-mara laws that provide for both the fining and the detention of individuals for their affiliation with a gang.

The candidate for the Liberal Party was José Manuel Zelaya Rosales (often called Mel Zelaya), a 52 years old ex rancher who started a civil engineering degree before turning to politics. He was the former Investment Minister during the 1997 Liberal mandate. Zelaya's measures to deal with gangs are much more moderate: he wants to put more emphasis on poverty and exclusion which originate the gangs and the violence.

The other candidates failed to draw widespread support and decided to withdraw at an early stage.

The campaign reflected the main preoccupations of Honduran citizens which are poverty and unemployment. As for economic reforms, both candidates claimed that they intended to pursue the CAFTA-DR, undertaken by former President Maduro. The candidates spent more efforts accusing and aggressing one another with little depth and constructive arguments. During the months prior to the elections Lobo was leading the polls, although only by a narrow margin according to a national survey.

b) Election Results

Although the elections took place without any major problems, they did not run as smoothly as they should have. The counting process was lengthy; and Zelaya's victory was announced officially and unofficially at several stages.

Two days after the elections a preliminary ballot count gave a clear advantage to candidate Zelaya, who declared himself the winner before the TSE made any formal statement. The ex-president and Lobo teamed up refusing to recognise Zelaya as the new president of Honduras. A more thorough counting was requested; indeed only 151 of over

5000 ballot boxes had been opened. Furthermore, it is not a secret that the President of the TSE, Aristides Mejía, is a PL affiliate.

The following two weeks were chaotic and tense, whilst the TSE continued counting the votes. With still 11% of the votes to be counted, Zelaya was officially declared President (as the remaining votes wouldn't make a difference to the outcome). Zelaya then revealed his cabinet minister's names: they are all ministers or officials that worked under the Liberal administration of Carlos Roberto Reina and Carlos Roberto Flores Facussé.

With 88.73% of the votes counted, the results were 49.95% for Zelaya, 46.16% for Lobo and less than 5% for the other candidates.

In Congress the PL won 62 seats, only 7 more than the PN, but still not sufficient to secure a majority of the seats.

3.4 The Zelaya Administration

When Zelaya was sworn in he promised transparency and crime reduction. There are very little differences between Zelaya's platform and that of his rival, Lobo. His programme is focused on tackling corruption and during the first months of his mandate, Zelaya fulfilled his promises by securing the Congress' approval for the "Citizen Participation Law" which is aimed at giving more power to the Hondurans in the policy making process. Another law submitted by the Zelaya administration during the first months of his mandate has been the "Transparency Law". This would allow citizens to access information on the public institutions, such as money spending and *modus operandi*.

The gangs have declared willingness to dialogue with the new President who had called for the negotiation of a truce when giving his inaugural speech in February 2006. *Mara Salvatrucha* leader is going to cooperate with the government only if measures regarding the detention of individuals related to gang activities are changed. Also the leader of the other important gang, Mara 18, claimed he is ready to negotiate.

4. External Policies

4.1. Regional blocs

Honduras is a strong supporter of Central American integration and is an active member of the Central American Integration System (SICA), the Central American Parliament (PARLACEN) and the Central American Security Commission (CASC). Honduras is also part of the Organization of American States (OAS) since 1995.

4.2. Relations with neighbouring countries

Minor disagreements with El Salvador and Nicaragua aside, Honduras enjoys generally good relations with its neighbours. The quarrel with Nicaragua stems from the fact that both countries covet the same part of the Caribbean coastline, which sometimes makes for customs disputes. The case has been submitted to the International Court of Justice in The Hague (ICJ). Following the 'Football War' of 1969, Honduras and El Salvador signed a peace agreement in 1980. In 1992, the ICJ allocated a large part of the disputed territory to Honduras, and a border demarcation treaty was signed in 1998, but has yet to be ratified.

Zelaya met Salvadoran president Antonio Saca in December 2005 to discuss the border issues and settle the problem once and for all. 10 km of the 345 km of frontier have been under discussion for many years, since negotiations began in the 1980's. The two presidents held another official encounter in April 2006; they both welcomed the positive outcome of the negotiations and proposed to join their efforts to promote regional cooperation and integration.

4.3. Relations with the United States

Relations with the US are close and Honduras has been particularly supportive of the US war on terror. Washington also maintains a military and counter-narcotics presence in Honduras. The US remains Honduras's main trading partner, accounting for 46% of its imports and 49% of its exports in 2001, while US direct investment is estimated to account for some two-thirds of the total of USD 1.3bn. These close ties have not been without their problems. Although protest is not specifically anti-US, there has been strong popular opposition to free trade deals and IMF-imposed targets from the population.

Congress approved the Free Trade Agreement between the United States and Central America and the Dominican Republic on October 3rd 2005. Finally, in March 2006, the legal proceedings for the CAFTA-DR are finalised. Five deputies of the minor leftist party lamented the changes as being beneficial solely for the businesses and multinationals.

The reforms associated to the CAFTA-DR consisted in transferring further responsibility from the Secretary of Commerce and Industry to the newly created Institute for External Trade. The establishment of the industry was announced in December 2005.

Furthermore, a law addressing the harmonisation of legislation on intellectual property and the consolidation of legislation on telecommunications was approved as a preliminary step to enforcement of the CAFTA-DR.

II. ECONOMIC SITUATION

1. Introduction²

Honduras is one of the poorest countries in the Western Hemisphere. During the 1980s, the debt crisis triggered a prolonged economic decline. Other prohibitors of economic development included a large and inefficient public sector, extensive administrative controls that discouraged private investment, a trade regime that was biased against exports, inefficient financial intermediation, low investment in education and insecure property rights.

However, beginning in 1990, a number of policy reforms were implemented that sparked a turnaround. By 1993, the economy was growing at over 3%, driven principally by booms in the manufacturing and construction sectors. This momentum was lost, however, when the government loosened the fiscal reins in the run-up to elections in the same year, forcing the succeeding government to adopt drastic contradictory policies. By 1997, the Honduran economy had once again recovered, with GDP growth improving, inflation failing, and a manageable balance of payments deficit.

Hopes of economic modernisation and sustainable development were shattered towards the end of October 1998 when Hurricane Mitch brought about severe flooding, leaving thousands of people dead and one million homeless. Estimates of the damage to the economy indicate those direct losses of inventories and fixed assets amounted to about 50% of annual GDP. For 1998 as a whole, the key economic effects of the hurricane included a slowdown in real GDP growth to an estimated 3%, an increase in unemployment, a pick-up in the 12-month rate of inflation to 15.5%, and a widening of the central government's and balance of payments deficits. Important areas of agricultural activity were severely disrupted, including the banana, shrimp and coffee industry. Bananas and coffee account for over 60% of the country's exports. Production of both of crops is, however, under pressure from both trade concerns and from falls in the price of global commodities.

The country's main imports are machinery and transport equipment, industrial raw materials, chemical products, manufactured goods, fuel and oil and foodstuffs. The main sources of imports are the US (50%), Guatemala (5%), Japan (5%), Mexico (3%) and El Salvador (3%).

In December 1998, members of the Paris Club agreed to suspend the country's debt repayment for three years, allowing some breathing space for the Government as it begins the arduous task of rebuilding its infrastructure. At the same time, the World Bank announced the provision of an interest-free USD 1bn loan over 40 years to both Honduras and Nicaragua. The US Government has also asked Congress to consider writing off 67% of the country's USD 144m bilateral debt.

² See Annex II.

As a result of the hurricane, the Honduran economy grew by 3% in 1998, well down on the projected 4.5-5%.

In March 1999 the International Monetary Fund (IMF) approved a three-year arrangement under the Enhanced Structural Adjustment Facility (ESAF) for Honduras for an amount equivalent to USD 215m to support the Government's economic programme for 1999-2001.

In July 2000 the IMF and World Bank approved USD 556m in debt relief for Honduras under an improved version of the Highly Indebted Poor Countries (HIPC) initiative. Although the World Bank aid was made available immediately, the IMF share of the debt relief is dependent upon an HIPC funding deal from 80% of the country's creditors. Other creditors will hand over their share of debt relief once the Government is seen to achieve social security reform and improve its health and education services. The debt relief package will save the Government some USD 556m in debt servicing over the next 15-20 years.

Honduras has received support from the International Monetary Fund and the Paris Club of Sovereign Creditors because of its achievements in debt relief, economic growth and poverty reduction. During the year 2004, Honduras completed its Poverty Reduction and Growth Facility (PRGF) target which helped the country obtain relief from the Heavily Indebted Poor Countries (HIPC) initiative. During the next decade Honduras will have to payback US\$3.5 billion foreign debt instead of US\$4.7 billion. According to the HIPC programme, the funds saved will have to be spent on poverty alleviation.

2. Current economic situation

The Honduran economy had, by May 2001, recovered from Hurricane Mitch. Following the hurricane, Honduras entered an economic recession that lasted until early 2000. Nonetheless, in 2001, the performance of the Honduran economy was returning to pre-Mitch levels. GDP growth was 2.6% and inflation was 9.7% (against a predicted 10-11%). The growth figure is attributed to a USD 293m investment of reconstruction projects that continued until December of 2001. Exports in the mining sector totalled about USD 62m between zinc, lead, gold and silver.

Despite brisk growth in 2001, the Honduran economy is feeling the effects of plummeting world coffee prices and a slowdown in the United States, exacerbated by crop devastation due to a prolonged drought in 2001. There are internal and external elements that could hinder sustained growth, especially in terms of the drop in export coffee prices and an increase in fuel prices. The Central Bank considers that Honduras will also suffer from the blow to the world economy that occurred with terrorist attacks on key US landmarks.

After a couple of months delay due to the change of government, the yearly budget was approved in May 2006. Budget deficit is 2.3% of GDP. In December 2003 Honduras

signed a three year agreement with the International Monetary Fund for Poverty Reduction and Growth Facility (PRGF). This has secured debt relief under the Heavily Indebted Poor Countries. Honduras has made progress on a number of fronts: the macro economic programme is back on track in agreement with the IMF.

However, trade deficit is continuously growing. It was at 1.3 US\$ bn in 1999 and has now increased to 3 US\$ bn in 2005. Exports are expected to recover, but imports will increase faster because of private projects and infrastructure programmes.

- **Economic Growth**

Given the scale of damage inflicted by Hurricane Mitch, the economic contraction of 1999 was relatively modest and short-lived. With increased international assistance (IMF, World Bank, US Congress) and trade concessions, growth exceeded 2% up until 2004.

In 2004 the recovery of agriculture and private investments were such that the economy grew 5%. In 2005, however, figures decreased compared to previous years (3.8%) mainly because the external environment was less favourable to the *maquila* exporting sector. This sector hires 115.000 people, but it is likely to lose some market share because of strong competition from China.

- **Inflation**

The Government succeeded in bringing inflation down to almost single figures by the end of the 1990s. It rose again in 2000, chiefly as a result of increased global fuel prices, to 11%, but dropped to 9.7% in 2001 and 7.7% in line with declining global growth³. In 2005 inflation has decreased to 7.1%.

- **Current-account deficit**

The current-account deficit is below the programmed level⁴. It was financed through external concessional loans and debt relief, as well as private sector capital inflows. However, a certain amount of public saving is required to counteract the external assistance to restore the country's infrastructure.

- **Fiscal policy**

An IMF mission reported that Honduras had performed favourably under the programme. A structural reform in the public sector is yet to be enforced and spending will be reoriented to recover public investment. The Poverty Reduction Strategy Programme increased the budget by 0.6% GDP on anti-poverty spending for the years 2004-2006.

- **Monetary policy**

³ World Markets Research Centre

⁴ See Annex III

The Government is committed to a low inflation path and has been successful in this regard so far. Sound fiscal policies have also helped reduce the treasury bill rate, although persistent high real interest on bank loans could impact negatively on private investment.

3. Economic forecasts

- **International assumptions**

The most important international assumptions for Honduras are tied to economic growth in the US, its main trading partner and biggest investor, and to commodity prices, particularly those for coffee.

- **Privatisation**

Progress with the privatisation of the telecommunications, infrastructure and airport sectors has been promising and the success has encouraged the Government to move forward with the sale of electricity distribution, the next sector likely to undergo privatisation.

- **Economic growth**

The US slowdown has hit the export sector in particular: the US accounts for almost all of Honduras's *maquila* (offshore assembly for re-export) exports and for 35 % of its non-*maquila* exports. Many *maquila* operations have either scaled down investment or closed, citing the decelerating US economy and domestic economic and security problems as reasons. Tourism is being affected by weaker demand and by increased levels of violent crime.

- **Inflation**

The *Banco Central de Honduras* will continue with its policy of reducing inflation gradually in line with the Government's commitments. Between 2004 and 2005, inflation increased from 8.1% to 8.8%. Observers from the WMRC⁵ expect the annual average rate of inflation to fall around 7.1% in 2005.

- **Exchange rates**

Since Hurricane Mitch struck in 1998, substantial levels of multilateral aid and debt-service relief have provided balance-of-payments support, leading to high levels of international reserves, which have helped to maintain currency stability. Reserves are growing since 2000 owing to continued multilateral support and remittances from

⁵ World Market Research Centre

Hondurans in the US, which increased by 30% in the first half of 2001. The lempira, however, has been gradually depreciating since 1999⁶.

- **Structural reforms**

There will also need to be a continuation of structural reforms despite the unavoidable setback caused by the natural disaster.

⁶ World Market Research Centre

III. RELATIONS BETWEEN THE EU AND HONDURAS ⁷

1. History

Since 1984, Honduras has participated in the interministerial 'San José Dialogue' between the countries of Central America and the European Union. The annual conferences held by the foreign ministers of Central America and the EU as part of this dialogue have gradually helped to develop the San José process as a platform for strengthening cooperation, economic links and regional integration. The San José Dialogue was modified at a meeting in Florence in 1996 to better suit the changes in relations between the two regions.

From 1976 to 2000, bilateral Community aid exceeded EUR 280m. Around EUR 120m was allocated for technical and financial cooperation. Food and humanitarian aid also accounted for a large percentage of this sum (the Central American region receives the most Community aid per head). Over the years, relations between Honduras and the EU have become concerned with more than just trade and development aid issues and now cover the economy, the rule of law and social development in the region.

2. Bilateral relations

Since February 1993, Honduras has been a signatory to a new 'third-generation' cooperation agreement between the EU and the countries of Central America, as a result of which relations with the EU have taken on a new dimension. Since 1994, they have rested on three main axes:

- aid to strengthen and modernise the rule of law;
- support for sustainable development (investment in human resources and/or aid for small-scale farming and non-agricultural production);
- economic cooperation.

Respect for human rights and strengthening democracy naturally remain very much on the agenda: the EU continues to support the democratic institutions through its assistance programmes.

In order to increase the efficiency and impact of EU aid, the multiannual strategy (1998-2000) for EU-Honduras cooperation proposed three lines of action:

- the main aims in terms of democracy concerned citizens' rights, the strengthening of the rule of law and progress with decentralisation;
- in terms of human capital, the priorities were education and health. Honduras's population, which is young and numerous, is one of its main resources and an important factor in its future development;

⁷ See Annexes IV and V

- to achieve fair and sustainable economic growth, a larger proportion of the population needed access to production and marketing tools. The government policies, which aimed to boost agricultural and non-agricultural production, were therefore to be followed by accompanying measures.

The Commission wished to increase the effectiveness of cooperation by defining and reinforcing the partners' rights and obligations, which in turn was to be achieved by simplifying and making more transparent the common provisions for carrying out future projects and creating the role of a single national coordinator. With this in mind, the Commission and Honduras signed a Financial Framework Agreement on 17 April 1999.

The EU responded to the devastation caused to the region by Hurricane Mitch by providing a considerable sum of emergency aid. Donors met in Stockholm from 25 to 28 May 1999, at which meeting the EU confirmed its commitment to rebuilding and transforming the country.

The two main financing tools are the Memorandum of Understanding signed in March 2001, providing for EU cooperation for an indicative amount of EUR 147m for the period up until 2006, and the Regional Programme for Reconstruction of Central America, known by the initials PRRAC, which allows intervention in Honduras for an amount of up to EUR 119m. Furthermore, Honduras is eligible for a series of horizontal programmes for Latin America, namely Alis, AL-invest, URB-AL, ALFA.

The main objective of EU cooperation is poverty reduction, with particular emphasis on the sustainable management of natural resources, education, social services and decentralisation. EU assistance is fully compatible with the country's poverty reduction strategy and is closely coordinated with other donors on the ground, with the Commission participating in the G-15 donor coordination group. There are also regular meetings between the EU Heads of Mission and directors of bilateral cooperation agencies present in Tegucigalpa with the presence of the regional Commission Delegation in Managua.

Honduras receives a large amount of funding under the Regional Programme for the Reconstruction of Central America (PRRAC). The main focus of this programme, which provides a total sum of EUR 256.6m, should be health and education. A decentralised management structure in Managua, for which the Head of the Commission Delegation in Nicaragua is responsible, is in charge of running the PRRAC.

Honduras retains strong ties with the United States in terms of both foreign policy and trade. However, over the last 12 years the country has begun to build relations with Europe, with the EU becoming its second trading partner (after the United States). Nevertheless, after being hit by Hurricane Mitch, Honduras sank into a deep economic recession and trade with the EU fell dramatically. In 2002, the EU was the destination for 16.4% of Honduran exports and accounted for 6.1% of the country's imports. Products like coffee and bananas remain Honduras's main exports. It was one of the countries to gain from the WTO ruling against the EC 'banana regime'. Traditional products make up almost 80% of exports to the EU, whilst EU imports to Honduras consist mainly of

capital goods and finished products. Like the other Latin American countries, Honduras benefits from the new Generalised System of Preferences, adopted on 7 December 1998, which grants special treatment for agricultural and industrial products.

3. Regional relations

In March 2001, the 17th San José Conference was held in Guatemala City. Once again, emphasis was placed on strengthening the rule of law, tackling the proliferation of light weapons (including eradicating anti-personnel mines) and drug trafficking (the joint responsibility of producer and consumer countries was reaffirmed), and continuing with regional integration, which has been supported by the EU for several years. The EU signed a Memorandum of Understanding defining the priorities in terms of the latter issue.

Regional integration seems able to provide an answer for the next few years to ensuring sustainable development in the region and allowing it to meet the challenges of globalisation. The EU is firmly convinced of the need to develop an 'integration-friendly' culture. Both partners reiterated their desire to see the region play an active role by putting forward programmes and projects that show its own commitment to integration.

In this context, the EU is attempting to channel regional cooperation efforts towards the broadening and deepening of Central American economic integration through programmes that provide added value and make a real impact on the regional integration process. The main aspects of cooperation proposed are:

- support for regional integration, the implementation of common policies and the strengthening of institutions;
- greater involvement of civil society in the integration process;
- reducing vulnerability and making environmental improvements

The Madrid Summit of May 2002 encouraged the EU and Central America to strengthen their relations. The Political Dialogue and Cooperation Agreement between the two partners, signed in December 2003, institutionalises the San José dialogue process launched 20 years ago, which served to re-establish peace and democracy in the region in the early nineties. It also extends cooperation to the areas of immigration control, fighting terrorism and the economy, which are in addition to those covered under the 1993 agreement.

The Vienna Summit, which took place in May 2006, was the fourth of a series of summits, and now represents a milestone for EU-LAC relations. The heads of States of Europe and their counterparts in Latin America met to discuss the possibility of enhancing trade relations. The main themes on the agenda were the Association Agreement with Central America and *Mercosur*. So far, Association Agreements have been signed with Mexico and Chile and negotiations with *Mercosur* are at a more advanced phase. The discussions covered many areas such as democracy, terrorism,

drugs, energy and environment, migration, poverty and education.

The main points in the final declaration on Central America can be summarized as follows:

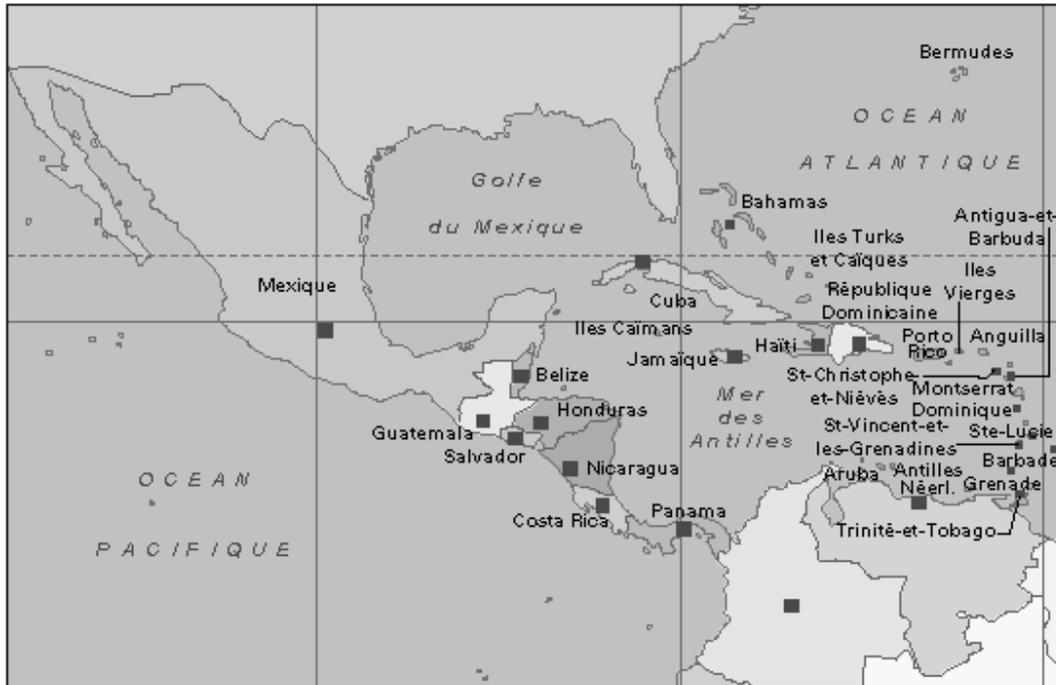
- the overall outcome of the joint assessment exercise on regional economic integration was positive.
- the EU is in favour of launching negotiations for the Association Agreement between the EU and Central America which includes the establishment of a Free Trade Area.
- the EU is very pleased that Central America has confirmed its commitment to implement the decisions taken by the Central American Heads of State in March 2006 in Panamá and to the ratification of the Treaty on investment and services and on the enforcement of regional economic legislation in the region.
- both parties would to conclude the Association Agreement through a rapid process.

4. Role of the European Parliament

Until 1984, there was a single European Parliament delegation for relations with the whole of Latin America. That year, two separate delegations were created: one for relations with Central America and Mexico and another for relations with South America. The EP has recently increased the number of delegations for relations with Latin America to five, which includes one for the countries of Central America. The work of these delegations has included the participation of MEPs as observers during elections and as mediators in regional conflicts. The EP also maintains steady relations with the national parliaments in the region and with the Central American Parliament (Parlacen). During the 1980s, the EP centred its attention on the peace and democratisation process in the region, and considered regional integration to be a solution to the difficulties encountered in those countries. This is one of the reasons why EU-Honduras relations must also be viewed in the context of the EU's relations with Central America as a whole.

The EP has promoted an increase in cooperation resources, the extension of the EIB's activities in Central America and a general refocusing of Community cooperation policy. It would like the European Union to make Latin America one of its leading dialogue partners in the world and to instigate, to this end, a 'transatlantic dialogue' on areas including security and defence, and to draw up a sufficiently-funded overall action programme for the region. The EP believes that these objectives should be reflected in new agreements that are more than simple trade and development aid agreements and which look to achieve a more extensive free trade area and closer political cooperation, so that a Europe-Latin America free trade area can be a reality by 2010.

CENTRAL AMERICA AND THE CARRABEAN



HONDURAS
MACRO ECONOMIC DATA AND FORECASTS

	1999	2000	2001	2002	2003	2004	2005	2006
Real GDP Growth %	-1.9	5.7	2.6	2.7	3.2	5.0	2.6	3.4
GDP Nominal US \$bn	5.4	6.0	6.4	6.6	6.9	7.5	8.0	8.8
GDP Per Capita US \$	862	933	967	970	999	1,054	1,100	1,183
Inflation (CPI) %	11.7	11.1	9.7	7.7	7.7	8.1	8.8	7.1
Population m	6.29	6.46	6.62	6.78	6.94	7.10	7.27	7.43
Population Growth %	2.7	2.6	2.5	2.4	2.4	2.4	2.3	2.2
Current Account Balance US \$bn	-0.6	-0.3	-0.3	-0.2	-0.3	-0.4	-0.3	-0.3
Current Account Balance % GDP	-11.5	-4.6	-5.3	-3.7	-4.2	-5.2	-4.1	-3.7
Trade Balance US \$bn	-1.3	-1.2	-1.4	-1.4	-1.7	-2.1	-2.6	-3.0
Trade Balance % GDP	-23.8	-20.5	-21.8	-21.9	-24.1	-28.0	-32.5	-33.8
Local Currency to Euro	14.57	14.09	14.03	17.75	22.42	25.57	22.37	25.03
Foreign Direct Investment US \$bn	0.2	0.3	0.2	0.2	0.2	0.3	0.3	0.3
Foreign Direct Investment % GDP	4.4	4.7	3.0	2.7	2.9	4.3	3.4	3.2
Total External Debt US \$bn	5.5	5.6	5.0	5.4	5.6	5.6	5.6	5.5
Total External Debt % GDP	101.7	92.5	78.9	82.0	81.3	74.8	69.7	62.7
Total External Debt Service % F.E.	22.3	15.7	14.2	15.8	15.6	12.4	10.9	10.6

Source: Global Insight

Trade relations EU(25)-Honduras, 2005

By products		1000 EUR			
HS Chapters	Harmonised System (HS): Sections and chapters	Imports (cif)		Exports (fob)	
		1000 EUR	% of total	1000 EUR	% of total
01-99	Total	378.443	100,0	358.348	100,0
	of which:				
01-24	Agricultural prod. (incl. fish, prepared foodstuffs etc.)	291.831	77,1	23.243	6,5
	of which:				
01-05	Live animals; animal products	34.037	9,0	3.543	1,0
	of which:				
03	Fish and crustaceans, molluscs and other aquatic invertebrates	33.922	9,0	289	0,1
06-14	Vegetable products	237.689	62,8	5.968	1,7
	of which:				
08	Edible fruit and nuts; peel of citrus fruits or melons	54.994	14,5	130	0,0
09	Coffee, tea, mat+ and spices	174.223	46,0	0	0,0
16-24	Prepared foodstuffs; beverages	19.903	5,3	12.445	3,5
	of which:				
16	Prep. of meat, of fish/crustaceans/molluscs or other aquatic invertebrates	13.108	3,5	114	0,0
25-27	Mineral products	28.232	7,5	1.951	0,5
	of which:				
26	Ores, slag and ash	28.197	7,5	0	0,0
28-38	Products of the chemical or allied industries	476	0,1	32.799	9,2
	of which:				
29	Organic chemicals	10	0,0	6.044	1,7
30	Pharmaceutical products	27	0,0	9.937	2,8
31	Fertilisers	0	0,0	3.469	1,0
33	Essential oils and resinoids; perfumery, cosmetic or toilet preparations	153	0,0	3.862	1,1
39-40	Plastics and rubber and articles thereof	886	0,2	11.947	3,3
	of which:				
39	Plastics and articles thereof	63	0,0	9.937	2,8
44-49	Wood/art. of woods etc; pulp of wood or other fibrous cellulose	4.796	1,3	10.594	3,0
	of which:				
44	Wood and articles of wood; wood charcoal	4.666	1,2	926	0,3
48	Paper and paperboard; art. of paper pulp, of paper or of paperboard	7	0,0	6.836	1,9
49	Printed books, newspapers, pictures and other products of printing industry etc.	3		2.682	
50-63	Textiles and textile articles	24.221	6,4	5.436	1,5
	of which:				
62	Articles of apparel and clothing accessories, not knitted or crocheted	2.351	0,6	1.143	0,3
63	Other made-up textile articles; sets; worn clothing/worn textiles art.; rags	3.448	0,9	64	0,0
68-70	Articles of stone, plaster, cement, asbestos etc.	20	0,0	6.500	1,8
	of which:				
69	Ceramic products	6	0,0	5.288	1,5
72-83	Base metals/articles of thereof	179	0,0	22.418	6,3
	of which:				
72+73	Iron and steel and articles of iron or steel	114	0,0	18.181	5,1
84-85	Machinery and mechanical appliances; elec. eq., sound recorders etc.	1.105	0,3	200.624	56,0
	of which:				
84	Nuclear reactors, boilers, machinery and mechanical appliances	246	0,1	154.288	43,1
85	Electrical machinery/equip. and parts thereof; sound recorders etc.	859	0,2	46.336	12,9
86-89	Vehicles, aircrafts, vessels and associated transport equipment	23.995	6,3	25.873	7,2
	of which:				
87	Vehicles other than railway/tramway rolling-stock etc.	69	0,0	11.984	3,3
89	Ships, boats and floating structures	23.882	6,3	12.410	3,5
90-92	Optical, photographic, cinematographic etc. instruments	538	0,1	6.655	1,9
	of which:				
90	Optical/photographic/cinematographic/measuring/medical or surgical inst. Etc.	205	0,1	6.641	1,9
Various ch	Other products	2.162	0,6	6.723	1,9

Source: COMEXT database, EUROSTAT

Production: JDa/DG4/European Parliament

Trade of the EU with Honduras by Member States, 2005

	EU-imports (cif)		EU-exports (fob)	
	1000 €	- % -	1000 €	- % -
Total (EU25) *	378.443	100	358.348	100,0
<i>of which:</i>				
France	41.226	10,9	30.334	8,5
Netherlands	34.222	9,0	21.341	6,0
Fr Germany	93.314	24,7	154.795	43,2
Italy	25.896	6,8	22.120	6,2
Utd. Kingdom	29.918	7,9	13.954	3,9
Ireland	922	0,2	1.033	0,3
Denmark	3.197	0,8	5.628	1,6
Greece	734	0,2	959	0,3
Portugal	5.880	1,6	2.094	0,6
Spain	41.898	11,1	49.152	13,7
Belgium	83.680	22,1	8.809	2,5
Luxembourg		0,0	4.888	1,4
Sweden	6.853	1,8	28.673	8,0
Finland	4.465	1,2	6.360	1,8
Austria	2.821	0,7	3.894	1,1
Malta		0,0	4	0,0
Estonia	7	0,0		0,0
Latvia	0	0,0	35	0,0
Lithuania	34	0,0	7	0,0
Poland	679	0,2	1.881	0,5
Czech Republic	1.096	0,3	1.483	0,4
Slovakia	8	0,0	723	0,2
Hungary	1.324	0,3	117	0,0
Slovenia	206	0,1	64	0,0
Cyprus	64	0,0		0,0

Source: COMEXT database, EUROSTAT

Production: JDa/DG4/European Parliament

Trade of the EU25 with Honduras: 1999-2005

	<i>MIO ECU/€</i>		
	EU-imports (cif)	EU-exports (fob)	Balance
1999	285	192	-93
2000	408	209	-199
2001	359	219	-140
2002	332	219	-113
2003	347	279	-67
2004	332	394	62
2005	378	358	-20

Source: COMEXT database, EUROSTAT

Production: JDa/DG INFO/European Parliament

