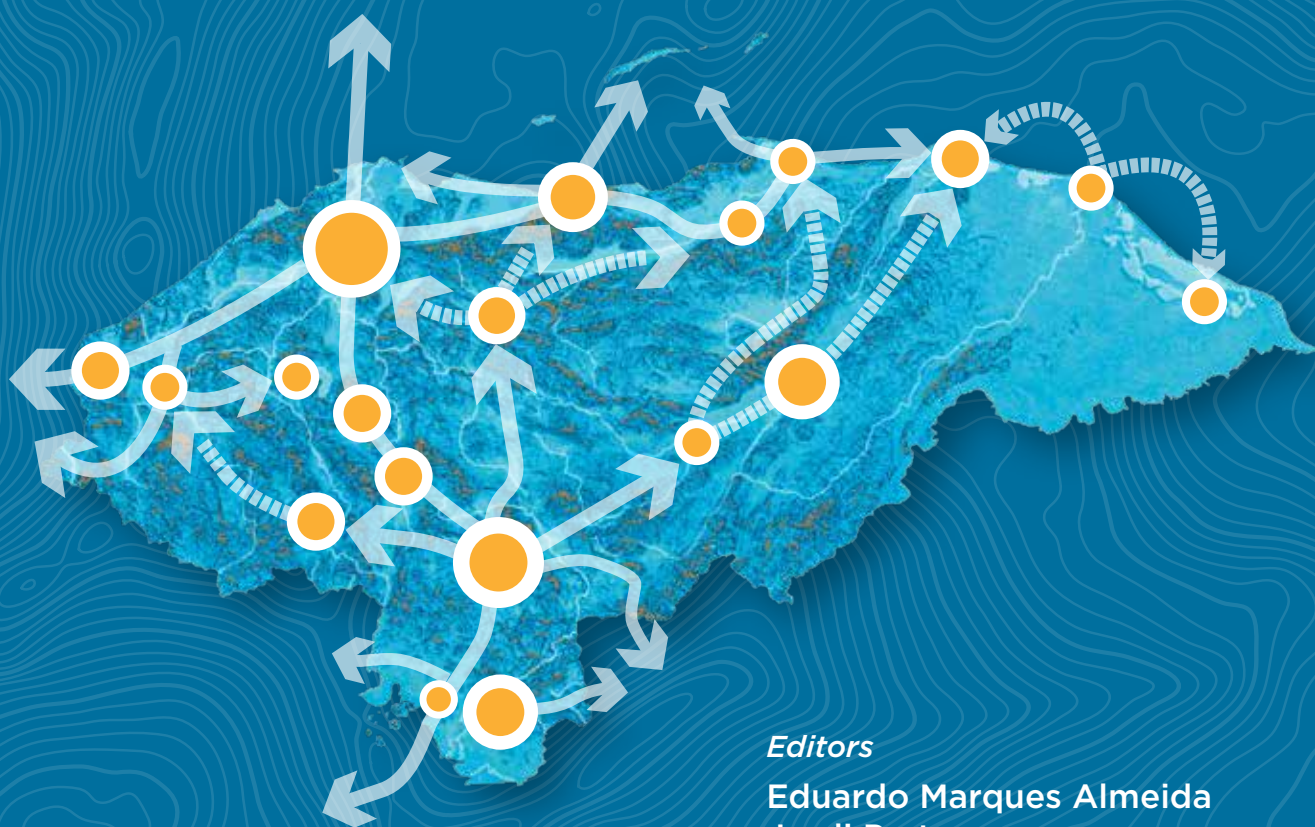


Honduras

A Territorial Approach to Development



Editors

Eduardo Marques Almeida
Jordi Prat
Juan Carlos Vargas-Moreno
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Abbreviations

BCH	Central Bank of Honduras, for its Spanish acronym
BPO/ITO	Business Process Outsourcing/ Information Technology Outsourcing
BVM	Bono Vida Mejor, for its Spanish acronym
CADR	Central America and the Dominican Republic
CAFTA	Dominican Republic-Central America Free Trade Agreement
CEPAL	Economic Commission for Latin America and the Caribbean
CID	Department for the countries of Central America, Haiti, Mexico, Panama and the Dominican Republic, for its Spanish acronym
CPI	Consumer Price Index
ENEE	National Energy Company, for its Spanish acronym
EPHPM	Permanent Multipurpose Household Survey, for its Spanish acronym
FAO	Food and Agriculture Organization
FAUCA	Central American Single Customs Form, for its Spanish acronym
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GIS	Geographic Information System
ICT	Information and Communication Technologies
IMF	International Monetary Fund
INE	National Statistics Institute, for its Spanish acronym
LAC	Latin America and the Caribbean
NDC	Nationally Determined Contributions
NFPS	Non-Financial Public Sector
PPP	Public Private Partnerships
SEFIN	Ministry of Finance, for its Spanish acronym
SES	Spatial Economic Strategy
SMEs	Small and Medium Enterprises
TERCE	Third Regional Comparative and Explanatory Study tests, for its Spanish acronym

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Foreword

Honduras is a small country with high levels of poverty but great potential for improving its inhabitants' living conditions. It is geographically privileged with access to both oceans, giving it the potential of becoming an international logistics hub. Its ample land area offers conditions for diversifying its agricultural production, and recent integration efforts have laid the foundation for a more complex industrial export basket. At the same time, the relatively young Honduran population represents a window of opportunity for strengthening long-term growth.

Honduras's growth over the past decade has surpassed that of Latin America and the Caribbean, and the country has enacted reforms for improving its macroeconomic stability and international investor perception. In recent years, the Honduran economy's upward trend has been sustained by a more robust macroeconomic framework and modernization of its tax administration, implying increased tax collection and greater integration within a favorable external context. Moreover, the country has substantially improved citizen security institutions by professionalizing and strengthening its police force and has achieved a 50% drop in the homicide rate in the past few years. Furthermore, the government has made headway on its healthcare delivery system by implementing a decentralized service provision model.

Despite this, the country has failed over the past twenty years to achieve inclusive growth. With poverty affecting over 60% of Honduran households during this period, the country has been unsuccessful to bring the benefits of economic growth to most Hondurans. This lack of inclusive growth may be the result of many factors, such as the country's limited capacity for accumulating quality human capital, violence and crime, weak institutions, a highly concentrated export basket, and economic development concentrated in a few low value-added activities with little technological innovation and located in a limited part of Honduras. This last factor is the focus of this document. Moreover, Honduras has logistical shortcomings in air and road infrastructure, affecting its competitiveness. Although it has improved its business environment for attracting renewable energy investment, the electricity sector's difficulties inhibit its electricity export capacity, the competitiveness of existing economic activities and greater economic diversification.

In the celebration of the Inter-American Development Bank's (IDB) 60th anniversary we are proud to present *Honduras: A Territorial Approach to Development*, which takes a new approach to the traditional question of how the country's development challenges should be tackled. The current model has led to the spontaneous concentration of the country's economic development in only a few regions. The proposed alternative approach seeks to maximize the potential of the country's different regions so that benefits reach the greatest possible number of Hondurans and economic activity is diversified and expanded geographically. We hope the proposed spatial economic strategy will enable a significant change in sustainable development management and a permanent reduction in its persistent poverty.

This document is expected to be an input in the debate on the country's development, which comprehensively involves the public and private sectors, civil society and the international community. A description is given here of the necessary enabling conditions to achieve higher, more inclusive growth rates. Nonetheless, these conditions must be translated into public policy and private sector investment pooled together towards this goal. The conditions include institutional strengthening, improved public spending quality and efficiency, human capital accumulation and expansion of productive opportunities to facilitate more investment and business startups and growth. The private sector can also participate in the development of strategic projects aimed at enhancing the country's logistics and diversifying its energy matrix, strengthening the quality of human capital and increasing the offer of finance instruments, primarily for small enterprises and other population segments with more restricted access to credit.

The goal of this roadmap is to generate a virtuous cycle where public action helps remedy market failures, in turn encouraging the private sector to push for higher wages and reduce poverty, taking advantage of Honduras's regional comparative advantages.

The moment has arrived for a dialogue to transform Honduras with innovative proposals to help it break out of the cycle of poverty and inequality that has afflicted it for so many years. We are confident the approach we are proposing is the key to achieving this, and the new IDB Country Strategy with Honduras for the next four years, approved in February 2019, will be an essential instrument for adapting it. In addition to serving as a roadmap for more inclusive and stronger growth, this document seeks to serve as a guide for effective coordination between the government and other key stakeholders. Partnering of the government, private sector and international community should catalyze the comparative advantages of each, exploiting their synergies to sustainably and lastingly maximize the impact on Honduras's development.

Verónica Zavala

Manager, Central America, Haiti, Mexico, Panama, and the
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Orlando Ferreira

Chief Strategy Officer, IDB Invest

Executive Summary

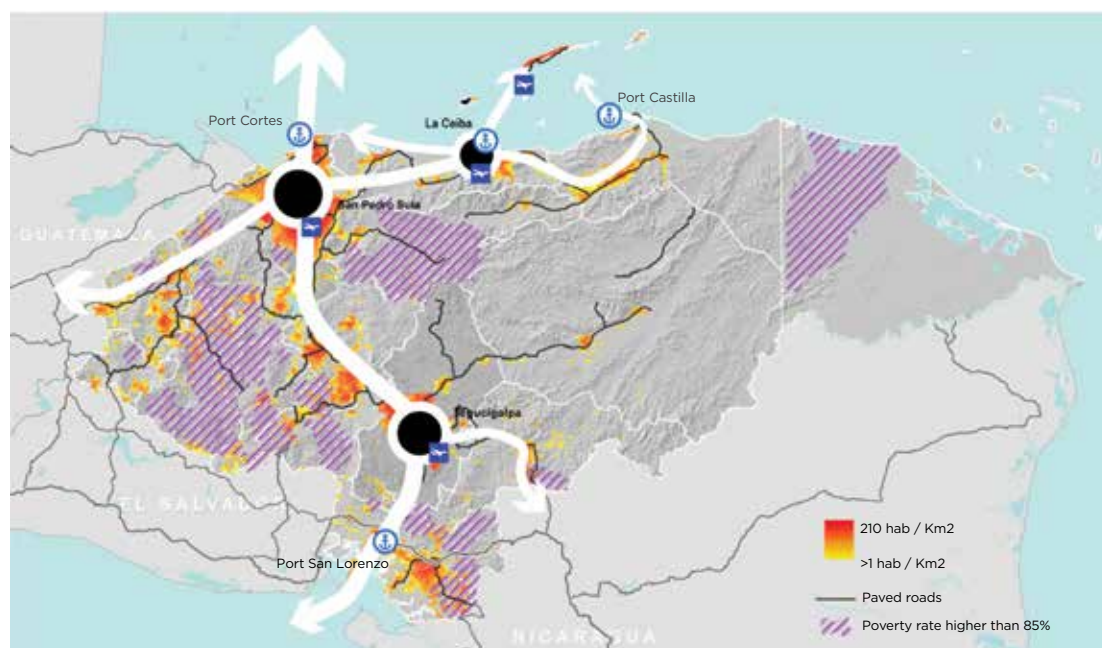
Honduras: A Territorial Approach to Development identifies the country's main achievements and development challenges and proposes a new approach to achieve more inclusive economic growth. In February 2019, the Bank approved its new Country Strategy with Honduras for the next four years, which takes a new approach whereby the IDB, together with other cooperants, could help transform the development strategy into one that could also be applied in other contexts.

In recent years, Honduras has enjoyed one of the highest growth rates in Central America and significantly improved citizen security. Its upward economic trend has been sustained by a more robust macroeconomic framework, increased tax collection due to modernization of the tax administration, and a greater integration within a favorable external context. In terms of citizen security, the country has reduced the homicide rate by half through professionalization and strengthening of the police force. It has also successfully implemented decentralization of healthcare service provision to improve healthcare delivery. Nonetheless, despite these improvements, good performance has not led to either a faster growth rate nor a significant reduction of poverty, nor yet a shift in the country's production and employment structure.

The many socioeconomic, production and environmental challenges facing the country must be systematically addressed to ensure economic growth, social wellbeing and vertical mobility, which would translate into strong, inclusive growth. Changes associated with global market dynamism and persistent inequality bring into question the traditional interventions aimed at increasing productive opportunities and reducing urban-rural differences, poverty and social gaps.

Over the years, Honduras has targeted public investment in a spontaneous manner to drive production, generating a territorial economic model in which both public administration and the private sector have concentrated their main investment efforts in two key areas: the capital city and the San Pedro Sula region. The territorial representation of these factors shows a clear T-shaped historical development pattern. The resulting consolidated territorial investment and development model has generated benefits for some and challenges for the country's economic policy, as well as systems that have perpetuated poverty and inequality (Graph 1). Thus, there is a lack of development of secondary or intermediate cities, with a lack of adequate infrastructure for connectivity. These factors have consolidated a scenario of winners and losers associated with a non-inclusive territorial model that has not been able to capitalize all the wealth and resources the country has to offer.

After major interventions in a variety of areas, the country still reflects one of the highest poverty rates in Latin America and the Caribbean. The government, cooperants and other key stakeholders have therefore taken on the task of reviewing the economic model and development instruments implemented in the country, reconsidering ways of tackling the challenges and obstacles in order to distribute opportunities more broadly and efficiently.

GRAPH 1. Honduras's T-Shaped Historical Territorial Economic Model

Source: GeoAdaptive 2018

In this context, public investment and social and production policy are the main tools in the public administration's toolkit for addressing gaps and taking advantage of opportunities. Appropriately used, they make it possible to achieve these goals, reduce perceived risks and drive private investment, triggering a desired effect of leveraging public funds. This effect is even more potent in small, low-income economies with limited fiscal space such as the Honduran economy. Achieving it requires careful design of targeted production and social policies and spending strategies, so that public spending instigates private spending.

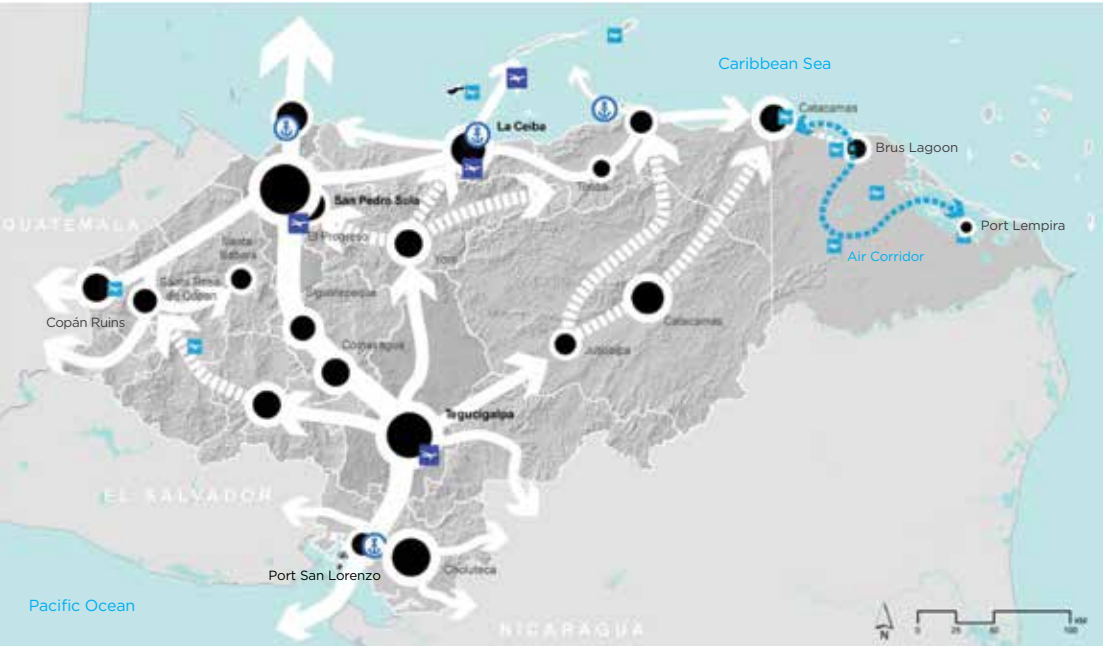
This study presents an innovative alternative to address economic development needs in Honduras. Together with GeoAdaptive, LLC., IDB has developed a Spatial Economic Strategy (SES) that extends across and connects the entire territory, taking advantage of sectoral synergies for enhancing productivity and breaking the established inequality and poverty cycles. The basis for the SES is a set of cross-cutting enabling conditions for triggering economic and social development in Honduras. These conditions include institutional strengthening, human capital accumulation, improved quality and efficiency of social spending, and expanded productive opportunities that facilitate more investment, business startups and growth.

The SES proposes targeted interventions in a network comprised by primary and secondary nodes connected by corridors. The network would have multisectoral growth poles, defined with extreme geographical precision, where coordinated investments would trigger stronger, more inclusive economic growth (Graph 2).

With the territorial structure and proposed economic model, the growth poles can serve as simultaneous investment areas coordinated among several sectors to support industrialization and social inclusion in a new economic model. To achieve this, the growth poles combine public and private investments already concentrated around an existing resource or economic activity in a specific location. In particular, the model identifies how infrastructure within an existing private investment can be developed in such a way as to generate positive externalities within other sectors. The study identifies current or potential productive activities in each growth pole that can serve as income generators. This construction has been developed from an evaluation of the geographical distribution of different value chains and their dynamics and productive and territorial characteristics. The approach highlights the environmental constraints and social factors that need to be addressed in order to generate, through linkages with production dynamics, social inclusion schemes in the economic development and a more sustainable system that can ensure delivery of growth benefits to the greatest number of inhabitants.

For the Inter-American Development Bank, the SES effort broadens the spectrum of knowledge-generating mechanisms and provides a way to foster integrated interventions aimed at a multisectoral and synergetic tackling of challenges. This tool can be used to significantly change Honduras's sustainable development management and for policymakers to implement their government program and long-term country vision.

GRAPH 2. Proposed Change to the Country's Territorial Economic Model



Source: GeoAdaptive 2018

This report is divided into four sections. The first chapter describes the country's current context, and the second gives the main achievements and challenges to inclusive development in Honduras, including institutional, productive and human capital challenges. The third chapter presents the territorial economic strategy where challenges and development are seen from a growth-pole-based territorial approach. Finally, the fourth chapter concludes and describes the enabling conditions needed for sustainable implementation as well as potential areas for intervention.



CHAPTER 1

Socioeconomic Context



Honduras is a small, open, lower-middle-income economy. The country has an area of 112,492 square kilometers and a population of 8.7 million inhabitants. In 2017, its per capita gross domestic product (GDP) at current prices was USD 2,480, the third lowest in Latin America and the Caribbean (LAC), topping only Nicaragua and Haiti.¹ In addition, its export basket is quite undiversified and highly concentrated in primary, low value-added goods, increasing the country's vulnerability to international price fluctuations and extreme weather events.

¹ World Development Indicators. (2017). World Bank. Data for 2017.

The country's macroeconomic performance over the past fifteen years has been volatile. From 2000 to 2008, the economy grew at an average annual rate of 5.3%, driven by end consumption and coffee and textile exports. In 2008 and 2009, however, twin crises (financial and sociopolitical) hit the economy with adverse repercussions on growth, inflation and public finance. Since 2014, the economy has followed a path of fiscal consolidation and improved economic performance. Economic reforms, endorsed by the International Monetary Fund (IMF) through a stand-by arrangement, achieved sustained growth, price stability and fiscal sustainability.² According to IMF data, average annual economic growth from 2000 to 2017 was 3.9%, higher than that of the rest of Central America and the Dominican Republic (CADR) (3.6%) and Latin America and the Caribbean (LAC) (2.6%). In addition, the authorities have reinforced their monetary policy framework, migrating to an inflation targeting scheme.

Honduras's prudent monetary policy and low commodity prices have helped decelerate inflation since 2014. Inflation rates in 2015 and 2017 were 2.4% and 4.7%, respectively (Graph 1.2),³ a result of policy decisions by the monetary authority and a more than 50% drop in oil prices from 2014 that favorably impacted fuel prices.

In the past four years, international markets have acknowledged the government efforts to strengthen its macroeconomic framework. In 2013, the non-financial public sector (NFPS) deficit reached 7.2% of the GDP as a result of a rapid rise in public expenditure (3.6 percentage points from 2010 to 2013) and reduced tax revenue (1.2 percentage points from 2010 to 2013).⁴ In response to these imbalances, in 2014 the authorities implemented a set of reforms: i) a 3 percentage point increase in the sales tax (from 12% to 15%); ii) a 25% increase in fuel taxes; iii) a minimum income tax payment for individuals and companies with yearly income of more than USD 500,000; iv) reduced transfers to decentralized entities; v) reduction of public sector hiring and freezing of public wages; and vi) reduction of the electricity subsidy.⁵ These measures helped bring down the NFPS deficit to 0.8% of the GDP in 2017. Public spending was reduced by 2.0 percentage points of the GDP, while revenue increased by 3.2 percentage points of the GDP.⁶ Fiscal policy adjustments also involved institutional framework reforms such as dissolution of the Executive Revenue Directorate, replaced by a new tax authority (Servicio de Administración de Rentas, or SAR), and passage of the Fiscal Responsibility Act and a new tax code, among other things. This led to an improved credit rating by Moody's Investors Service in 2016 – from B3 to B2 –, with a continued positive outlook, and an improvement from B+ to BB- from Standard & Poor's in 2017.

The country's geographical location, though a competitive advantage, also makes it vulnerable to climate change impacts. The country is located at a strategic point for

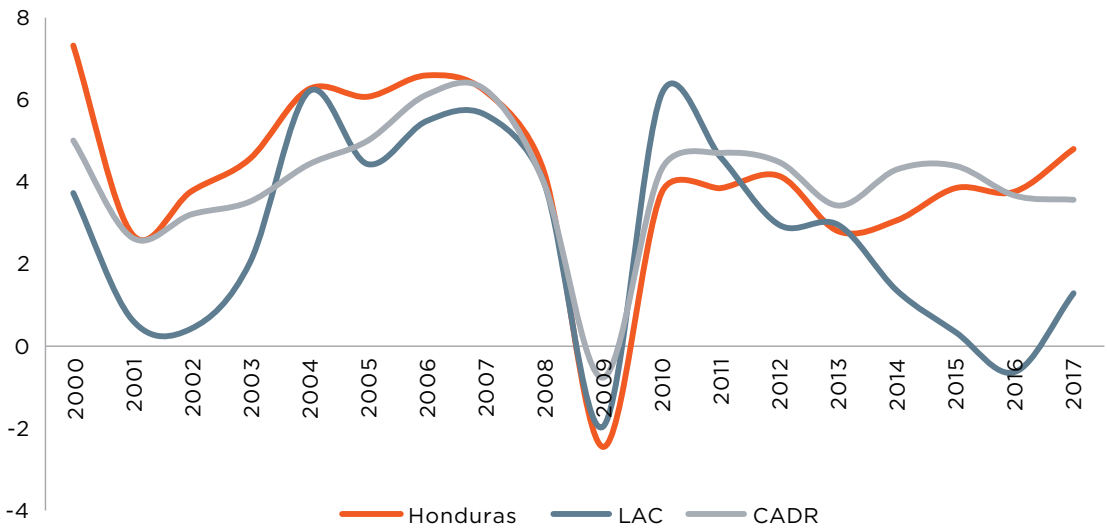
² The Stand-By Arrangement with access to financing for up to USD 200 million had a duration of 36 months with semester reviews of targets. The arrangement established fiscal policy, monetary, and exchange rate targets, changes to the National Electricity Company (ENEE) and strengthening of the financial regulatory framework.

³ Honduras's target inflation for these years was 4.75% to 5.75%.

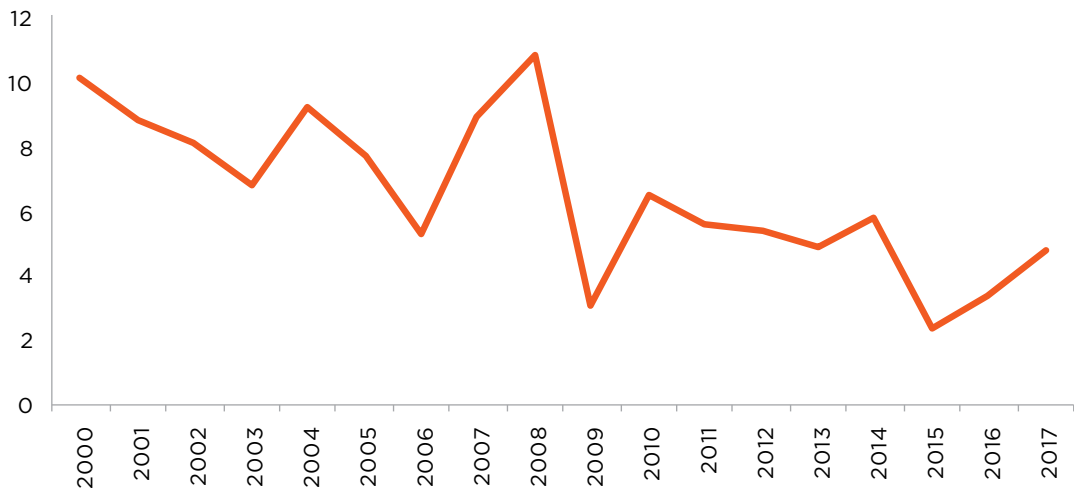
⁴ SEFIN and IMF (2018).

⁵ Reforms in line with the Law for Public Finance Planning, Exemption Control and Anti-evasion Measures, passed in 2013, facilitated implementation of the 3-year IMF Stand-By Arrangement.

⁶ SEFIN.

GRAPH 1.1 Economic Growth (%)

Source: Estimates of the Department for the countries of Central America, Haiti, Mexico, Panama and the Dominican Republic of the IDB (CID) with data from the Central Bank of Honduras (BCH) and the IMF (World Economic Outlook, April 2017).

GRAPH 1.2 Inflation (%)

Source: Central Bank of Honduras.

sea and land access to different American markets. With coasts on both oceans, it is attractive territory for air and sea traffic connections.⁷ Honduras has the potential for distribution and production hubs for intra- and extra-regional destinations. Its extensive coastal strip allows for large ship access at various points along its maritime border. However, according to the Germanwatch Global Climate Risk Index 2015, hurricanes, flooding and extreme droughts were increasingly more frequent and difficult to predict from 1994 to 2013. Climate change currently impacts the availability of water for human use, agriculture, industry and power generation, primarily in places that previously received large amounts of rainfall. The distribution and abundance of flora and fauna species and the distribution of natural ecosystems are also negatively affected.

The Honduran economy is also vulnerable to external shocks. Due to its poorly diversified export basket (concentrated in primary goods), the country is vulnerable to changing international commodity prices. In the past decade the trade deficit has been financed with remittances, external aid flows and foreign direct investment (FDI).

Nevertheless, the economy's upward trend has not led to a jump in the potential growth rate or a more pronounced structural transformation. The satisfactory performance has been aided by a robust macroeconomic framework, a strong integration effort,⁸ and a favorable external context of low fuel prices, low interest rates, and the dynamics of its main trading partner, the U.S. However, this growth spurt has not translated into a deeper structural change with improved growth potential or better-quality jobs for the workforce. Economic activity is still closely tied to the production of primary and low value-added manufactured goods, while total factor productivity has remained relatively stagnant, explaining only 5% of the observed growth in the past twenty years compared to the 50% attributable to physical capital accumulation and 45% to labor.⁹

Honduras's economic recovery and stable growth have not been reflected in a significant improvement in the population's wellbeing. The country has been unable to sustainably reduce its poverty levels, which have fluctuated between 58% and 66% from 2001 to 2017, with few periods of steady reduction (Graph 1.3). In 2017, 64% of Honduran households were living in poverty, and one out of every four households was living in extreme poverty.¹⁰ Poverty rates were especially high among the rural population, where more than half were poor (69.3%) and 58.8% were living in extreme poverty.¹¹ Although income inequality, as measured by the Gini coefficient, has fallen in the last decade (from 0.59 in 2007 to 0.52 in 2017), Honduras is still the fourth most unequal country in LAC. Its rate of extreme poverty is the highest in Central America and the second highest in LAC. On average, 16% of Hondurans live with less than USD 1.90 per day, compared to 3.7% in

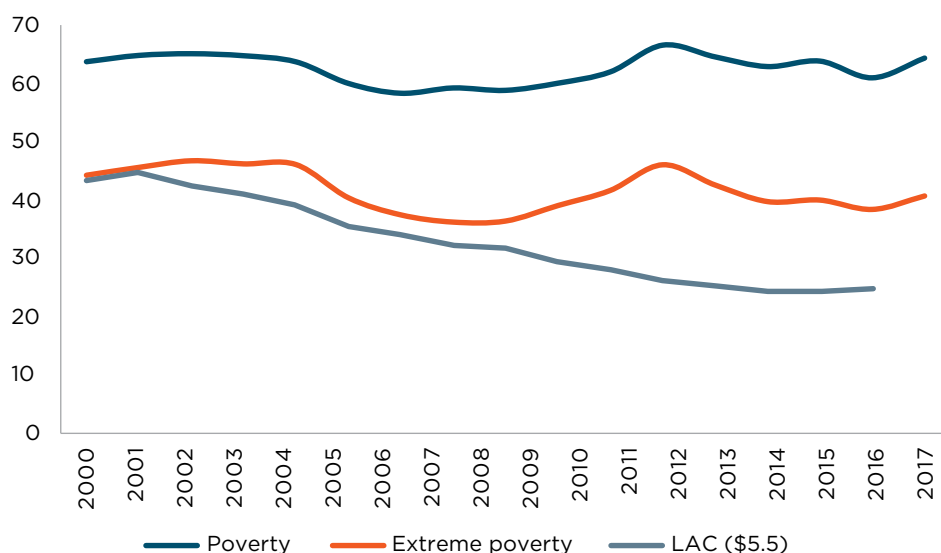
⁷ The country has Puerto Cortés, one of the most efficient ports in Central America.

⁸ As part of its international insertion and development strategy, Honduras has made headway on regional integration. The country is a member of the Central American Integration System (SICA), which represents the most important market, after the United States, for Honduran exports. It has also moved forward on actions to implement a deep integration program with Guatemala aimed at achieving free transit of merchandise and people between the two nations' territories.

⁹ IDB estimates based on Central Bank of Honduras (BCH) and International Monetary Fund data (World Economic Outlook, April 2017).

¹⁰ At June 2017.

¹¹ National Institute of Statistics (INE), Permanent Multipurpose Household Survey (EPHPM) 2001 and 2007.

GRAPH 1.3 Moderate and Extreme Poverty Rates (% of households)

Source: Data for Honduras, National Institute of Statistics (INE), Permanent Multipurpose Household Survey (EPHPM); data for LAC, PovcalNet, World Bank

Note: The poverty line for LAC is USD 5.50 per day (2011 PPP).

LAC and 5.6% in Central America.¹² Unlike in Honduras, poverty in LAC has steadily and substantially declined over the past decade.

High poverty rates are exacerbated by high levels of informality and underemployment. In 2017, 44.2% of the population was underemployed, while 51.4% of urban employment was informal. Both informality and underemployment are mostly associated with low value-added activities that required unskilled labor, such as agriculture and construction.¹³ Informality has increased since 2009 from 73.0% to 83.2% in 2017 for men and from 74.8% to 80.6% for women during that same period.¹⁴

Even though female labor force participation has increased, it is still low in Honduras. From 2012 to 2017, female labor participation rose nine percentage points (p.p.), but the gender gap is still high (36.5 p.p.). This gives the country the lowest female labor participation (48%) in LAC, where the average participation is 57%.¹⁵

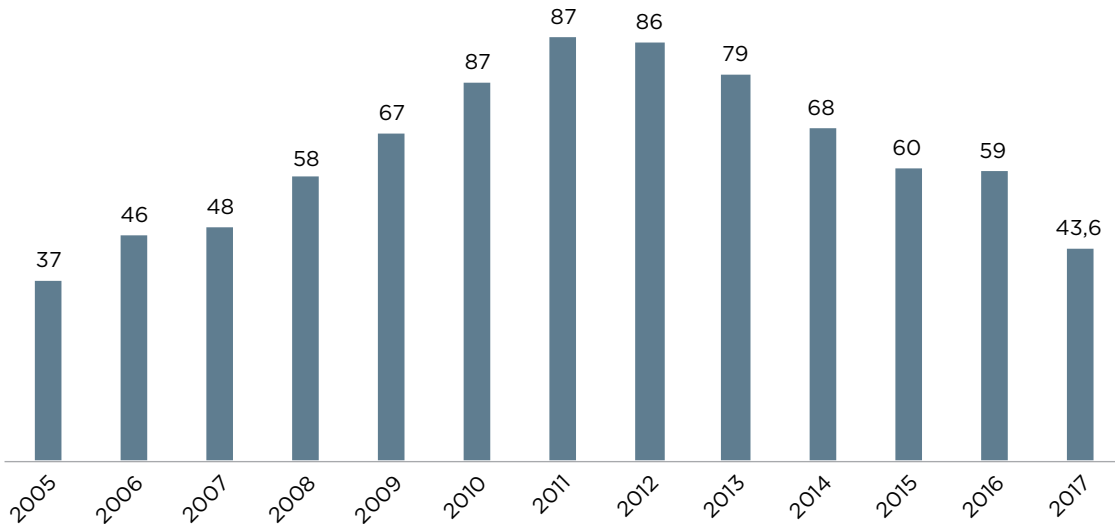
¹² Ibid. The USD 5.50 per day line (2011 PPP) is more comparable to Honduras's official poverty line. LAC has reduced its poverty levels in this indicator from 44% in 2001 to 24.6% in 2016. (PovcalNet, World Bank).

¹³ As explained in Prat & López (2018), factors such as a young population, percentage of rural workers and a high minimum wage compared to the average wage have an impact on informality. In Honduras's case, the size of the minimum wage appears to have the greatest impact on informality levels and the proportion of young people as a percentage of all workers.

¹⁴ INE, EPHPM.

¹⁵ World Development Indicators. (2017). World Bank. Data on the labor participation of women aged 15 to 64.

GRAPH 1.4 Homicide Rate per 100,000 inhabitants



Source: National Violence Observatory, National Autonomous University of Honduras.

Though the private sector is one of the main contributors to economic activity, informality is particularly high among micro and small enterprises. In the past decade, the private sector has generated an average of 83% of the GDP, employing 81% of the workforce and pursuing 87% of the investment.¹⁶ Retail and other services constitute a large share of private sector activity, predominantly through micro and small enterprises (87%), with only 8% and 5% represented by medium and large enterprises, respectively.

Notably, the homicide rate has fallen and the quality of police institutions have improved in recent years, but Honduras is still one of the most violent countries in the world.¹⁷ Between 2011 and 2017, the homicide rate fell from 86.5 to 43.6 per 100,000 inhabitants,¹⁸ a result of more police patrols, improved response to complaints and stronger investigative capacity (Graph 1.4). Institutional reforms have built the investigative capacity of the police and improved the Police Technical Institute (ITP) infrastructure, adding new curriculum. More than 7,000 new police have been trained under a community policing approach. Crime is still identified as one of the country's top problems, however.¹⁹ Although most homicide victims are men, Honduras ranked second among the region's 17 countries in terms of femicides in 2017, with a rate of 8.8 per 100,000 women over the age of 15 compared to 2.4 in LAC.²⁰ Moreover, 22% of women aged 15-49 had experienced some type of domestic violence (psychological, physical or sexual).²¹

¹⁶ IDB (2018a).

¹⁷ United Nations Office on Drugs and Crime. Available at <https://dataunodc.un.org/crime/intentional-homicide-victims>

¹⁸ National Violence Observatory, National Autonomous University of Honduras.

¹⁹ Latin American Public Opinion Project (2017).

²⁰ Gender Equality Observatory for Latin America and the Caribbean. (United Nations, 2017).

²¹ National Health and Demography Survey (ENDESA) 2011-2012, Honduras.

A fragile economy, added to an expanding working age population and high levels of informality, violence and poverty, has triggered massive emigration of the Honduran population, primarily to the U.S. At present, 630,000 Hondurans are living in the United States (17% of the working age population),²² of which approximately 375,000 are undocumented.²³ Family remittances accounted for 18.7% of the GDP²⁴ and 28% of household income in 2017.²⁵ These phenomena could negatively impact growth not only through forgone job income but also by making the country largely dependent on the large aggregate volume of remittances to stabilize household income. The main concomitant implication is that U.S. immigration policy changes could potentially increase the flow of returned migrants, bringing negative consequences for aggregate growth by risking the aggregate volume of remittances, potentially driving up unemployment rates and triggering other social ills such as crime and violence.

This chapter has given an overview of the Honduran socioeconomic context, concluding that the recent progress and major policy efforts have not been able to substantially improve living conditions for its population. The next chapter gives a more in-depth diagnostic of the country's key development challenges that urgently need to be tackled.

²² IDB with data from INE, EPHPM (2016) and the American Community Survey (2016). Working age includes individuals ages 18 to 65.

²³ Pew Research Center (2017).

²⁴ Central Bank of Honduras (2017).

²⁵ INE, EPHPM 2017.



CHAPTER 2

Recent Achievements and Development Challenges



In recent years, Honduras has had one of the highest growth rates in Central America and has significantly improved citizen security. Honduras has underpinned its upward economic trend on a sounder macroeconomic framework, improved tax collection with a modernized tax administration, and more integration within a favorable international setting. It has cut the homicide rate in half by professionalizing and reinforcing the police, and it has improved the provision of health care services by successfully decentralizing the sector.

Despite this progress, Honduras's economic growth has not translated into sustained reductions in its high rates of poverty and inequality.²⁶ The country presents significant weaknesses that limit the positive impact of growth on the wellbeing of the population. The main challenges are: i) *institutional weakness*, given the high perception of corruption and high levels of crime; ii) *human capital deficits*, evident in the low levels of coverage, pertinence and quality of learning, as well as deficiencies in the provision of health and other basic services; and iii) unsatisfactory levels of productivity, the result of a poorly diversified export basket, insufficient investment in research and development, high vulnerability to climate change, and gaps in infrastructure, logistics, energy, telecommunications, connectivity and water and sanitation.

The private sector is dynamic, though the current context hinders its development. The quality of institutions, the size of the domestic market, and the capacity to innovate, including the adoption of information and communication technologies (ICTs), all constitute structural challenges in the business environment. These constraints affect both the creation and the growth of new enterprises.²⁷

Institutional Quality

Honduras has strengthened its institutional framework in recent years, but weaknesses persist. Approval of the Fiscal Responsibility Act in 2016 marked a milestone in fiscal institutionalism geared towards safeguarding sustainable public policies. Deficit reduction and debt containment have been essential for strengthening the country's macroeconomic stability and underpinning sustainable, more equitable growth. However, Honduras is still below the CADR and LAC averages on the Index on the Strength of Budget institutions, lagging in fiscal risk management, medium-term budget framework and results-based budgeting.²⁸

The country's governance indicators also lag behind those of LAC. Honduras is among the world's lowest quartile in rule of law, government effectiveness and corruption control, and below the global average in regulatory quality, political stability and participation and accountability.²⁹ In spite of advances in the fight against corruption, owing to the Office of the UN High Commissioner for Human Rights, the creation of a Special Commission for the Discharge and Transformation of the National Police, and the Mission to Support the Fight against Corruption and Impunity in Honduras, the country is still among those with the highest corruption perception. The Corruption Perception Index (CPI) ranked Honduras at 135 on a list of 180 countries in 2017. Likewise, 58% of Hondurans believe that half or more of the country's politicians are involved in acts of corruption.³⁰ Similarly,

²⁶ Between 1960 and 2017, LAC's per capita growth rate was considerably lower than that of emerging Asian countries (2.4% and 4.9%, respectively). During this same period, emerging Asian countries experienced significant convergence with U.S. per capita income compared to LAC: convergence increased from 11% in 1960 to 58% in 2017, while in LAC the increase was merely four percentage points (20% to 24%) (IDB, 2018b).

²⁷ International evidence on the importance of the business environment on company growth is given in Batra and Stone (2008), Klapper, Laeven and Rajan (2004), Klapper and Love (2010), Levy (2018) and Woodruff (2003), among others.

²⁸ IDB calculations based on *Budget Institutions in G-20: An Update*, IMF (2014); and *Budget Institutions in Low-Income Countries: Lessons from G-20* (Gupta et al., 2017).

²⁹ World Bank Governance Indicators. Data for 2017.

³⁰ Latin American Public Opinion Project (LAPOP) (2017).

65% of businesspeople identified corruption as a major challenge for their companies, while the average for LAC is 36%.³¹ At the same time, the Global Competitiveness report mentions weak institutions as one of the main vulnerabilities affecting the country's productivity. The rankings on institutional quality show the country lagging on various fronts, especially in the fight against organized crime, trust in the police, high business costs due to crime and violence, and the burden of government regulations.³²

Weak protections for property rights, minority investors and contract enforcement pose serious challenges for the Honduran business environment. Close to 80% of privately-owned land is either untitled or improperly titled. In addition, title disputes tend to take years to settle in court, partly due to the weak judicial system. Furthermore, public sector functions that have a major impact on the ease of doing business, such as contract enforcement, minority shareholder protection and insolvency resolution, perform unsatisfactorily.³³ The World Economic Forum ranks Honduras 113 in a list of 140 economies, with a score of 29 out of a possible maximum of 100.

Regulatory environment challenges have negative consequences on innovation and company startups. Cornell University's Global Innovation Index highlights constraints related to the government's effectiveness and the regulatory environment as some of the main challenges to innovative activities.³⁴ The high cost of starting a business, for example, is another key factor of the regulatory environment that dampens the entrepreneurial spirit.³⁵

Productivity

Honduran productivity is lagging considerably. A growth decomposition analysis shows that physical capital accumulation has been one of the main drivers of the country's economic growth in recent decades. Between 2000 and 2017, the average GDP growth rate was 4.2%, with capital and labor contributing 2.0% and 1.7%, respectively, while total factor productivity contributed only 0.5% to growth (Graph 2.1). Moreover, Honduras has one of the lowest productivity levels in Latin America, with the region's second lowest productivity gap in 2016 (0.30), higher only than that of Nicaragua (0.27).³⁶

Even though agriculture and manufacturing contribute significantly to the economy, their productivity levels are not enough to improve wages in these sectors. Agriculture generates 30% of employment, constituting the country's primary source of labor income (Graph 2.2). However, agricultural productivity (measured as value added per worker), has remained stagnant since 2001 and below the averages for both the Honduran economy and LAC. Productivity in the Honduran agricultural sector reached USD 2,232 per worker, while for Latin America and the Caribbean this figure was close to USD 4,000.³⁷ Productivity is not only lower in agriculture but also in the industry and services sectors,

³¹ World Bank (2016).

³² World Economic Forum (2017).

³³ World Bank (2018). Doing Business Report 2019: Washington, DC.

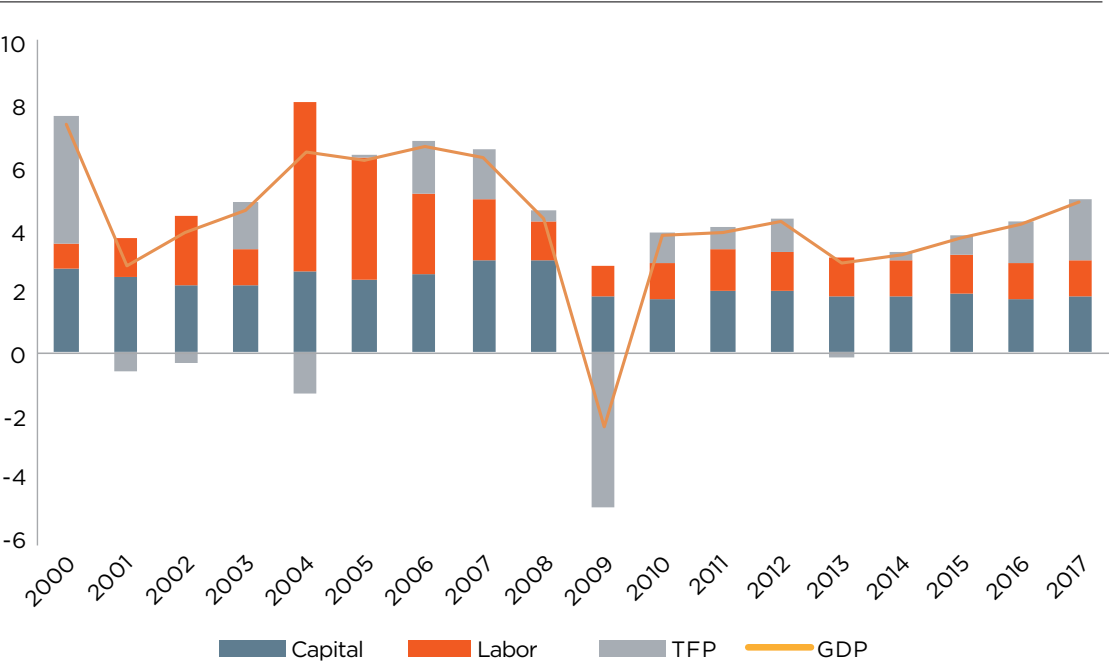
³⁴ Cornell University, INSEAD, and WIPO (2017).

³⁵ Economic Freedom Index (2019). Available at <https://www.heritage.org/index/>.

³⁶ The productivity gap is the ratio of one country's productivity to that of another. For the purposes of this book, the Latin American average is used as a benchmark. The productivity indicator is gross domestic product in constant 2010 dollars per worker.

³⁷ World Development Indicators (World Bank). Data for 2017.

GRAPH 2.1 Growth Decomposition (%)



Source: IDB calculations based on data from the Central Bank of Honduras and the International Monetary Fund (World Economic Outlook, April 2018).

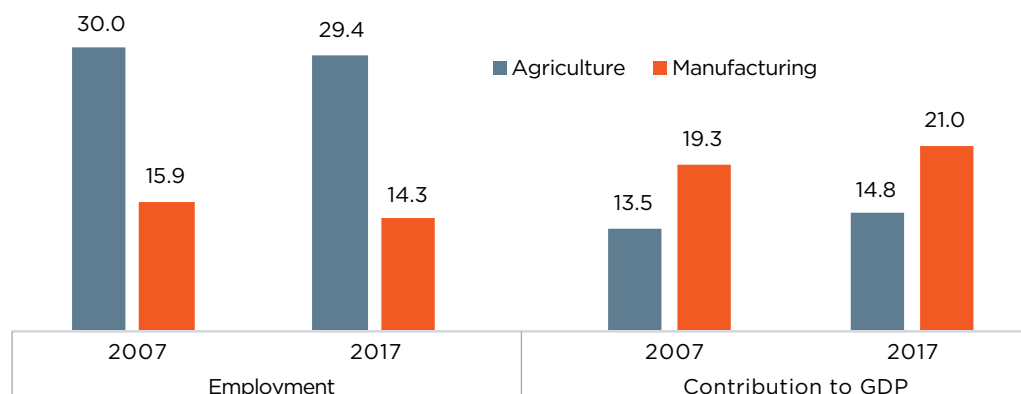
where the LAC value added per worker is almost four times higher. In addition, the yield of the main agricultural crops in Honduras is lower than that of its Central American peers. Compared to the country with the highest productivity in CADR, Honduras has a relatively weak performance in bananas (-46%), palm oil (-15%), coffee (-3%) and vegetables (-35%).³⁸ In addition, manufacturing has performed unsatisfactorily in recent years, growing only 3.1% in the past five years, in contrast to the 5.8% annual production growth registered between 2000 and 2005. The decline may be attributed in part to shrinking demand in the U.S., the main buyer of textiles and car harnesses.

Low productivity, coupled with Honduras's vulnerability to external shocks, exacerbates poverty and hinders asset accumulation. Agriculture in Honduras is exposed to extreme hydro-meteorological phenomena (Imbach, P., et al., Medellín 2017) and recurring events of lesser intensity but greater frequency (Smirnov, O., et al. 2016). Agricultural products are also affected by short- and long-term weather changes and disruptions at different stages of the value chain. Floods, for instance, affect the harvest, storage, processing and shipping of produce (Imbach, 2017). Honduras ranks 163 among 180 economies in the index of agricultural nitrogen management, suggesting that besides climate change vulnerability, there are important challenges to the environmental performance of the primary sector.³⁹

³⁸ United Nations Food and Agriculture Organization. Data on food and agriculture, FAOSTAT (2014). Available at <http://fao.org/faostat/en/#home>

³⁹ Yale Center for Environmental Law & Policy (2018).

GRAPH 2.2 Agriculture and Manufacturing Share of Employment and Contribution to GDP (%)



Source: IDB calculations based on Honduran household surveys (*Encuesta Permanente de Hogares de Propósitos Múltiples*, or EPHPM) and data from the Central Bank of Honduras.

As a small, open economy, Honduras periodically faces price volatility in its main export markets. Honduras contributes less than 1% of world trade, which limits its ability to set prices and forces it to absorb the volatility of international markets. Volatility has a greater impact on small farmers, who generally have less access to risk management tools, increasing rural poverty. In effect, agricultural workers account for 60% of those living in extreme poverty.⁴⁰

The export basket is highly concentrated, and economic complexity, a measure of the knowledge content of foreign sales, is low. The goods that were exported ten years ago still constitute a large share of the export basket (Graph 2.3). In addition, the four main products (coffee, bananas, palm oil and farmed shrimp) account for 56.8% of total exported goods in 2017.⁴¹

Honduras enjoys favorable foreign market entry conditions for agro-industrial products, but logistic challenges prevent it from taking greater advantage of international trade agreements. Honduras is among the top 20 out of 136 nations with the best foreign market access, primarily because of its preferential treatment in destination markets.⁴² Factors that favor agro-industrial exports include the connectivity provided by Puerto Cortés, a deep-water port with good access to U.S., Caribbean, Gulf and East Coast ports. Nonetheless, the high cost of exporting is still a major barrier to trade.⁴³

Informality, underemployment and labor market rigidities also place constraints on productivity. The country's labor force tends to work in low-productivity sectors (agriculture and services) that do not require high levels of schooling. Although the unemployment rate in 2017 was 4% (compared to 7% for LAC), underemployment

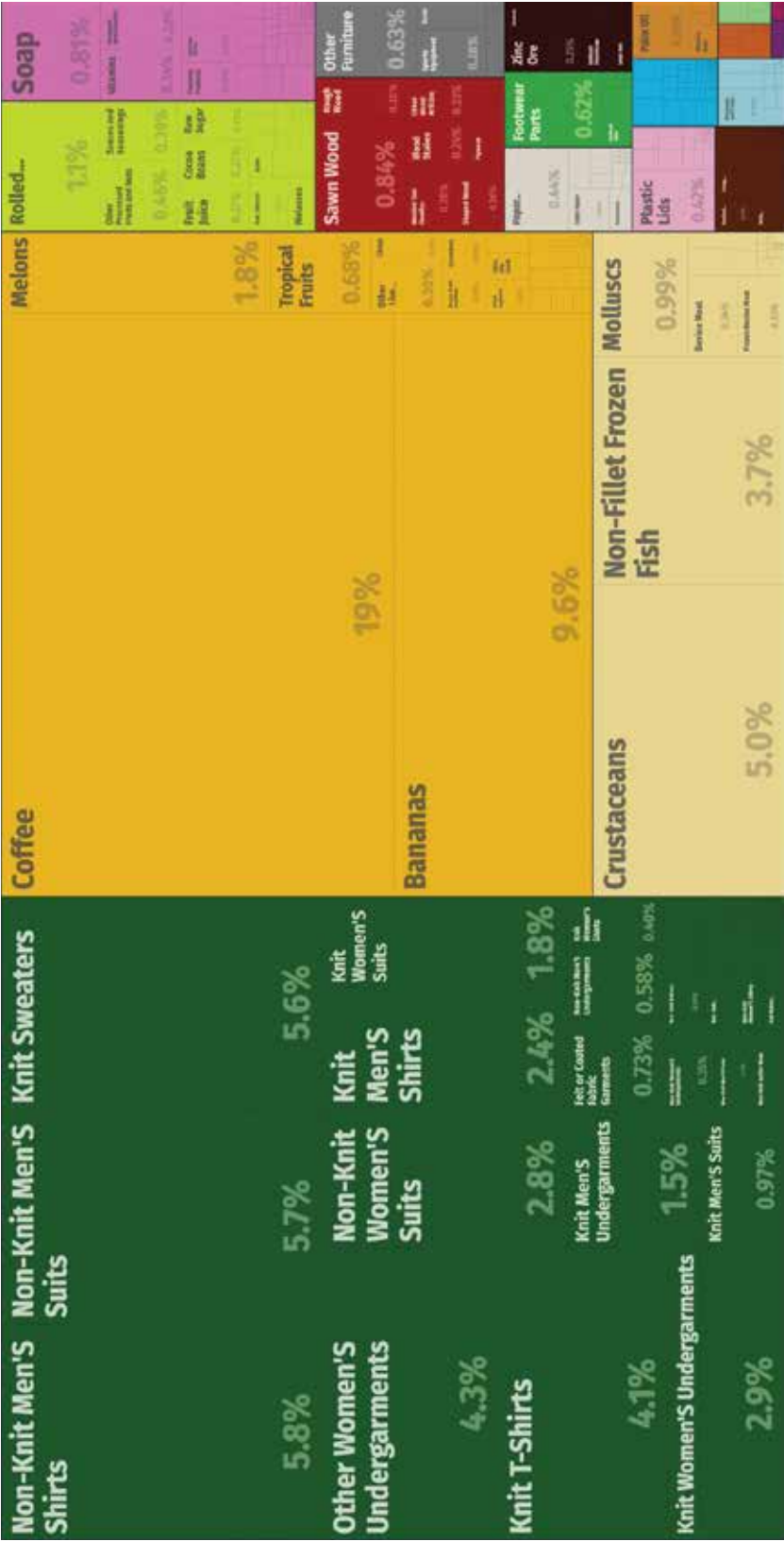
⁴⁰ INE, EPHPM (2017).

⁴¹ Central Bank of Honduras (2017). Available at <http://www.bch.hn/exportaciones.php>

⁴² World Economic Forum (2016).

⁴³ World Economic Forum (2016) and World Bank (2017b).

GRAPH 2.3 Panel A: Honduran Exports in 1995



reached 44.4% and informality affected more than 80% of the workforce.⁴⁴ Female labor participation is low (48%, compared to 58% in LAC), and one out of every four youths aged 15-24 neither studies nor works, surpassing the figure for LAC (15.5%). The Honduran workforce will expand over the next 22 years,⁴⁵ providing potential opportunities linked to the demographic dividend and a young working-age population.

Infrastructure

Transport/logistics

Honduras's poor performance in logistics impacts its productivity and competitiveness. The country ranks 112 among 160 economies in the Logistics Performance Index (LPI), compared to 86 for CADR and 100 for LAC (Graph 2.4). A decomposition of this index shows that Honduras lags behind other countries in LAC in terms of infrastructure (143), customs (126) and logistics competence (110). According to the National Logistics Plan, infrastructure and specialized logistics services are poorly developed in Honduras.⁴⁶ Ports lack supporting logistics services zones; and in particular, the agriculture sector is challenged by insufficient storage systems and facilities for cold chains. In addition, no specialized logistics infrastructure exists along the borders.

Transportation infrastructure limits production potential. Honduras ranks fourth in the region behind Panama (11th globally), the Dominican Republic (48th) and Costa Rica (64th) in the Global Competitiveness Index. Globally, the country is in the 93rd position out of 138 economies (Table 2.1). Limited cargo handling infrastructure, process shortcomings and limitations in foreign trade administrative procedures adversely affect cargo and passenger transit.⁴⁷

The road system suffers from poor coverage and quality, especially in secondary corridors, and port access bottlenecks. Although 86% of foreign trade is shipped by sea, road infrastructure and border crossings are strategic for regional trade.⁴⁸ In fact, the country has the highest import-export costs in CADR and ground freight costs represent the highest expenses (48% of import costs and 53% of export costs).⁴⁹ Despite progress in national and regional integration corridors, the road system is deficient and faces constraints that affect average cargo transport speed. Road density (0.30 km/km²) is the

⁴⁴ Informality is the term given to the work activity of those who work and earn income outside of the state's tax control (individuals aged 18-65 who do not contribute to any social security institution, pension fund, union or worker association). IDB calculations based on the data from INE, EPHPM (2017).

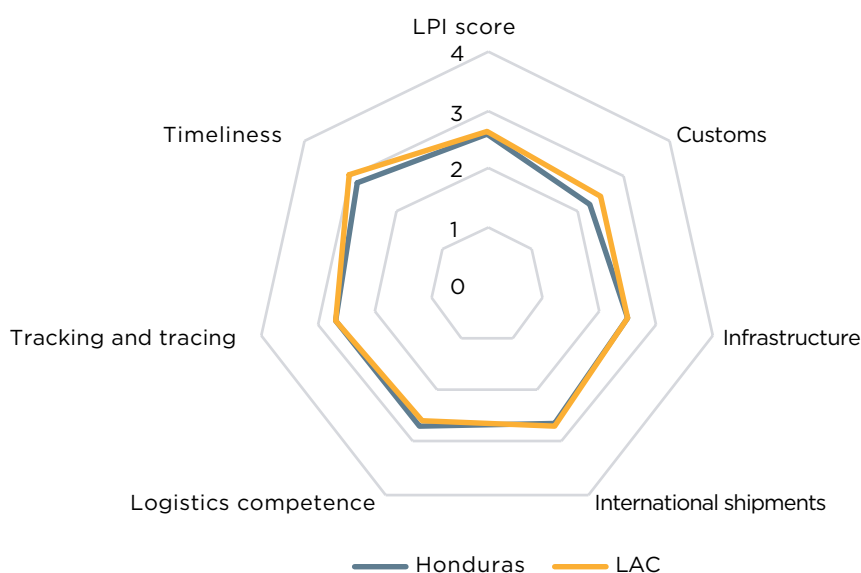
⁴⁵ Prat & Solera (2017).

⁴⁶ The value-added logistics service is done in-house, with local input and low levels of outsourcing (3PL, Third Party Logistics Services); thus, the supply is relatively undiversified, offering producers few options (Prat & Solera, 2017).

⁴⁷ Infrastructure limitations include a short runway (2,021 meters), location in a high urban pressure area far from important cargo-generating centers in the country's central and southern areas, limited cargo handling capacity at the Toncontin International Airport, limiting the supply of cargo flights and forcing warehouse mobilization of commercial passenger aircraft. The operating capacity of the Ramón Villeda Morales International Airport is limited by inadequate foreign trade processes (IDB, 2016; IDB, 2018a).

⁴⁸ IDB (2013).

⁴⁹ Average CADR exporting cost of US\$ 1,211.30 and importing cost of US\$ 1,321.40. In Honduras, Puerto Castilla reports an exporting cost of US\$ 2,308 and importing cost of US\$ 2,359, and Puerto Cortés reports costs of US\$ 1,450 and US\$ 1,630, respectively. (World Bank, 2014a).

GRAPH 2.4 Logistics Performance Index, Honduras and LAC (2018)

Source: Logistics Performance Index (World Bank, 2017a).

TABLE 2.1 Infrastructure Quality for Honduras and Selected Countries (2017)

Country	Transport Infrastructure	Quality of Roads	Quality of Ports	Quality of Airports
Honduras	80	81	58	93
Guatemala	106	106	89	111
El Salvador	93	72	99	99
Dominican Republic	53	56	38	48
Costa Rica	103	123	98	64
Panama	32	49	6	11

Source: World Economic Forum (2017). Note: 138 countries in the ranking.

lowest in CADR (0.34 km/km²),⁵⁰ and only 24% of the 15,000 kilometers of the national road system is paved. The private sector identifies the secondary road system and access to Puerto Cortés as the biggest challenges.⁵¹ Additionally, there is no balanced, equitable territorial connectivity between the country's departments, limiting access to tourism, agricultural and forest exploitation areas. These challenges, combined with low levels

⁵⁰ International Road Federation, World Road Statistics (2015). Available at <https://worldroadstatistics.org/>

⁵¹ According to interviews with businesspeople conducted by IDB Invest in 2017.

of transportation service competition⁵² and efficiency,⁵³ push logistics costs upward and hinder regional integration.

Limited cross-border trade infrastructure, including equipment, increases the costs of trade.⁵⁴ Wait times at customs and inspection stations account for 15-20% of total shipping time in international routes. At land borders, the biggest obstacles are the low capacity of roads approaching border crossings, little support infrastructure, the absence of non-intrusive inspection equipment, and the separation of customs processing points and merchandise dispatch processing. Another limitation is Honduras's one-stop shop system for customs processing, equipped to handle only a limited number of documents, including the Central American Single Customs Form (*Formulario Aduanero Único Centroamericano*, or FAUCA) and export origin documents.⁵⁵

The institutional capacity to plan, implement, and maintain infrastructure projects could be improved. Jurisdiction over infrastructure maintenance and construction is fragmented. The country lacks road planning mechanisms such as an updated road inventory for guiding and prioritizing spending, and road maintenance management is limited. Technical and professional training in the government and private sector for design preparation and quality control is deficient, hampering service and infrastructure performance. Experiences with road concession projects have been mixed due to weak structuring and execution. While private participation in the port sector has enhanced service and infrastructure capacity and quality, road projects have not performed as expected.⁵⁶ The robustness of demand studies is a key issue in road concession contracts, with implications on the difference between estimated fiscal contingencies and those materializing from minimum income guarantees.

Energy

In recent years, the country has made headway in energy matrix diversification. Honduras has invested the most in renewable energy as a share of GDP in CAGR and ranks among the top ten countries worldwide in terms of variable renewable energy as a share of total electricity generation.⁵⁷ The entry of new electricity generation technologies has been partly due to the Law for the Promotion of Electrical Energy Generation with Renewable Resources and the Law for the Promotion of Public-Private Partnerships. This is reflected in greater private participation in the energy sector (private electricity generation increased

⁵² All CAGR countries prohibit cabotage, so no foreign operator can provide such service between two domestic destinations. The Honduran Transportation Law limits the share of foreign capital in carriers to 49% and transportation within the country is restricted to domestic carriers (World Bank, 2014a).

⁵³ A high percentage of ground shipments return empty (40.3% on routes shorter than 150 km and 41.2% on long routes), which raises prices in order to recover costs (Osborne et al., 2014). Other road transport weaknesses concern: (i) overloading practices due to the absence of certifications and weight inspections at the source; (ii) high levels of fleet obsolescence (averaging 18 years); and (iii) limited supply of refrigerated vehicles (IDB, 2016).

⁵⁴ In high-income OECD countries there are fewer required documents, import and export times vary between four and six days less, and expenses are 22-25% lower (World Bank, 2015).

⁵⁵ World Bank (2014a).

⁵⁶ "Aumento en la productividad promedio en la operación de buques y reducción en los tiempos de atención por camión." (Operadora Portuaria Centroamericana, 2018).

⁵⁷ Renewable Energy Policy Network for the 21st Century. 2018. Renewables 2018: Global Status Report. Available at: http://www.ren21.net/wp-content/uploads/2018/06/17-8652_GSR2018_FullReport_web_final_.pdf

from 39.5% in 2000 to 80.3% in 2015).⁵⁸ Between 2010 and 2016 the sector attracted USD 2.3 billion in clean energy investment, largely driven by tax incentives and high rates for solar energy generation.⁵⁹ Investment in renewables is estimated to have created more than 11,360 direct jobs in construction and 34,080 indirect jobs in surrounding areas, and to have expanded the energy grid by more than 250 km, benefitting more than 20,000 rural families.⁶⁰

Despite progress in energy diversification, limitations in the energy sector obstruct the competitiveness of existing activities and restrict economic diversification. Coverage is limited, with considerable urban/rural gaps (67% in rural areas and 77% nationwide)⁶¹ and widespread use of firewood as a source of cooking energy (55% nationwide and 88% in rural areas). Electricity grid instability has hindered an efficient operation of the energy system, limiting the maximum potential use of renewable resources and affecting the electricity supply to demand centers such as the northern industrial zone and tourism destinations in the country's western area.⁶² Access to quality (i.e., reliable) electricity affects competitiveness and diversification of growth poles. Although distribution and transmission losses have been reduced as a result of public and private sector efforts, they are still the highest in the region (27.3%). Transmission losses impact electricity rates negatively, since a considerable share of the generation fails to reach the end consumer.⁶³ The technical losses originate in facilities used for transmission systems operated by ENEE, either because of inadequate design, lack of maintenance, or extensive distribution circuits with sections of inadequate powerlines and overburdened transformers. Fiscally, ENEE has implied an outlay for the government. ENEE's deficit reached 1.6% of the GDP in 2014, then declined to 0.7% of the GDP as oil prices fell, only to rise again to over 1.2% of the GDP in 2018.⁶⁴ Letting consumer rates reflect market costs is essential for reducing the electricity sector's fiscal contingency, but this would be difficult due to the high costs of generation, largely a result of the high prices agreed in non-traditional renewable energy generation agreements.

Electricity is essential for doing business in Honduras, but service shortfalls impose serious costs for the private sector. The private sector accounts for close to 54% of domestic electricity use.⁶⁵ Large companies have identified electrical service as the second most relevant factor for doing business in Honduras and small and medium enterprises (SMEs) report that power cuts and poor quality service cause losses equivalent to 2% of annual sales.⁶⁶ Companies must go through seven steps to get electricity (two more than the LAC average), which takes an estimated 39 days and costs 791% of per capita income. At the same time, service reliability is rated zero on a maximum scale of eight. These factors place Honduras in the 144th position out of 190 countries worldwide in ease of grid integration.⁶⁷

⁵⁸ Echevarría, et al. (2017).

⁵⁹ Climatescope (2018). Bloomberg NEF.

⁶⁰ Asociación Hondureña de Productores de Energía Renovable (2018).

⁶¹ National Electrical Energy Company (ENEE) (2017).

⁶² IDB (2015).

⁶³ IDB (2018b). Energy sector losses in LAC average around 15%.

⁶⁴ National Electrical Energy Company (ENEE) (2018). The Finance Secretariat estimates ENEE's debt at USD 2,150 million, equivalent to 9% of the GDP.

⁶⁵ ENEE (2016).

⁶⁶ World Bank (2016).

⁶⁷ World Bank (2018).

Water and Sanitation

Even though the country has 90% coverage of access to improved water sources, there are significant gaps between urban and rural areas. Water and basic sanitation coverages are at 92% and 80%, respectively, but the lack of water quality data makes estimation of safe water supply impossible. Steady water supply is limited to only 54% of households in urban areas and 66% in rural areas. In addition, only 1% of wastewater is treated. The gap in access to water supply by income level is significant: while 96% of the wealthiest quintile have access to water, only 25% of the poorest quintile do. Regarding basic sanitation services, 99% of the wealthiest quintile have access to an adequate sanitation services relative to only 80% of the poorest quintile.⁶⁸

Digital Infrastructure: Information and Communication Technologies

Honduras has low access and adoption of Information and Telecommunication Technologies. In 2017, the country ranked 129 out of 176 on the Information and Communication Technologies (ICT) Development Index, surpassing only Nicaragua (130) and Cuba (137) regionally. The lowest sub-index is use, which measures Internet intensity and usage as well as fixed and wireless broadband subscriptions. Honduras is one of the countries with the highest mobile telephone prices as a percentage of average monthly gross national income per capita (7.4%, compared to a regional average of 6.2%). It has low cellular broadband use (17 subscriptions per 100 inhabitants versus the average for CADR of 28) and a low percentage of households that have access to a computer or the Internet (23% compared to 30% for CADR).⁶⁹ Furthermore, less than a third of households have Internet access in Honduras (30%, compared to 57% for LAC).⁷⁰ Another major challenge concerning the use of ICTs in Honduras is investment disparity. Telecommunications infrastructure investment totaled USD 1,324 million between 2008 and 2014, concentrated primarily in urban hubs to the detriment of rural areas, which have digital supply problems associated with topographical difficulties, less purchasing power and low population density.⁷¹ In addition, most of the infrastructure has resilience problems, increasing the country's vulnerability to natural disasters.

Tourism

The country is lagging in tourism competitiveness compared to the rest of the region. In the past decade, international visitor arrivals to Honduras grew on average 1.0% annually⁷² (compared to almost 4% worldwide⁷³). A comparison of these figures to those of Costa Rica (4.5%), Nicaragua (7.3%) or Panama (6.9%) shows that Honduras has been losing competitiveness and international tourism market share, both in terms of number of visitors and income per tourist.⁷⁴ The evolution of other Central American countries shows two trends: (i) nations with relatively higher tourism growth (Costa Rica) or very

⁶⁸ IDB estimates based on data from INE, EPHPM (2017)

⁶⁹ It should be clarified that affordability is a problem in not just mobile telephony (23 of 26 LAC countries), but also in fixed broadband (25) and mobile broadband (24).

⁷⁰ World Development Indicators (World Bank). Data for 2016

⁷¹ Almost all this investment is private (INFRALATAM 2018), retrieved from <http://infralatam.info/>.

⁷² Compounded Annual Growth Rate, or CAGR.

⁷³ Authors' calculations based on UNWTO databases, specifically different UNWTO barometers.

⁷⁴ The market share of international visitors has shrunk by 19%, and that of international tourism arrivals by 13%; all data are from different UNWTO barometer years.

high average growth (Belize, Nicaragua and Panama) above global and regional averages, and (ii) countries where tourism has stagnated, growing well below the global or regional average (El Salvador, Guatemala and Honduras).⁷⁵ There is a strong correlation between the levels of violence and violent crime⁷⁶ and the potential competitiveness of the destination; in fact, some studies have established causality between the two variables.⁷⁷

At the same time, climate change is adversely affecting tourism.⁷⁸ Honduras is one of the hardest hit countries in this respect, primarily through: (i) endangerment of key factors of attraction for the destination (i.e., coral reefs, weather, beaches and heritage sites); (ii) impacts on seasonality (increased seasonality versus the expected trend without climate change); and (iii) impacts on critical infrastructure, both basic and productive. Although climate change is expected to have a massive impact on all industries, its consequences for tourism could be devastating.

Access to Credit

The financial system's efficiency is lagging, and the diversity of existing financial services is limited. Honduras's external funding comes primarily from multilateral sources and foreign direct investment (FDI). The country has had access to multilateral concessionary financing for many years. The private sector has received a growing flow of FDI as a result of legal reforms and market opening. Free trade agreements with the U.S. and Mexico helped boost FDI inflows, especially those of *maquilas*. However, the national banking system has a wide margin for efficiency improvement. Honduras's inefficiency index is 91.2%, compared to 78.8% for CADR.⁷⁹ This results in a high financial intermediation margin, and although the margin has shrunk in recent years, dropping from 12% in 2008 to 9.8% in 2016, it is still one of the highest in the region, surpassed only by Nicaragua and the Dominican Republic. Margins could increase the cost of credit and reduce the amount of funds available for investment.

Access to credit is limited for SMEs. SMEs account for more than 80% of jobs,⁸⁰ and 76% of them have difficulty accessing credit.⁸¹ With the country's high level of informality, available information for a proper credit analysis is inadequate. With incomplete information, financial institutions lack the ability to accurately evaluate credit risk, and credit classification models are unavailable. Moreover, the ability of customers to meet the requirements for filling out a loan application is also low. Information asymmetries, together with the inability of SMEs to elaborate feasible business plans, lead financial institutions to prioritize security interests when making credit decisions. The secured transactions law has not been implemented by local banks, as costlier monitoring of these transactions drives up total financing cost. Therefore, the Honduran financial

⁷⁵ It is worth mentioning that in the first group Costa Rica could be considered a consolidated destination, which explains its slower pace of growth despite its strengths.

⁷⁶ Measured, for example, by weighted or simple indices of the prevalence rates of the different types of violent crimes, or simply using the number of homicides per 100,000 inhabitants as a proxy.

⁷⁷ See, among others, Mawby (2003) and Alleyne & Boxill (2003).

⁷⁸ UNWTO (2009).

⁷⁹ Ratio of administrative expenses to the financial margin. The higher the percentage, the less the efficiency.

⁸⁰ 75% of the jobs are concentrated in small enterprises with ten or fewer employees, and 6% are in medium-sized enterprises with 11-15 employees (INE, EPHPM, 2017).

⁸¹ World Bank (2016).

system is especially concentrated in large-scale, lower-risk production sectors, reducing the probability of SMEs obtaining long-term financing.

Access to financing is also limited for agriculture. The suboptimal intermediation of financial resources for agroindustry is due to various reasons, including: (i) insecure property rights, that limit the use of land as collateral and reduce the expected return on private investment; and (ii) unavailability of ex-ante and ex-post risk management mechanisms, which results in increased risk for the bank if the borrower is faced by a catastrophic event.

Access to finance presents gender gaps. While 17% of men over the age of 15 report they are saving to create or expand a business, including in rural areas, only 10% of women affirm the same.⁸² Female-led companies face tougher conditions to access credit: only 71% have access to a bank account, in contrast to 85% of male-led companies; 91% of loans require collateral, compared to 68% for companies whose manager is a man; and the value of this collateral is 36% higher for loans to companies led by women.

A small percentage of companies report having problems applying for a loan, although many are internally financed. According to the 2017 Honduran business survey, 25% of SMEs and informal companies had problems getting a loan. The percentage drops to 23% for formal companies and 7% for large ones. Lack of guarantees is the primary reason that companies cannot obtain financing. Empirical evidence also suggests that Honduran companies exclude themselves from the financial market.

Climate Change Vulnerability

Honduras has some of the highest losses due to climate change in LAC. Direct losses due to climate change are estimated at more than 2% of GDP, above the Central American average of 1.1% (Graph 2.5).⁸³ The substantial temperature and rainfall changes associated with the *El Niño* phenomenon have adversely impacted harvests and food security and led to an increase of communicable diseases and forest fires. Moreover, an estimated 47% of the population lives in areas that are highly vulnerable to natural hazards.⁸⁴ Hurricane Mitch, for instance, had an economic cost of USD 3.8 billion, resulting in damages for up to 70% of the GDP in 1998.⁸⁵

The colossal impact of aggregate shocks is largely caused by the country's low resilience to extreme weather events. This is consistent with international evidence of a negative correlation between the damages of aggregate shocks (as a percentage of GDP) and a country's income level. Low resilience is explained by several causes: (i) poor institutional capacity to adequately handle aggregate shocks, such as appropriate countercyclical programs and policies; (ii) low resilience of physical infrastructure and inadequate risk management technologies; and (iii) insufficient risk management mechanisms, including low penetration of financial instruments such as insurance.

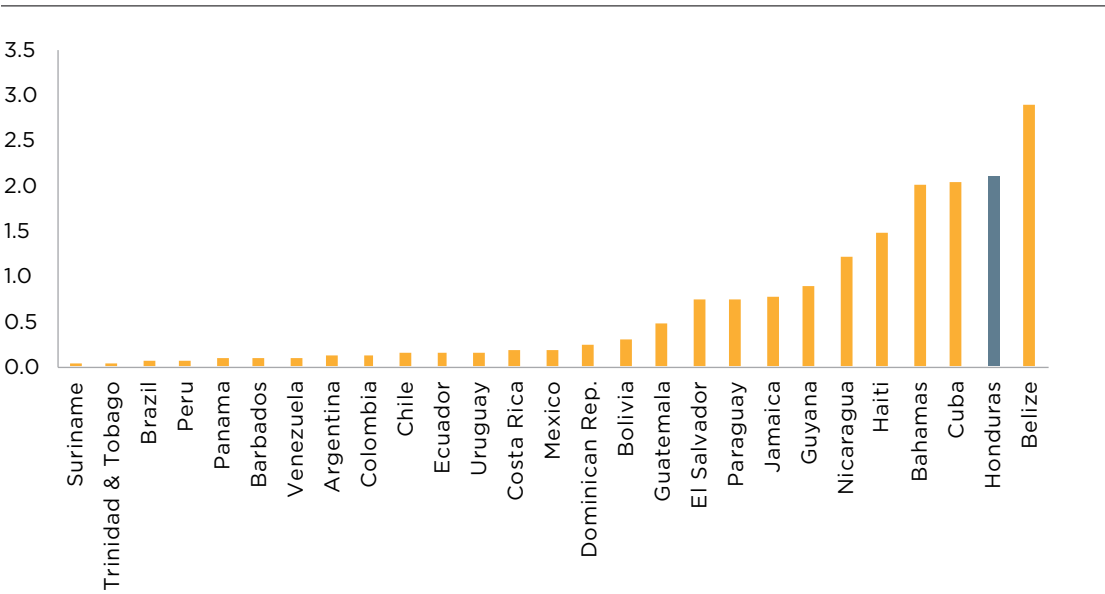
⁸² Demirgüç-Kunt et al. (2018).

⁸³ Germanwatch. (2017).

⁸⁴ GeoAdaptive and IDB (2018).

⁸⁵ ECLAC (1999).

GRAPH 2.5 Climate-Related Losses (% of GDP)



Source: Germanwatch (2017).

Note: Reports average annual losses between 1996 and 2015, including insured and uninsured assets.

Honduras has a high level of deforestation. Deforestation is the primary cause of the country’s greenhouse gas emissions. The consequences of deforestation are particularly significant in broadleaf forest areas and, more recently, in pine forest areas after the pine bark beetle infestation that destroyed more than 500,000 hectares between 2013 and 2016. In the draft Nationally Determined Contribution (NDC) submitted to the United Nations Framework Convention on Climate Change, Honduras prioritized the forest and energy (biomass) sectors for its contributions.⁸⁶ Focused actions in these sectors will help the country meet its commitment of reducing greenhouse gas emissions within the framework of the NDC.

Vulnerability to weather events has a particularly profound impact on poor households. Without adaptation measures, by 2030 an estimated 6,000 Hondurans will fall below the US \$4 a day poverty line as a result of climate change impacts.⁸⁷ The consequences of climate change affect poor households in different aspects, such as health, nutrition, education, income and consumption. School and work attendance could be reduced, for instance, by making transportation more difficult, or adults may be forced to stay at home to care for sick children. A comparison of poverty maps with threat maps shows that Hondurans living in extreme poverty have a 12% higher risk of flooding than the overall population. Likewise, because poor households depend on more fragile assets, they tend to suffer higher financial losses than non-poor households when affected by extreme events.

⁸⁶ http://www4.unfccc.int/ndcregistry/PublishedDocuments/Honduras%20First/Honduras%20INDC_esp.pdf
⁸⁷ IDB (2018a).

Human Capital

Education

Access to education remains low and unequally distributed, limiting inclusive growth. Despite progress on coverage, there is still room for improvement: the net rate of primary school attendance is 95%, but the rate drops drastically in the third cycle of basic education to 45.3%, one of the lowest in LAC.⁸⁸ Furthermore, there are marked differences in coverage at this level in urban vs rural areas (64% and 32%, respectively) and by income decile (73% and 24% for the wealthiest and poorest quintiles, respectively).⁸⁹ In the western region, which has a high concentration of poverty and indigenous populations, gross third-cycle coverage is lower compared to the rest of the country (58.2 vs 69%). Honduras has limited capacity to create a skilled workforce at the tertiary level: only eleven percent of the economically active population has higher education (for every 100,000 inhabitants, there are only 18.3 with a master's degree and 0.26 with doctorates).⁹⁰

Education is of low quality and limited relevance for the labor market. The country underperforms on both international and national test scores. Reading, math and natural science results on the Third Regional Comparative and Explanatory Study tests (*Tercer Estudio Regional Comparativo y Explicativo*, or TERCE) are below the regional average. On national tests for ninth grade, 34% of children had a satisfactory or higher level in reading, but only 7% passed mathematics.⁹¹ Moreover, the education system has no means to detect and develop the labor market's human capital needs and lacks administrative and pedagogical management capacity (UNESCO, 2017). In 2016, more than 35% of employers identified the workforce's inadequate education as a serious limitation for doing business.⁹²

A third of businesspeople see their workers' educational shortcomings as the main barrier to doing business. The World Bank's Enterprise Survey ranks Honduras below the LAC average of 32.1% in this respect. Small firms (with 5-19 workers) are the most affected, with 37% citing workforce preparation as a major constraint for their company's operation.⁹³

The workforce's skills surpass only Nicaragua in CADR, and the limitations are more pronounced regarding skills for the future labor force. Honduras performs poorly compared to CADR when grouping different variables into current labor force skills, including digital and future labor force skills.⁹⁴ The country also performs poorly when compared to the LAC average: while Honduras scores 48.2 on current labor force skills, LAC reaches 52. On skills for the future labor force Honduras scores 50.9 while LAC scores 63. Variables in the current labor force indicator include average years of education and

⁸⁸ In Honduras, basic education consists of three cycles: the first cycle is grades 1, 2 and 3, the second cycle is grades 4, 5 and 6, and the third cycle is grades 7, 8 and 9. To compare the region, primary education refers to the first and second cycles.

⁸⁹ Prat & Lopez (2018).

⁹⁰ INE, EPHPM (2018).

⁹¹ MIDEH (2016).

⁹² World Bank (2016).

⁹³ Ibid.

⁹⁴ World Economic Forum (2018).

the business perception of the workers' skills for work, including digital skills. Variables in the future labor force indicator include quality of teaching (such as the student-teacher ratio, among others).

Health

Honduran productivity could also be affected by shortcomings in the health sector. Almost 18% of the population has problems accessing health services, primarily in rural areas of poor municipalities.⁹⁵ Spending on healthcare is low compared to the region; in 2015, healthcare expenditures in Honduras were 2.9% of GDP, compared with 3.8% in the rest of LAC.⁹⁶ This results in a limited level of services and coverage. The density of health professionals between 2005 and 2013 was 14.5 for every 10,000 inhabitants, compared to 43.5 in LAC, and the percentage of newborns cared for by trained staff between 2006 and 2014 was 83%, while in CADR it was 88%.⁹⁷ In addition, accessibility gaps are more evident in rural areas. The maternal mortality rate is not only higher in rural areas but also dropping at a slower rate. Between 2010 and 2015 the rate fell from 86 to 65 deaths in rural areas, while in urban areas it fell from 68 to 29. In 2015, 47% of maternal deaths occurred during the first 24 hours post-partum (compared to 59% in 2010). Many deaths occurring in the first two hours post-partum are a result of hemorrhaging, which is related to low quality birth-care and obstetric complications. Honduras is also one of the countries with the highest adolescent fertility rates in the region, with 72 births for every 1,000 women aged 15-19, compared to an average of 62 in LAC.^{98,99}

El gasto público en salud es limitado e ineficiente. El gasto por persona es de USD 212 mientras que para ALC asciende a USD 696. Esto responde a una débil focalización en resultados y a una limitada rendición de cuentas, dispersión de recursos y escasa articulación entre iniciativas de las diferentes agencias. Además, el modelo hondureño de salud pública ha tenido tradicionalmente un enfoque curativo (más que preventivo). Por otro lado, los altos niveles de informalidad han hecho poco viable la creación de esquemas de aseguramiento de la población con mecanismos contributivos y la población de menores ingresos recibe baja protección financiera. En 2017, el 44% del gasto en salud provenía del bolsillo de los dos quintiles más pobres del país principalmente.

Public health spending is limited and inefficient. Per capita healthcare spending in Honduras is USD 212, compared to USD 696 in LAC. This stems from a weak focus on results, insufficient accountability, scattered resources and a lack of coordination of initiatives among the different agencies. Furthermore, the Honduran public health model has traditionally focused on treatment rather than prevention. High levels of informality make the creation of public insurance schemes with contributory mechanisms unrealistic, and the lowest income population receives low financial protection. In 2017, 44% of health spending was out-of-pocket, especially among the country's two poorest quintiles.

⁹⁵ Carmenate-Milián et al. (2016).

⁹⁶ World Development Indicators (World Bank). Data for 2015.

⁹⁷ World Health Organization (2018).

⁹⁸ World Development Indicators (World Bank). Data for 2016.

⁹⁹ Honduran National Health and Demography Survey (Encuesta Nacional de Demografía y Salud, ENDESA) 2011-2012.

To solve some of the sector's problems, the IDB helped implement a decentralized management model for health services in five hospitals in the country's poorest municipalities. The results-based financing model is expected to improve service efficiency, quality, access and coverage. It covers more than 1.5 million inhabitants with emphasis on maternity-childcare services. The interventions have resulted in improved obstetrical and neonatal services¹⁰⁰ and improved health of children under the age of five.¹⁰¹ Despite this progress, institutional weaknesses persist and healthcare services lack technological applications to improve their efficiency and quality and facilitate patient management.

Territorialization of Development Challenges

Given the challenges described above, IDB asked GeoAdaptive LLC to elaborate a georeferenced multisectoral diagnostic that territorializes the main challenges; the result was a territorial economic development strategy that is presented in the following chapter. This innovative approach seeks to break away from the traditional sector-approach and proposes comprehensive interventions that would enable key stakeholders to maximize synergies and the impact of their actions and help Honduras significantly and sustainably reduce its poverty and inequality statistics.

¹⁰⁰ In particular: (i) first trimester pregnancy care increased from 51% to 90%; (ii) prenatal control increased from 23.7% to 94.1%; (iii) institutionalized childbirth increased from 68.6% to 84.7%; (iv) postpartum care increased from 67% to 91% for the first three days and from 47% to 60% for the first seven days; and (v) management according to standards of neonatal complications increased from 7% to 43%, and of obstetric complications from 11% to 63%. (*Informe final de evaluación de impacto Programa de Transferencias Monetarias Bono Vida Mejor*. Retrieved on December 12, 2017 from <https://sedis.gob.hn/sites/default/files/Informe-final-de-EI-FEB-7.pdf>).

¹⁰¹ An increase by 11.3 percentage points (+45%) of control attendance in clinics, a reduction by 3.8 percentage points (-22%) of acute diarrheal diseases, a reduction by 4.6 percentage points (-12%) of respiratory infections, and a reduction by 1.8 percentage points (-17.6%) of global malnutrition (weight-for-age) (Ibid.).

CHAPTER 3

Spatial Economic Strategy: An Innovative Development Approach



As shown in the preceding chapters, despite achievements in economic growth, Honduras still faces many socioeconomic, production and environmental challenges that must be systematically addressed. Without adequate attention, social vertical mobility schemes cannot prosper, plans cannot be made for inclusive development, resource sustainability will not be assured, and private investment will not be attracted.

In this chapter an innovative approach is proposed to maximize the impact of actions from a multisectoral perspective. This approach ensures that the challenges and opportunities can be addressed systematically and comprehensively through a territorially-focused development agenda. The strategy—constructed from a territorial review using geospatial econometric methods—helps characterize the economic model at work today in Honduras. From this perspective, considering the development challenges described in Chapter 2, a set of integrated interventions are proposed, aimed at maximizing the country's potential and overcoming the most pressing social challenges. The territorially focalized interventions generate a geographically specific Spatial Economic Strategy (SES) that addresses needs and creates a new model for territorial economic development.

Need for a New Territorial Economic Model

The SES helps identify actions for boosting the country's productivity and pinpoints economic expansion opportunities that promote development throughout the entire country, changing the historical pattern of development concentrated in just a few areas. Far from being a plan, the SES is a tool to assist with planning and investment for an inclusive economic development policy. Although developed here for the case of Honduras, this approach is applicable to a variety of contexts and scales where the goal is to enhance the efficiency and impact of public spending and create the conditions for encouraging and attracting private investment in sectors and regions with strong potential.

This study seeks to address economic development needs through the geographic delineation of key areas for increasing production, fostering a change in the country's development paradigm and model. The SES proposes focalized interventions aimed at implementing a spatially decentralized development model and capitalizing on the territory's inherent opportunities.

The territorial proposal results in a network comprised of primary and secondary nodes connected by corridors. This spatial network links together the entire territory, taking advantage of sectoral synergies for enhancing productivity and breaking the established cycles of inequality and poverty. In addition to fostering economic development, the strategy has several specific goals such as promoting equity and social inclusion, establishing a more resilient economy through product sophistication and diversification, and proposing areas with development potential accompanied by multisectoral actions to help consolidate or drive economic development in a specific geographical area.

The purpose of the identified growth poles is to focalize investment in various sectors through a holistic vision. The approach thus helps to increase productivity and social inclusion within a new territorial economic model that would comprehensively address the challenges identified in Chapter 2. To achieve this, the growth poles combine public and private investments already concentrated around an existing resource or economic activity in a specific location. In particular, the model identifies how infrastructure within an existing private investment can be developed in such a way as to generate positive externalities within other sectors. The study identifies current or potential productive activities in each growth pole that can serve as income generators.

The next section describes territorial analysis and focalization as mechanisms for public policy and investment allocation, based on the fundamental concept of growth poles.

Targeting Investments and Territorial Economic Development Models

Public investment and social and production policy are the main tools in the public administration's toolkit for addressing gaps and taking advantage of opportunities. Appropriately used, they make it possible to achieve these goals, reduce perceived risks and drive private investment, triggering a desired effect of leveraging public funds. This effect is even more potent in small, low-income economies with limited fiscal space such as the Honduran economy. Achieving it requires careful design of targeted production and social policies and spending strategies, so that public spending instigates private spending.

Two mechanisms have been used over the years for allocating and managing public spending on social and production issues: universal allocation and targeted allocation (DNP, 2007). Since universal economic development policy is conceived for and aimed at the entire population and all productive sectors, it is inefficient and costly, as its effect is to dilute territorial resources. It fails to drive private sector participation, which operates under more narrowly focused schemes that allow for managing and containing risk. On the other hand, targeted allocation leads to efficient spending, since it directly addresses production opportunities in specific sectors and population groups. As for risks, while universal allocation is associated with dilution and sustainability, the risks of targeted allocation center on over-targeting and potential neglect of other important groups and areas.

Of course, targeting in public policy and spending allocation is nothing new, but there are many ways to design it.¹⁰²

The territory, then, is defined as the expression of a country's model of environmental and social management and economic development within a specific geographical space. The economic territorial structure is formed by the location and distribution of human, natural and capital resources and infrastructure. These factors, when articulated collectively, promote or inhibit the development of productive activities, and are closely linked with natural and socioeconomic conditions.¹⁰³ With these conditions in mind, territorial interventions can be developed because the location and production patterns can be changed by both policies and specific public and private investments.

A territorial economic development approach requires an analysis of the heterogeneity of the economic and internal social structure, and an understanding of the degree to

¹⁰² A study by Coady et al. (2004) provides empirical arguments that targeted allocation is efficient when used sectorally. The average targeting program provides approximately 25% more resources to the poor than would random allocations. This implies that the best program could transfer 80% of program benefits to the poorest quintile. The best ten programs evaluated in this study were able to deliver two to four times more benefits as compared to random allocations.

¹⁰³ By not incorporating the territory dimension as an "active context" or "actor" in development, economic development strategies based on an aggregate vision pose significant constraints (Boisier, 1996) and prevent adequate targeting.

which production is disarticulated (Albuquerque, 2002). With this in mind, an approach is proposed and developed that analyzes and recognizes the degree of heterogeneity of the economic and social structure and leads to territorial interventions using econometric approximations.

One of the available territorial targeting mechanisms – the one used here – is based on the concept of “growth poles”. The fundamental concept of growth poles is that they exploit agglomeration economies and spillover effects to spread resulting prosperity from the core of the pole to the periphery (World Bank 2013).¹⁰⁴ At the root of this theory is the hypothesis that economic development is not uniform in a region but rather concentrated around a geographical characteristic or economic center (Rodriguez, 2017). It is frequently based on a key industry from which the development of linked industries is unleashed. The potential for creating jobs in new productive activities can be expanded by fostering direct or indirect linkages with the main industry. The indirect effects of this may involve demand for goods and services by the people employed in the core industries. From the standpoint of human capital, the poles offer advantages either by agglomerating skills and knowledge or by generating more responsive and efficient technical training schemes according to real industrial demands.

The benefits of generating production strategies, based on territorial concepts associated with growth poles, have been found in different institutional and production contexts.¹⁰⁵ There is evidence of the effects of territorial structuring by means of industrial clusters or growth poles and the way these positively impact Total Factor Productivity (Escalona-Ulloa, 2014).¹⁰⁶ This improvement occurs primarily in industries that generate export goods, due to technology transfer and horizontal and vertical labor mobility.¹⁰⁷

Because of the positive effects of targeted territorial investment and the use of growth poles, these approaches have been adopted by many development institutions (Healey, 2004; Christofakis & Papadaskalopoulos, 2011; Eggenberger & Partidário, 2000; Wood & Ridao-Cano, 1999; Anselin, 2010; World Bank, 2013; etc.). Their application has varied across sectors and contexts. For example, growth pole-defined mechanisms have been used for coordinating investment in such areas as sub-Saharan Africa (Madagascar, Burkina Faso, Mozambique and Democratic Republic of the Congo), Asia (Afghanistan, China, Malaysia and Indonesia) and Latin America and the Caribbean (Chile, Brazil, Nicaragua and México). The IDB has recently produced investment targeting strategies

¹⁰⁴ The theory of the functioning of growth poles (also called development poles) was conceived in 1955 by French regional economist Francois Perroux, who was interested in the phenomenon of economic growth and the process of structural change in production. Perroux explained how the modern economic growth process deviated from the stationary concept of equilibrium growth. He based his arguments on Schumpeter's theories on the role of innovations and large-scale enterprises. Expansion of the core industry implied expansion of production, employment and related investments, as well as new technologies and new industrial sectors. Due to economies of scale and agglomeration in proximity to the growth pole, regional development is asymmetrical.

¹⁰⁵ The first growth pole was established in 1966 in France when the French government identified eight '*métropoles d'équilibre*' in all France to promote regional growth and equality among the provinces. After several years of inactivity, the growth pole approach reappeared recently when the World Bank adopted it in several countries at the start of the first decade of the 21st century.

¹⁰⁶ Escalona-Ulloa, et al. gives examples in the Mercosur region.

¹⁰⁷ Other efforts seek the reformulation and reorganization of the spatial economic structure of production using postulations and analyses taken from economic geography and economic agglomerations in geographical spaces.

that include Paraguay, Nicaragua, Guatemala and Mexico as part of a process of developing comprehensive, focalized interventions. Up to this point the returns seem to be favorable, therefore growth poles are viewed as an economic development model for the next era (World Bank, 2013).

Before a draft territorial economic model for Honduras can be developed, however, it is necessary to determine what its territorial model has been historically by looking at how its population and infrastructure is concentrated; this is dealt with in the following section.

Honduras's Territorial Economic Model

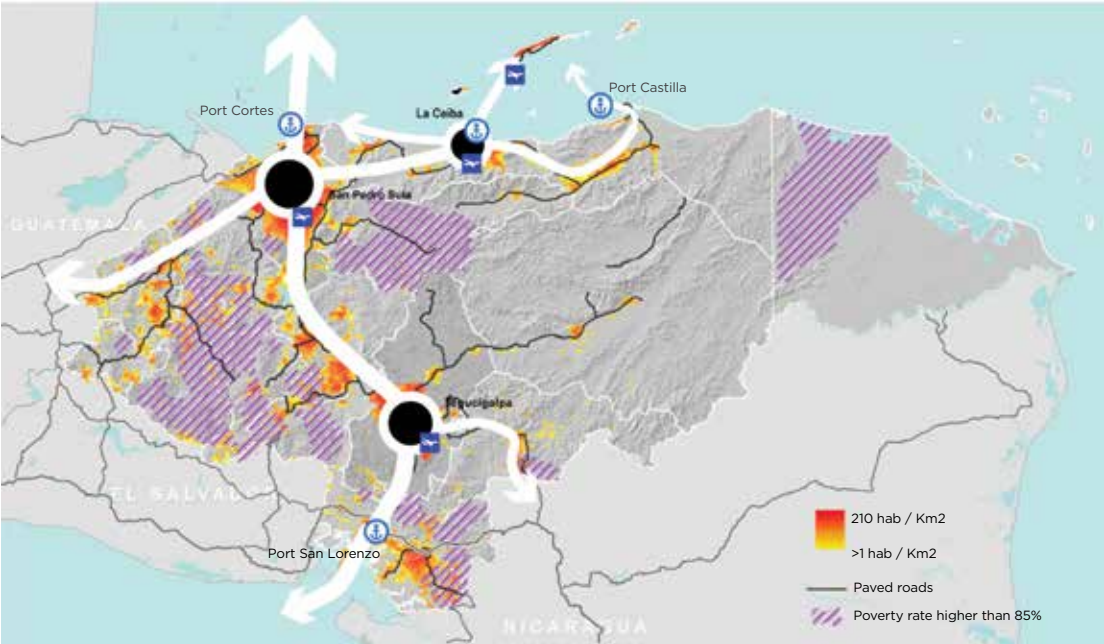
Over the years, Honduras has targeted public investment in a spontaneous manner to drive production, generating a territorial economic model in which both public administration and the private sector have concentrated their main investment efforts in two key areas: the capital city and the San Pedro Sula region. The resulting consolidated territorial investment and development model has generated benefits for some and challenges for the country's economic policy, as well as systems that have perpetuated poverty and inequality.

To understand where this territorial economic model has been developed, the concentration and dynamics of population and infrastructure were evaluated over the past two decades. The territorial representation of these factors shows a clear T-shaped historical development pattern.¹⁰⁸ The pattern links the northern production axis, formed by an east-west corridor between Copán and La Ceiba, with Puerto Cortés as an intermediate point, and the central axis that crosses the country from north to south, linking the main cities of San Pedro Sula and Tegucigalpa, to the area of the Pan-American Highway in the south (Graph 3.1). The consequences of this spatial development are evidenced by the inequality between urban and rural areas, with steady migration in search of opportunities. Thus, there is a lack of development of secondary or intermediate cities, with a lack of adequate infrastructure for connectivity, limited access and poor quality of basic services, a permanent shortage of technical capacities, and limited access to education. These factors exacerbate poverty and limit the country's inclusive growth opportunities.

Due to the many constraints posed by the historical model, a proposal is needed for an innovative model that can encourage social and economic development and include the largest number of Hondurans.

¹⁰⁸ The concept of the historical model in "T" has been addressed in other studies, particularly in *T: Realidad y Propuestas para el Caso de Honduras*, (Falck, 2000). Falck argues the pattern of production and concentration of growth the country presents since pre-Mitch (1998), can be schematized in a "T". This pattern is formed by the corridor Puerto Cortés-Choluteca and referred to as the top of the T, which is the Atlantic Coast. The "T" is evidenced and clearly characterized by the levels of the Human Development Index (1998) by department. In addition, Falck argues the "T" of development excludes majority sectors mainly the rural poor, deepening the social, territorial and productive inequality of said scheme."

GRAPH 3.1 Honduras's T-Shaped Historical Territorial Economic Model



Historical T-shaped Model. Two economic activity epicenters: Corridors: SPS-Tegucigalpa and Copán-La Ceiba

Source: GeoAdaptive (2018).

Proposed Territorial Economic Model for Honduras

The overall goal of the spatial economic strategy (SES) proposal for Honduras is to promote the country's human and economic development using a multisectoral geographical targeting tool that can help the government identify interventions for enhancing productivity in an inclusive way, addressing the challenges that have been identified.

The SES seeks to create a guiding instrument to help boost human and economic development and improve current conditions, transcending an isolated local approach. To do this, the productive structure and organizational patterns of industries must be examined and used to identify specific interventions aimed at fostering industrial, technological and organizational linkages. This makes it possible to link value chains and enhance regional connectivity, as well as labor force skills and productive capacity.

To achieve this, an in-depth analysis of Honduras's current productive capacity was conducted, which has helped identify areas with greater productive potential. The strategy spatially identified operating productive structures as well as new economic products, goods and services connected to higher value-added production chains. With this, it was possible to characterize the way production is organized in the territory. This is the basis for the proposed SES, which aims to help the country develop more sophisticated activities and add value to current economic activities, increasing the productivity of available resources.

In the territorial dimension, the SES seeks to identify areas with high economic potential for expanding development throughout the Honduran territory, changing the country's historical T-shaped development pattern. The consequences of this poorly planned spatial development trend are seen in the inequality between urban and rural areas, underdeveloped secondary cities and regional production centers, and unequal distribution of connectivity infrastructure, as well as gaps in basic services, technical capacities, job opportunities and access to education.

To reverse this trend and take advantage of Honduras' territorial opportunities, this approach is proposed as a tool to help with planning and investment to drive development using the perspectives of geospatial analysis. The approach also identifies, measures, and pinpoints different types of challenges and interventions that can boost the productivity, establishment and growth of industries and lead to more inclusive growth (Box 3.1).

The SES for Honduras is proposed in three sequential stages (Graph 3.2). The first is a diagnostic consisting of a review of the relevant factors for identifying the main national challenges, presented in Chapter 2, from a geographical viewpoint.

BOX 3.1 A Territorial View for Honduras's Economic Development

The expansion of productive opportunities presented in the SES is based on an assessment of existing productive logics* and takes advantage of government-defined corridors to drive socially inclusive economic development. At the same time, it includes the sectorial challenges discussed in Chapter 2 with a multidimensional approach. It also addresses the gaps identified in the evaluation of existing conditions and considers the inclusion of these opportunity areas with unrealized potential, contributing to a process of territorial expansion of economic activities through which the benefits of economic growth can reach the greatest number of inhabitants.

These areas of opportunity contain a concentration of biophysical conditions and unique population groups that can foster agroindustrial and tourism development. Simultaneously, there is also a concentration of poverty and a lack of basic services, in addition to poor connectivity within the transportation network. This view of expansion reinvents traditional economic strategies while also targeting the areas in need through coordinated spatial strategies. The development goals include:

- Promoting current or proposed public and private sector interventions together with other interventions to address the country's socioeconomic gaps;
- Capitalizing on the country's unique territory, culture and dynamics to develop the areas in need as a means of enhancing social inclusion and mobility;

* The "productive logics" are a schematic and geographical presentation in the territory of the dynamics of occupation of a group of value chains (goods or services) in the same economic sector. The analysis specifically represents the collective geographic patterns of production, transformation and distribution of the value chains studied. It represents how the production of products or services are organized and distributed in the territory. This type of analysis is carried out in the "strengthening of products and services" because it requires knowing the current distribution of the activities as a whole.

BOX 3.1 A Territorial View for Honduras’s Economic Development (cont.)

- Strengthening and diversifying the established economic sectors through selected products to expand and promote economic development; and
- Consolidating incipient products for which Honduras has a strong competitive advantage in order to create jobs and grow the economy.

The second involves strategy, which includes identification of products for promoting sustainable economic development and a spatial economic characterization of the associated sectors.

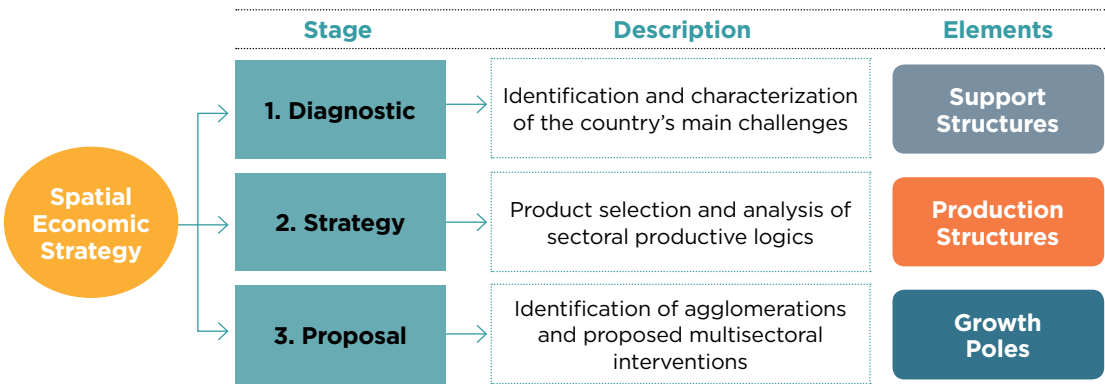
The third identifies and measures an ecosystem of areas in the territory with development potential, or “growth poles”, where a set of multisectoral interventions will be proposed to drive development.

Stage 1. Diagnosis and Territorialization of Challenges

In order to locate the different challenges affecting the country’s productivity, social development and environmental sustainability, a diagnostic phase was conducted based on a holistic understanding of the current context at its various scales: global, regional and local.

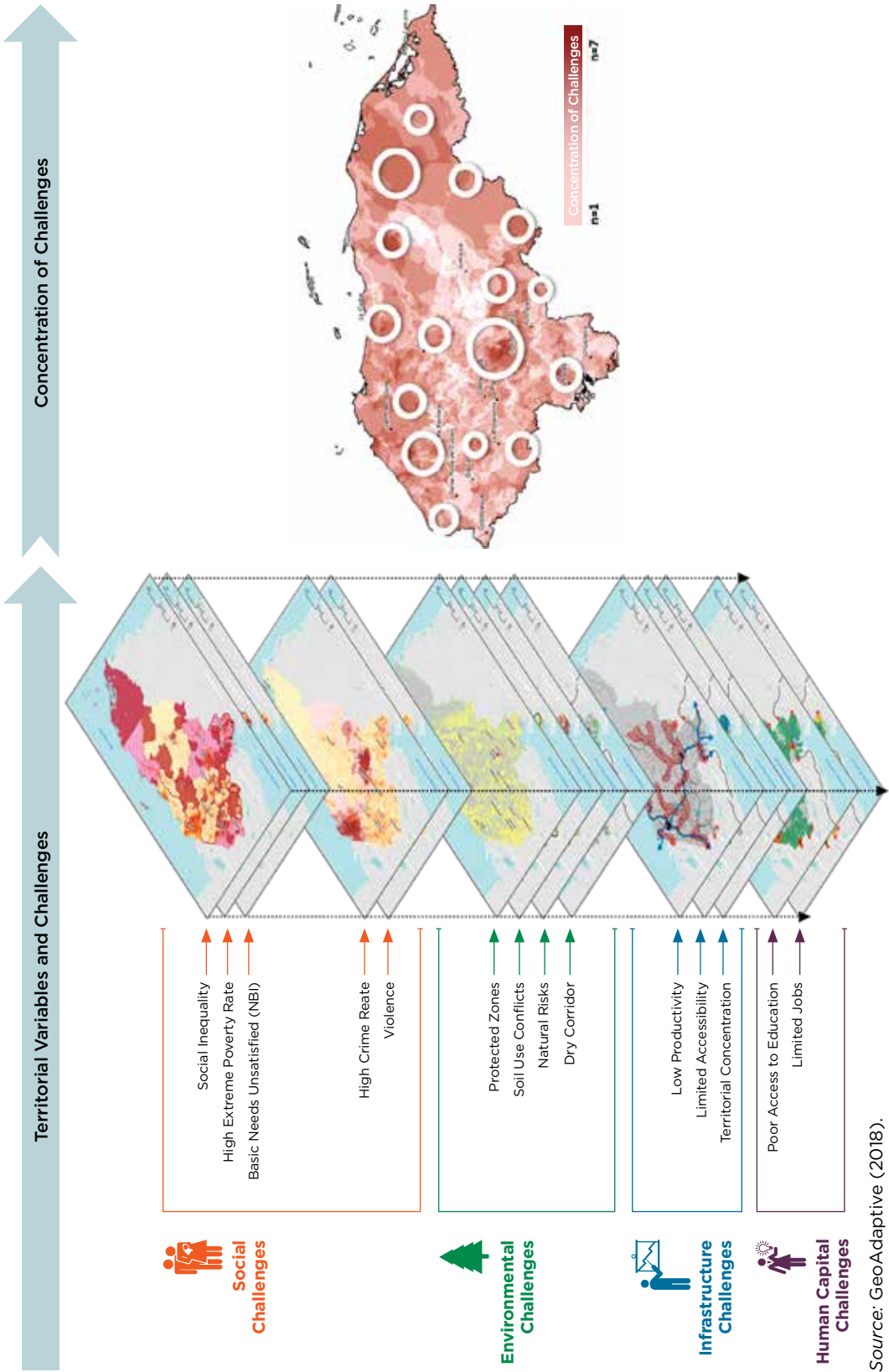
To incorporate the spatial dimension into the sectoral analysis presented in Chapter 2, the multidimensional diagnostic of challenges identified the existing T-shaped territorial model and the lag in various regions of the country (Graph 3.3). The consequences of this model are expressed in the inequality between urban and rural areas and a steady migratory flow in search of opportunities. Furthermore, as a result of this concentration of investment, intermediate or secondary cities have been left without development options, connectivity infrastructure is weak across the territory, basic services are characterized by limited access and poor quality, capacities are lacking, and access to education is limited. These factors restrict poverty reduction and growth opportunities in the country (Box 3.2 and Infographic 3.1).

GRAPH 3.2 Stages of the Spatial Economic Strategy



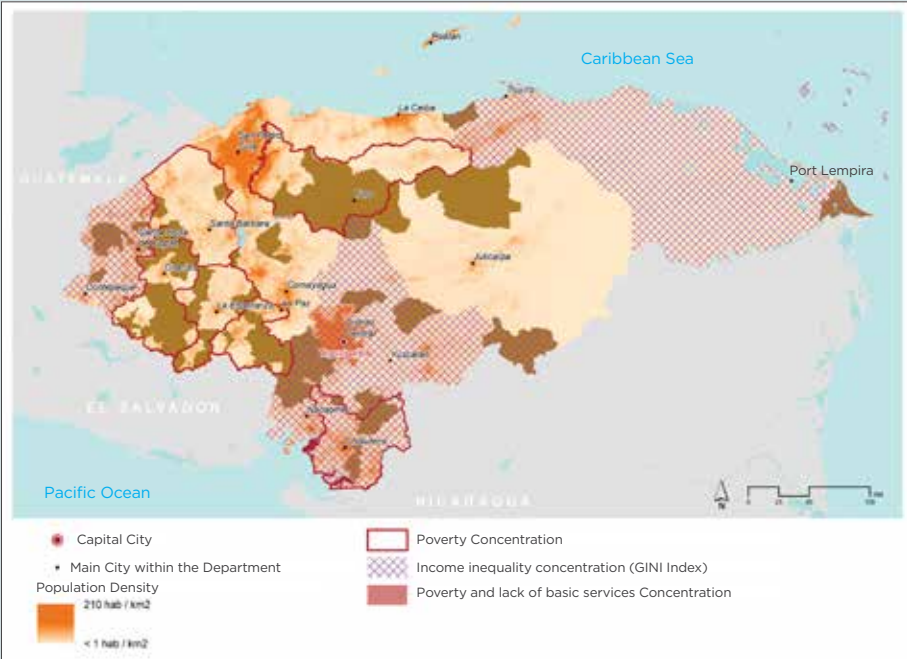
Source: GeoAdaptive (2018).

Graph 3.3 Territorialization of the Key Challenges



Source: GeoAdaptive (2018).

BOX 3.2 Example of Territorialization of Challenges Associated with Unsatisfied Basic Needs, Poverty and Inequality



Considering the challenge of promoting inclusive development with social equality using an approach based on social wellbeing and reduction of poverty and inequality, it is apparent that distinct areas within the country pose numerous challenges with regard to poverty, income inequality and limited access to basic services. These areas are the ones with the largest concentration of challenges. This figure quantifies the concentration of these factors territorially with respect to area and population.

An estimated 65% of the population of Honduras live below the poverty line (INE, 2017). This population is spread throughout the entire country except for departments in which the main cities (Tegucigalpa and San Pedro Sula) are located.

Honduras suffers from unequal income distribution, manifested by an average Gini index of 0.50. Choluteca was found to have the highest level of inequality (0.59), and it is also the department with the second highest percentage of people living in poverty.

Limited access to basic services poses a barrier to the strengthening of human capital in Honduras, impacting the country's economic productivity.

Source: GeoAdaptive (2018).

INFOGRAPHIC 3.1 Summary of the Main Development Challenges

Social Challenges



Concentration Areas of Social Challenges

1.5 million people

At least two social challenges, including high inequality and poverty rates and lack of basic services, affect Concentration in **Yoro, Choluteca, central western area**

Goal

■ *Economic growth focusing on greater social inclusivity through targeted actions in lagging areas*

High Crime Rate as a Production Constraint

57%

of the population live in conditions with medium to very high insecurity. Concentration in **San Pedro Sula** and **Tegucigalpa**.

■ *Continued improvement of security conditions to strengthen the investment climate and promotion of development in areas with a lower crime rate*

Environmental Challenges



Productivity Affected by Climate Change

47%

of the population lives in areas that are highly vulnerable to natural hazards. The 'dry corridor' covers **54%** of the territory and affects 50% of the pastures and crops.

Goal

■ *Develop an adaptation and mitigation plan to reduce vulnerability to climate change, complemented by initiatives to improve resilience*

Natural Resource Depletion

70%

of protected areas include productive activities and 50% contain tourism nodes. **49%** of natural areas are affected by some degree of productive activities.

■ *Promote sustainable development strategies to seek a balance between protection and extraction of natural resources*

Infrastructure Challenges



Inaccessible Areas with Limited Connectivity

68%

of the population live in areas with limited access. **49%** of damaged bridges are located along the main transportation corridors.

Goal

■ *Continue and expand plans for improving transportation infrastructure, thereby improving a consolidated national logistics network*

Areas with potential without electrical coverage

20%

of the population live in areas without access to power. **Areas with development potential**, such as secondary urban or production centers cannot be developed.

■ *Expanded electricity coverage so that areas with development potential, such as subcenters, can be developed*

Human Capital Challenges



Areas with potential without electrical coverage

46%

of the population live in areas with limited access to education or jobs. Territorial concentration of manufacturing and services sectors.

Goal

■ *Strengthen and expand scope of educational programs in the territory to reduce the gap between job opportunities and capacities*

Stage 2. Production Strategy and Territorialization

Production analysis and territorialization implies a sectoral study of the spatial patterns of value chains and productive logics for the key sectors of the Honduran economy.

A product selection process was coupled with a spatial analysis of their corresponding sectoral productive logics. The purpose of this process was to target efforts and link diversification and degrees of sophistication of goods and services. In doing this, the territory's existing capabilities were considered, as well as international and domestic demand, to focus on products pertaining to the country's primary productive sectors, the idea being to prioritize already established products and those that could offer a strong competitive advantage if they were developed. Given the need to keep economic growth in line with social inclusion, additional criteria were also considered, such as the impact of these activities on inequality.

Five productive sectors of enormous importance for the Honduran economy were selected, keeping in mind their economic relevance as well as their social and environmental impact. The five productive sectors that structure the different types of spatial analyses comprising the SES are agriculture, extraction, manufacturing, tourism and services.

Next, products were identified and selected for driving sustainable economic development. First three basic principles were established to guide product selection: social equality and inclusion, sustainable economic expansion, and agglomeration of productive infrastructure.

More than 2,000 goods and 23 services were analyzed, of which 33 products were selected, including 28 goods and 5 services, with a focus on three main strategies:

- (i) strengthening of existing income generators for economic expansion;
- (ii) the potential for adding new products and creating jobs by achieving greater complexity and diversification of existing products; and
- (iii) consolidation of alternative products that are currently incipient but have a competitive advantage due to biophysical factors.

These strategies constitute a prioritization mechanism based on economic complexity, positing that the basis for economic growth is a country's increased productive knowledge. To develop, then, a country must accumulate productive knowledge and use it to achieve a wider variety of more complex products (Hausman et al., 2014). This concept encompasses a set of criteria that would include, among others, the degree of contribution to exports, growth trends and return in global and regional markets, available human capital, and the products' impact on income inequality.

Within the prioritization scheme for product selection, the products for strengthening make up the core of this study's economic strategy, since they show consolidated income generation and an employment base throughout the territory for the analyzed productive sectors. To capitalize on the full potential for added value and economic expansion of these key sectors, the team evaluated the productive logics to identify potential opportunities and obstacles for future development.

The productive logics include a sectoral interpretation of spatial analyses of the value chains of the products for strengthening that comprise this strategy's key productive sectors. These analyses focus on the spatial patterns of the production, transformation and distribution of value chains of the selected goods and services.

The productive logics analysis of the five sectors confirms that the production, distribution and transformation patterns of the products for strengthening in Honduras are concentrated in the aforementioned historical T-shaped spatial development model. To counteract this concentration pattern of economic activities within the Honduran territory and thereby initiate development in some of the country's lagging areas, the SES proposes to geographically expand these activities. This spread proposal is built on the territorial development opportunities detected in the analysis of challenges, the selected products and the productive logics productive logics.

The knowledge and patterns extracted from the sectoral productive logics provide an opportunity to illustrate the multisectoral dynamics of the main economic activities in Honduras (Graph 3.4). Tegucigalpa and San Pedro Sula. Two minor corridors to the northeast and west consolidate the Emerald Coast¹⁰⁹ and the Copán region as poles for agriculture and tourism.¹¹⁰

A combined review of the multisectoral productive logics and government plans indicates the following:

- The multisectoral dynamics of the main economic sectors in Honduras follow a pattern that has been generated with little planning of activity concentration in San Pedro Sula and Tegucigalpa.
- This polarization is further heightened through government proposals aimed at improving the connectivity between these two cities and other areas of the country.
- Available ports, airports and major customs points on the Emerald Coast and in the Copán region suggest these areas as secondary economic nodes.
- The Honduran geography makes connectivity extremely difficult, so geography plays a significant role in current economic activity and social development patterns.

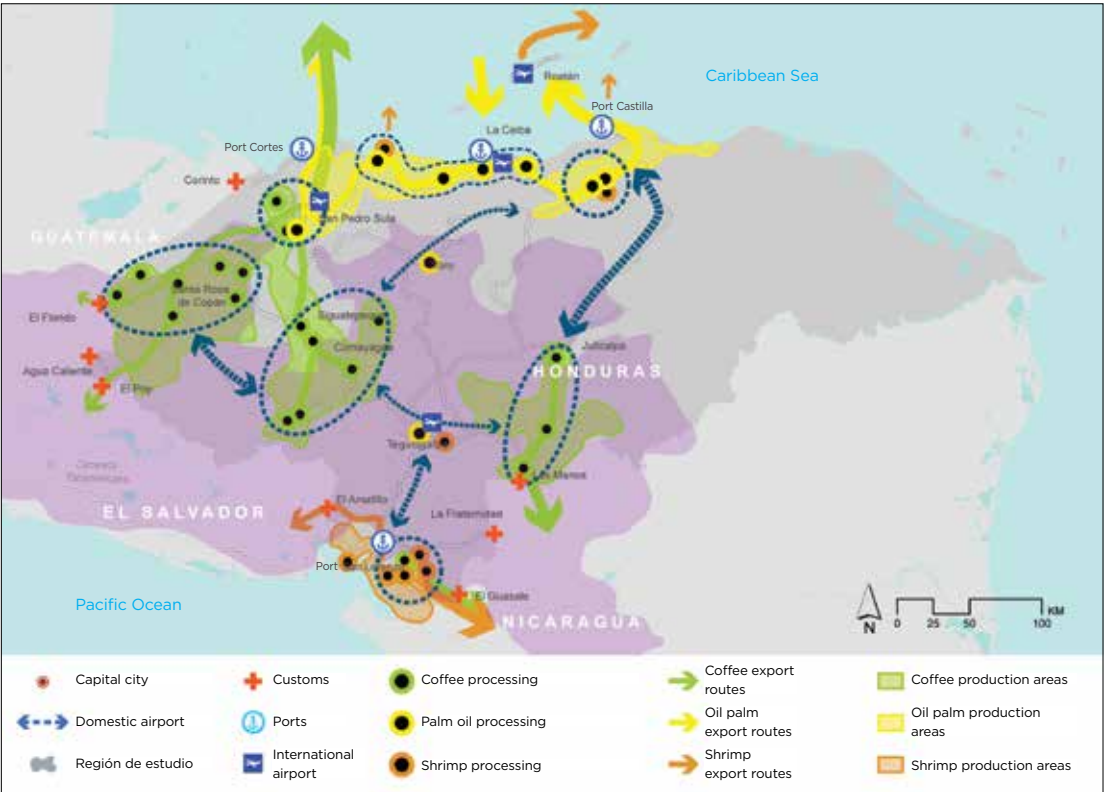
In addition, territorialization of the productive infrastructure shows clear clusters that continue the process of territorial concentration of the economic activities extracted from the analysis of multisectoral productive logics. Processing and production facilities are primarily grouped in the north-south corridor, the Emerald Coast and Copán. The country's southern, central and eastern sections have comparatively less variety and density of facilities.

As for the level of economic maturity, all clusters share a multisectoral nature with the presence of at least one product for strengthening. As part of a process for shrinking socioeconomic gaps and capitalizing on growth opportunities, using a structured spatial strategy, these patterns could help in the implementation of interventions to break up and expand economic activities based on the three strategies used in the product selection.

¹⁰⁹ The Caribbean Emerald Coast area consists of the municipalities of La Ceiba, Tela and Trujillo.

¹¹⁰ It should be noted that included in the evaluation of these multisectoral dynamics were the government's proposals in the 2020 Honduras Plan, 2010-2022 Nation Plan and 2010-2038 Country Vision for implementing transportation corridors to promote economic development. Juticalpa and the Olancho region, for instance, show great potential for agriculture; this was reflected in the government's proposals, while Yoro's potential as a logistics center is not addressed.

GRAPH 3.4 Sample Territorial Diagram of the Agroindustrial Productive Logics

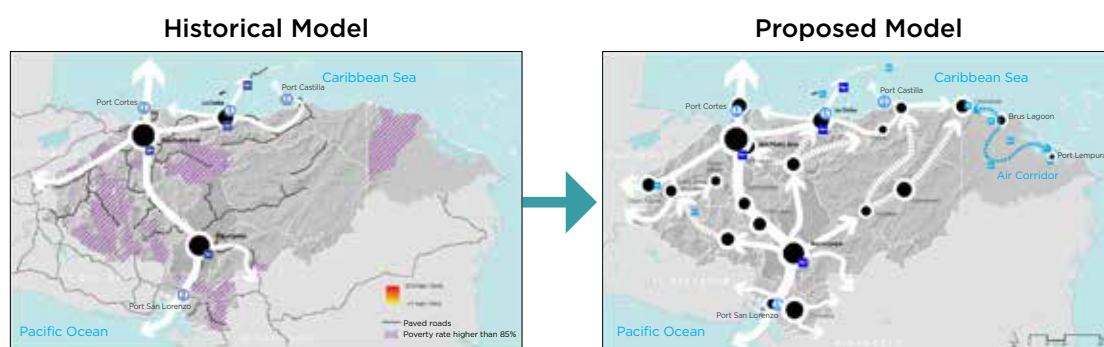


Source: GeoAdaptive (2018).

Stage 3. Proposed Growth Poles and Territorial Model

With an eye to focalizing interventions for driving economic development, in this stage the SES proposes a territorial prioritization and structure that addresses the territorialized challenges posed in stage 1 and capitalizes on the areas with multisectoral productive potential.

The territorial proposal results in a geographical pattern organized into a network made up of primary and secondary nodes (growth poles) connected by corridors. This network seeks to extend across and connect the entire territory, taking advantage of sectoral synergies for enhancing productivity and breaking the established inequality and poverty cycles. In addition to promoting economic development, it also seeks to promote social inclusion and equality by addressing areas with social deficiencies.

GRAPH 3.5 Proposed Change to the Country's Territorial Economic Model**Historical T-Shaped Model**

- Two economic activity epicenters
- Corridors: San Pedro Sula-Tegucigalpa and Copán-La Ceiba

Results

- Concentration of investment along the “T”
- Incipient development outside the “T”
- Loss of economic opportunities
- Social inequality and inequity

Growth Poles and Networks

- Expansion of production outside the “T”
- System of new corridors and nodes

Goals:

- Integrated use of the entire territory
- Added value and options for new production centers and rubrics
- Territorial diversification and distribution of opportunities and human capital

Source: GeoAdaptive (2018).

Within the SES structure, the identified growth poles function as focal production nodes for coordinated investment among various sectors. Increased production is thus supported within the new territorial economic model, which comprehensively addresses the identified sectoral production challenges and cultivates a more resilient economy through product diversification and sophistication.

Growth poles are identified through a geostatistic and territorial targeting process that uses a set of criteria concerning location of productive variables and social and environmental vulnerability.¹¹¹ The growth poles were identified according to the following four criteria:

- Concentration of productive activities;
- Available human capital;
- Accessibility; and
- Environmental constraints.

The growth poles were identified and dimensioned using a geostatistic algorithm in a Geographic Information System (GIS) that explores and optimizes synergies between the productive conditions of the different prioritized value chains and the areas where

¹¹¹ The scientific approach used for defining growth poles is accompanied by validation in the field. Several missions were made for this to the country, visiting the areas of interest and holding meetings with key actors in each economic sector. These missions were a key component for understanding the country's reality and adapting the hypotheses that were proposed using the methodologies.

human capital conditions, environmental and biophysical resources and public and private (productive) infrastructure are superimposed.

A total of eight growth poles traversing the Honduran territory were selected through this computational and territorial planning process, fostering the economic development of five prioritized sectors. Each growth pole was validated in the field and in different workshops with the public and private sectors. In addition, their current conditions were characterized in social, productive and natural terms and with regard to public service provision and private sector participation. Taken together, the growth pole ecosystem covers approximately 31% of the country's area and includes close to 45% of the population (Graph 3.6).

From an economic policy standpoint, growth poles are relatively reduced geographical areas where there is a proposed concentration, incentivization and location of productive activities that drive economic activity. Since each pole's area is small,¹¹² efforts can be concentrated on specific issues and potentialities. Specific investments can be targeted, avoiding a dilution of funds and unnecessarily complex institutional coordination. In this context, the growth poles represent an instrument for economic coordination and territorial planning nurtured by multisectoral coordination. Thus, resource efficiency is generated where economies of scale are achieved. Within this action framework, the growth poles are designed to trigger sustainable, inclusive economic growth through spillover effects.

Given the existing imbalances in Honduran spatial development, the growth poles differ widely, falling into three categories of dynamics: (i) consolidated poles, the country's traditional growth engine, corresponding to areas with consolidated economic activity and clear potential for expansion; (ii) 'trigger poles', corresponding to areas that have consolidation opportunities for promoting regional development and have been part of the productive system but have not enjoyed the importance or development enjoyed by the first type of poles; and (iii) potential long-term poles, corresponding to areas with incipient activities and services and strong economic development potential, seen as medium- and long-term options with significant investment but without much current economic activity.

Identifying these poles implied defining strategies to promote greater social inclusion and equality, and it is anticipated that productive opportunities would reach a larger area of the country. An ecosystem of different recommendations and proposals was generated for each pole to address the main challenges and opportunities detected within the geographical space. The intervention proposals for the eight growth poles include more than 200 interventions that incorporate a wide range of topics and, taken together, comprise a territorialized action framework aimed at improving national productivity and development.

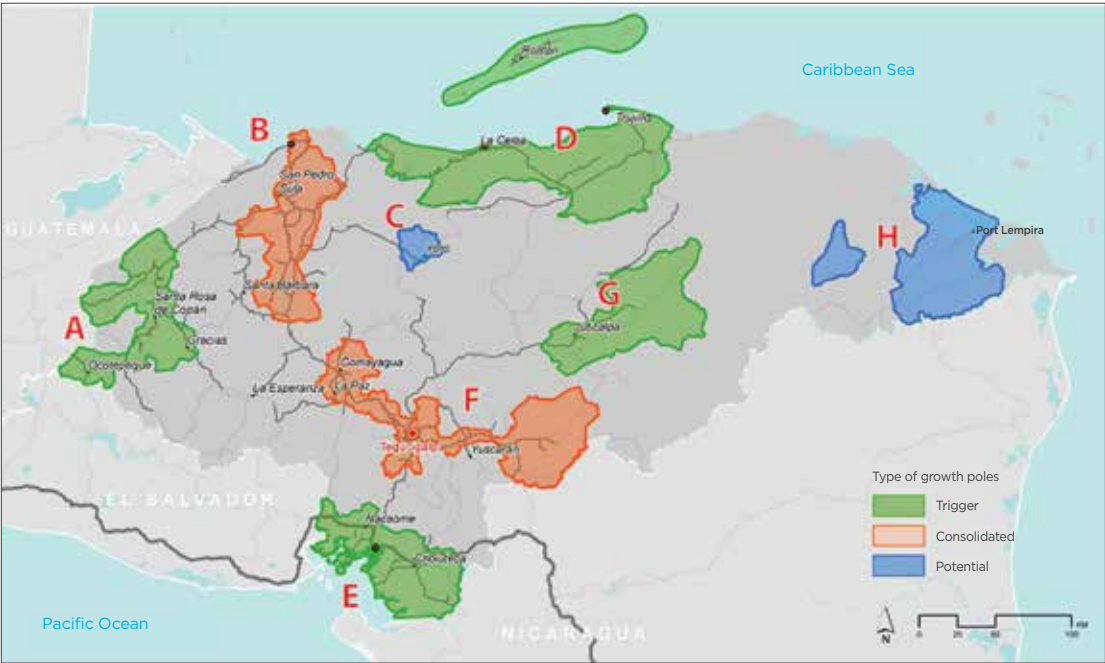
Six types of proposals can be seen illustrated in Graph 3.7. The first group focuses on improving productivity levels through product innovation and improved production management. A second group centers on medium- and long-term infrastructure proposals. Finally, initiatives are indicated for developing human capital, taking advantage

¹¹² Each growth pole covers approximately 3.8% of the national territory. Collectively, they cover 31% of the country's geographical area.

Graph 3.6 Growth Pole Proposal

Total pole population: 3,976,751 people (~ 51.9% of the country's population)

Total pole area: 35,819 km² (~32.1% of the country's area)



Pole	Development Sector	Direct Jobs
Copán	Tourism, agriculture, processing and logistics	~40,000
San Pedro	Manufacturing and agricultural processing, logistics and services	~20,000
Yoro	Processing, agriculture and forestry	~8,000
Costa Esmeralda	Tourism, agriculture and logistics	~70,000
Golfo de Fonseca	Processing, logistics, agriculture and manufacturing	~20,000
Tegucigalpa	Manufacturing processing, forestry, agriculture and services	~95,000
Juticalpa	Agricultural processing, forestry and tourism	~60,000
Puerto Lempira	Forestry and agricultural processing and artisanal fishery	~27,000
Total		~350,000

~350K
Direct
Jobs

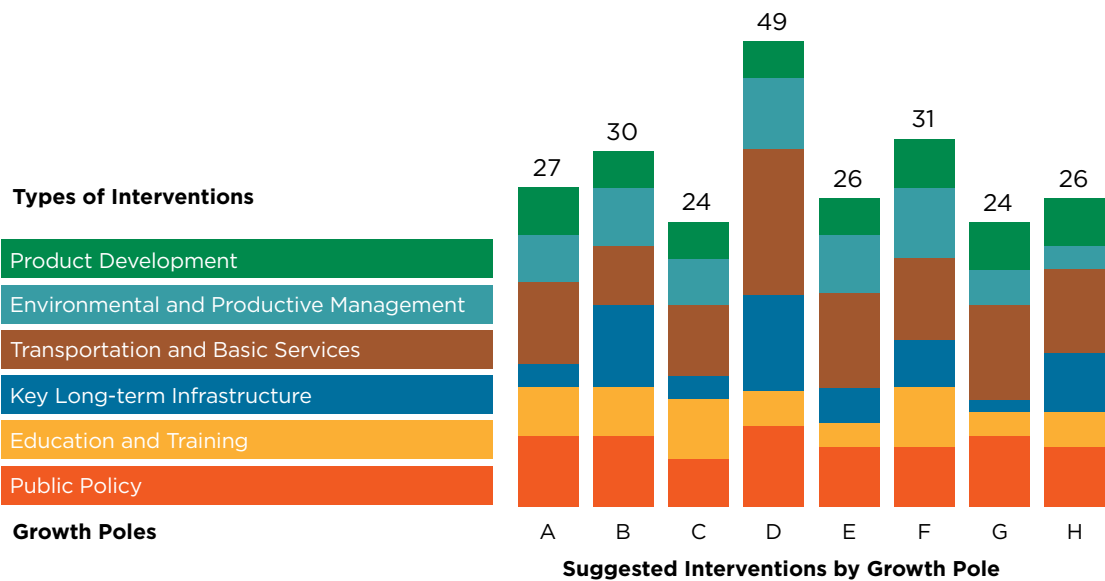
800K
Indirect
Jobs

Source: GeoAdaptive (2018).

of the national demographic dividend, and initial public policy recommendations are given. These recommendations are essential for building an institutional framework that fosters the necessary enabling conditions for the country's development. Collectively, the actions and interventions are primarily aimed at optimizing and generating sophistication in existing productive processes in order to add value and improve returns on exports and products for domestic consumption.

Box 3.3 gives the types of proposals considered in the study with a brief description of the data limitations for each.

GRAPH 3.7 Growth Pole Proposals



Source: GeoAdaptive (2018).

BOX 3.3 Types of Interventions

Product Development

This category includes interventions targeting productive diversification and expansion. Quantitative and qualitative criteria aimed at overcoming this deficiency were considered in each growth pole in order to identify productive expansion areas for specific products. To identify productive areas by product, a spatial analysis was made of multiple biophysical aptitudes to establish the aptitude for different products in the same geographical space. This information was used to estimate the potential expansion areas for specific products in areas with multiple aptitude where the product of interest is dominant, near the main roads, and it was contrasted with the information obtained in field visits. The following proposals were formulated:

- Diversification of agricultural products
- Expansion of product crops
- Increase in production efficiency in established areas
- Promotion and linking of tourism products
- Expansion of forest plantations and markets for ecosystem goods and services based on the natural capital

Environmental and Productive Management

This category includes interventions targeting new productive facilities for generating added value and improvements aimed at promoting greater productivity. Based on the analysis of the sectoral production rationales, preliminary challenges were identified which were validated during missions to Honduras in consultations with public and private stakeholders and visits to productive operations. By interviewing stakeholders in the field, it was possible to characterize those deficiencies with regard to infrastructure for improving product positioning and competitiveness. Environment-wise, reforestation with native species through environmental compensations in deforested or monoculture areas is considered helpful in recovering the ecosystem, including the aquifer and local fauna. Proposals were formulated in consideration of the following needs:

- New processing facilities, added value and diversification for the agricultural, manufacturing and forest sectors. New facilities are also needed for developing tourism and expanding the service (BPO / ITO) industry;
- Irrigation system to reduce water use and operating costs, in addition to increasing current productivity; and
- Reforestation and integrated recovery of the ecosystem, including the aquifer and local fauna, with native species.

BOX 3.3 Types of Interventions (cont.)

Transportation and Basic Services

The growth poles include different areas with varied development levels, so interventions have been formulated for different infrastructure issues, from improving multimodal connectivity to expanding the coverage of basic services. It should be clarified that, given the lack of updated data on basic services, including water, sanitation and energy, a variety of information sources were used to complement the interventions. In identifying interventions, qualitative and quantitative criteria were considered in each pole to address this lack. The results from the spatial data analysis were validated in the field whenever possible. The demands and investment plans for the development regions listed in the Nation Plan were reviewed to identify infrastructure needs in the study areas. Public expansion plans and newspaper articles were also used to identify current intervention proposals. The following is a list of the different types of proposals:

- Improvements to the existing road network instead of construction of new roads;
- Reconstruction of damaged bridges located on the main transportation corridors between poles;
- Improvements to the electrical power grid;
- Improvements to health facilities providing primary health care to local residents;
- Improvements to existing airfields and facilities;
- Expansion of sanitation and potable water services; and
- Water tanks for agricultural production to address drought periods.

Key Long-term Infrastructure

This refers to proposed complex infrastructure projects implementable over the long term, considering that improved basic infrastructure and equipment conditions are necessary for their development. Given these characteristics, these were not taken into consideration in the analysis of investments

- Logistics platforms;
- Key infrastructure projects; and
- Plan of rural roads for productivity.

Education and Training

The proposals and recommendations concerning education stem from specific gaps and demands detected from a projection of human capital skilled in the prioritized productive activities. The following types of interventions were identified: 1) Training programs, including bilingual programs for BPO/ITO services and tourism and training in different sectors (agricultural-technical, manufacturing, forest management and the Indigenous population); and 2) Improvements to educational facilities, where the focus is on improving existing facilities and, in exceptional cases, proposed building of new educational facilities.

BOX 3.3 Types of Interventions (cont.)

In addition, the following public policy initiatives are suggested to help improve educational levels and technical training:

- Program for new teacher training;
- Capacity building in existing institutions; and
- Promotion of cooperation programs for entrepreneurs.

Public Policy

Proposals were developed for improving the regulatory framework and public institutions. Public policymaking is essential for setting quality standards and regulatory frameworks that can provide guarantees to the stakeholders in productive processes, particularly for natural resource-based sectors or industries, which directly impact the territory. The public policy recommendations are varied and specific for each pole, but the following themes can be noted:

- Strengthening and enforcement of the regulatory framework;
- Risk management program; and
- Administrative simplification and decentralization.

A characterization of the selected poles, based on the above types of interventions, is given below, along with an overall summary of the suggested actions.

Growth Pole A: Copán Ruins-Santa Rosa de Copán-Ocotepeque (Trigger)

Located in the western section of the country, this pole's main economic activities are agroindustry, archeological tourism and, to a lesser extent, forest extraction and manufacturing. This pole plays a key role in the national logistics network, with customs points going into Guatemala and El Salvador for the flow of products to and from Puerto Cortés. There is serious deforestation here, along with water supply issues and high concentrations of poverty combined with a large Indigenous population. Future interventions are recommended to focus on: (i) improving infrastructure and institutions for building a national logistics network; (ii) developing tourism products that link destinations; (iii) diversifying and sophisticating manufacturing and agricultural production; and (iv) reducing the high levels of poverty and inequality by developing human capital, with special emphasis on Indigenous populations.

Growth Pole B: Puerto Cortés-San Pedro Sula (Consolidated)

This pole contains the metropolitan region of San Pedro Sula and nearby cities, Puerto Cortés to the north and Lake Yojoa to the south. It concentrates much of the country's manufacturing, agricultural processing, logistics activities, and services. The pole is traversed by the main logistics corridor that connects with Tegucigalpa and Puerto Cortés. The area has high levels of crime and violence as well as pollution in San Pedro Sula. Efforts should be concentrated on: (i) promoting development with greater economic complexity, adding value to the production; (ii) expanding and spreading the economic activity to nearby cities; (iii) establishing a secure environment for business and investments and addressing invisible employment; and (iv) regulating pollution in urban areas and protecting water resources.

Growth Pole C: Yoro (Potential)

Located in the department of Yoro in the country's central eastern area, this pole's main productive activities revolve around forestry and agroindustry and, to a lesser extent, textile manufacturing. The area is characterized by its limited accessibility, concentrated poverty and shortages of basic services. The region's unexploited potential is related to Yoro's strategic location in Honduras, close to the main production centers but at present still isolated in the center of the country. Suggested improvements focus on: (i) basic improvements in land connectivity and extension of basic service networks; and (ii) efficiency-related improvements to increase productivity and develop human capital in this area's sectors.

Growth Pole D: Caribbean Coast-Bay Islands (Trigger)

Located on the Caribbean coast, this growth pole covers an area of agricultural production, primarily of palm oil, and has potential for more tourism development. The area is relevant logistically, since it contains Puerto Castilla and an emerging service sector (business process outsourcing, or BPO / information technology outsourcing, or ITO) in La Ceiba. There is also a bilingual population that makes expansion of services and tourism possible. Also included in this pole are the Bay Islands, with an economy based on tourism and, to a lesser extent, fishing. Both areas share an overriding need for improved infrastructure and environmental protection, so suggested interventions focus on: (i) improvements in connectivity, basic infrastructure and security for tourism; (ii) implementation of sustainable agriculture and tourism practices; and (iii) measures to protect and preserve the marine and land environment.

Growth Pole E: Nacaome-Choluteca (Trigger)

Located in the country's southern section in the departments of Valle and Choluteca, this growth pole provides access to the Pacific Ocean through Puerto San Lorenzo and to El Salvador and Nicaragua through the Pan-American Highway. Shrimp and melons are produced in this area. The coastline has high ecological value and tourism potential. Agroindustry has suffered from severe drought, and Choluteca has a high index of inequality—the highest in the country—and underdevelopment of human capital. Considering the region's strategic location and challenges, efforts should focus on: (i)

developing the area as a domestic logistics and economic center; (ii) reducing the high rates of poverty and inequality with education and training; and (iii) tackling the severe drought with measures for more resilient agriculture.

Growth Pole F: Comayagua-Tegucigalpa-Danlí (Consolidated)

This pole covers the departments of Francisco Morazán, Comayagua and El Paraíso and includes the metropolitan region of Tegucigalpa and the nearby cities of Comayagua and Danlí. The main economic activities in Tegucigalpa are manufacturing, BPO/ITO services, agricultural collection and processing, and business tourism. Comayagua is strategically located and known for manufacturing and forestry production. Danlí is characterized by its agricultural activity. The area has high rates of crime and violence. Efforts should focus on: (i) promoting development with greater economic complexity, adding value to the production; (ii) expanding and spreading the economic activity to nearby cities; (iii) establishing a secure environment for business and investments and addressing invisible employment; and (iv) promoting Comayagua as a logistics platform.

Growth Pole G: Juticalpa-Catacamas (Trigger)

Located in the department of Olancho, this growth pole is characterized by rural activities and forest exploitation. The region is known for its production of basic grains, especially corn; this is relevant, due to the imminent elimination of corn tariffs in CAFTA. The pole has good connectivity and infrastructure, a major contribution being the recent improvement of the agricultural corridor, which has also encouraged emerging tourism. There are serious deforestation problems due to the expansion of agriculture and livestock farming. Efforts should be directed towards: (i) reforestation and environmental recovery; (ii) optimization and increased efficiency in agricultural production; (iii) production with greater added value; (iv) financial support for small agricultural and forest producers; and (v) crop diversification.

Growth Pole H: Puerto Lempira (Potential)

Located in the country's easternmost area, this pole is characterized by its limited accessibility, indigenous communities and extensive protection zones. Economic activities here revolve around tourism, forest exploitation, cacao production and artisan fishery. The area has high poverty rates and lacks basic services. Growth in this pole builds on the development of Puerto Lempira, as the main production node, and its connection with small emerging nodes spread out over the department of Gracias a Dios in order to encourage future tourism development. Targeted interventions are suggested to: (i) improve connectivity and extend basic services; (ii) improve education for social development and integration of the Indigenous population; and (iii) develop a sustainable development strategy.

Final Considerations

A look at the territorial economic development strategy and approach presented in this chapter shows that the government is addressing many of the aspects needed for improving the country's productivity. The analysis identified opportunities, however, that could be expanded by applying a spatial development approach in order to achieve more sustainable and inclusive growth.

A territorial approach provides an opportunity to identify gaps, opportunities and synergies for promoting integrated economic and social growth throughout the entire country. It also establishes targeted territorial allocation, in which interventions can be prioritized to maximize their potential for promoting development.

The approach and analyses used here, with their strengths and weaknesses, have led to suggestions and guidelines for steering Honduras's human and economic development from a multisectoral territorial perspective in which the full potential of synergies is exploited.

The SES recognizes that sustained economic growth depends on close coordination with the private sector, and that public investment should be strategic to address social needs and attract and leverage private investment, which generates income and jobs, the best combination for sustainable poverty reduction. Moreover, for investments to be adequately implemented, enabling conditions need to be established to create a favorable investment climate.

CHAPTER 4

Final Remarks: The Road Forward



As seen in the preceding chapters, the main challenge that Honduras faces is to boost growth while making it more inclusive. In the last 20 years, even though growth has been stable, it has not helped reduce poverty or inequality. In the country, most of the employed population works on low value-added activities with relatively low wages and mainly in the informal sector. Furthermore, structural challenges of infrastructure, human capital, citizen security, low productivity and institutional weakness constrain

the country's economic growth and the private sector's ability to develop and attract foreign direct investment. Even though, the private sector constitutes a key driver of economic growth, the extent of its actions depends largely on cross-cutting government measures.

Traditionally, the productive and social public investment management mechanisms have had a universal approach that has turned out to be inefficient and costly. As explained in Chapter 3, this approach has resulted in economic development concentrated in relatively few areas in the shape of a "T". Therefore, a geographically focalized allocation provides opportunities to directly apply a production strategy for boosting specific sectors and population groups, increasing spending efficiency. The proposed territorial scheme promotes integrated, multisectoral expenditure, which can help set up productive development and social assistance arrangements that generate economies of scale and maximize spillover effects while attracting private participation.

This chapter suggests the enabling cross-cutting conditions – the foundation for a spatial economic strategy – needed to drive economic and social development in Honduras. The main goal of this roadmap is to create a virtuous circle where public measures can help remedy market failures (such as incomplete or non-existent markets), encourage the private sector investment that leads to higher incomes and a sustained decrease in poverty, taking advantage of regional comparative advantages. We hope policymakers will be able to use this tool to implement their government program and the country's long-term vision.

Necessary Enabling Conditions

Institutional Strengthening

After the international and political crisis suffered by Honduras in 2009, the authorities experienced a period of volatility, consequently, as of 2014, they advanced in a process of fiscal consolidation that has managed to stabilize the public debt. Notwithstanding, steps must still be taken in two directions. Firstly, fiscal institutions need to be strengthened to achieve stronger governance of public finance. Secondly, spending control systems need to be developed to increase efficiency – for example, using evidence-based policymaking and developing ongoing evaluation mechanisms for social programs. Moreover, efficiency in the use of resources must be encouraged.

In order to create a favorable environment for new investment, public institutions must be improved, and regulatory frameworks should be strengthened and enforced. This includes modernizing, improving efficiency, transparency, strengthening and enforcing regulations, improving budget management, enhancing the quality and efficiency of public spending and taxation, decentralizing and clearly defining the responsibilities of local governments, and furthering the process and regulations for public-private partnerships.

Moreover, the intra-government processes for interacting with citizens – including those who make it possible to do business in the country – should be evaluated and improved, promoting digitalization and enhanced efficiency. Honduras is already in the process of implementing a digital agenda that will allow the country to reduce the cost of doing business and facilitating public services for citizens. The country also needs the

necessary broadband infrastructure in order to ensure that this digital revolution reaches the greatest number of inhabitants.

Human Capital Accumulation

A fundamental prerequisite for boosting Honduras economic growth is the improvement of the skills of its population. By providing better conditions to accumulate human capital, individuals become more productive, thus fostering more inclusive economic development. Skill improvement is closely linked to more job training and the optimizing of educational conditions, especially at an early age. Although Honduras has made great strides in improving these indicators, there is still a long way to go.

The country should create a knowledge network and build capacities to take advantage of the demographic dividend through technical training in areas with employment potential. Education and training need to be improved for the vulnerable population, the security of at-risk youths needs to be addressed, and the coverage of specialized services for women needs to be expanded. Additionally, bilingual education and technical capacities should be promoted, the educational infrastructure and teacher training should be developed, and technologies should be incorporated to provide quality solutions. Likewise, the private sector could also contribute through in-company training, apprenticeships and professional practices, among other modalities, which could be promoted through public-private partnerships.

On the other hand, special attention should be given to improving human capital in rural areas. More productive job opportunities would reduce emigration and attract a higher percentage of skilled labor. The sectoral approach is important for defining the skills to be developed; business associations can provide pertinent information on these specific unmet skill needs. The sources of income for workers should be diversified, especially in rural areas. For example, the Laboratoria initiative has proven successful in training vulnerable women in countries such as Chile, Peru and Mexico on programming.

Honduras should also address the challenges of healthcare accessibility and quality, particularly in rural areas. Since the decentralized management model has improved service efficiency, quality, access and coverage, it should be reinforced and extended throughout the territory. Furthermore, healthcare technologies can be applied to enhance service efficiency and quality and facilitate patient management. The use of mobile ultrasound in Honduras, for instance, has made prenatal care more accessible to women in rural areas.

Expansion of Sustainable Productive Opportunities

For a stronger, more inclusive economic growth, a business environment should be created that facilitates business development and encourages the digitalization of processes that would reduce the cost of doing business. A wide variety of variables need to be considered for this, among them: infrastructure, climate change resilience, the use of information technologies and finance mechanisms that could help with promoting the formalization of the private sector.

Investment in sustainable natural capital is recommended to reverse the high costs of inaction where there is progressive environmental degradation. The country needs to

expand its forest cover and boost its climate change resilience through reforestation, environmental protection and risk management for reducing vulnerabilities. In the short term, good climate-smart agricultural practices should be scaled up, and in the medium term, actions should be undertaken that combine climate change mitigation with adaptation. Included among these are more ecosystem-based adaptation approaches, water management and irrigation systems, introduction of heat-resistant strains, biological pest and disease control practices, development of organic fertilization systems, computerization, and landslide and flooding prevention. Investments in agroforestry systems would help the agroindustry adapt to climate change for the extended time needed; these investments would, of course, require access to financial instruments with extended repayment periods.

In line with the spatial strategy proposed in Chapter 3, Honduras should start building an integrated logistics ecosystem, comprised by platforms and corridors, for decentralizing and expanding production opportunities. The country needs to improve its logistics performance by developing a logistics network (corridors, nodes and customs offices), expanding the territorial scope of basic services, and improving the efficiency, coverage, quality and sustainability of the electrical power supply. The private sector could be a key partner in the development of strategic logistics projects and implementation of PPP energy projects.

Productive resilience could be increased by means of production diversification and sophistication combined with new productivity-enhancing technologies, through innovation and technology (efficient irrigation network) and product diversification and sophistication (economic complexity).

Driving development in the different production sectors and scales requires a wide array of diverse finance instruments. These would be used to expand access to finance for agricultural SMEs, providing support for undertakings, small and medium producers, women-led enterprises and even PPP mechanisms. The private sector can contribute by developing complementary insurance products and new financial instruments that mitigate perceived risk.

Addressing Crime as a Limiting Factor for Growth

Lastly, crime reduces the country's competitiveness by increasing operating costs in terms of safety and insurance. In areas of greater crime, habitat improvement programs could be developed in vulnerable neighborhoods. The idea would be to foster access to urban infrastructure services and generate safe spaces, thereby promoting healthy coexistence and building citizen capacity for peaceful compliance with the law. At the same time, a more effective police force is needed. This can be achieved by consolidating the education and professionalization system and improving police training using a community care and scientific crime investigation approach.

Final Remarks

The IDB's new country strategy with Honduras for 2019-2022,¹¹³ approved in February 2019, presents a new approach that, worked together with other donors, could lead to a transformed development strategy that would be applicable to other contexts. Based on the proposed development model, the Bank will focus its efforts in this new strategy on three complementary programs: (i) comprehensive productive development; (ii) strengthening of citizen security; and (iii) digital service transformation and promotion of a digital economy. The Bank will also support a comprehensive reform of the electricity sector to improve power generation, distribution and transmission.

The SES is a powerful instrument that, integrated with the new country strategy, could serve as a guide for coordinating and organizing the different interventions in Honduras, focusing them on the geographical areas and sectors with the greatest impact. The result would be enhanced efficiency and synergy among the actions of the public and private sectors, civil society and international donors. Integrated and coordinated interventions would keep efforts from being duplicated and help set up social and production development systems that generate economies of scale and maximize the impact on public wellbeing.

With a productive development agenda, the IDB, together with other development partners, will promote a multisectoral poverty reduction program in areas identified as having productive potential. In particular, the idea is to develop and strengthen operations based on a holistic multisectoral model, which requires internal coordination among the sectors and the participation of the Government, civil society, the private sector and other donors. The goal is to exploit the comparative advantages of the IDB Group and international donors to complement and maximize the impact of existing operations on Honduras's development.

At the same time, the IDB recognizes the importance of modernizing the government and citizen services, so in this country strategy we will be pushing an ambitious agenda for the digitalization of Honduras. Special emphasis will be put on learning from international experiences for moving ahead with digital government initiatives; broadband amplification will be essential for ensuring that the fourth industrial revolution reaches the entire national territory. Likewise, innovation will be promoted through the development of the digital economy.

The last component of the new country strategy, which would strengthen the business environment and human capital accumulation, will be our citizen security program. Consolidated and continued reduction of violence and respect for the police institution is essential for maximizing Honduras's productive potential and promoting foreign direct investment.

The diagnostic and SES proposal that are presented in this publication seeks to expand productive opportunities to more areas of the country. We hope this publication will serve as a roadmap for political leaders, civil society and international donors and foster a change in the development paradigm and model, thus breaking the decades-long vicious cycles of poverty and inequality that have persisted in Honduras.

¹¹³ IDB (2019).

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Honduras: A Territorial Approach to Development presents an innovative approach to address the development challenges of the country. The document first describes the main challenges to inclusive development in Honduras identified by IDB technical staff, which results in a proposal for a Spatial Economic Strategy (SES) developed with the company GeoAdaptive LLC. The Strategy extends across and connects the entire territory, taking advantage of sectoral synergies for enhancing productivity and breaking the established inequality and poverty cycles. This innovative approach seeks to break away from the traditional sector-approach and proposes comprehensive interventions that would enable key stakeholders to maximize synergies and the impact of their actions.