

AID-FOR-TRADE CASE STORY

HONDURAS

SUPPORTING COMPETITIVENESS REFORM IN HONDURAS

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EXECUTIVE SUMMARY

The Honduran apparel and textiles industry, with its industrial clusters and vertically integrated structure, has long served as an example of competitiveness to the Latin America region and the world. Given its multi-style production, quick delivery, and labor certification standards, it retains competitive advantages vis-à-vis Asian competitors. Likewise it has been able to benefit from generous export incentives and unilateral trade preferences. The industry's success, however has been hard to translate to other sectors.

Using the development of the textiles industry as a benchmark, in 2003 the Honduran government launched the National Competitiveness Program (*Honduras Compite*). The program set a range of actions for increasing private sector productivity, thereby improving the country's economic growth and contributing to job creation and poverty reduction. In order to support this effort and complement a USD 25 million World Bank (WB) program to improve the country's business climate, in 2003 the Inter-American Development Bank (IDB) arranged a concessional loan worth USD 10 million targeted at improving the country's capabilities to negotiate and implement trade agreements and the development of exports in specific sectors where Honduras enjoys competitive advantages, including forestry/furniture, tourism, and agribusiness. The joint IDB/World Bank contribution has led to considerable results, including reduced transaction costs, an enhanced negotiating position, and swift ratification of the U.S.-Dominican Republic-Central America Free Trade Agreement (CAFTA-DR)

ISSUES ADDRESSED

Honduras has been able to develop sophisticated exports knowledge in the textiles and apparel sector, but it has been unable to translate this success to other production sectors. Textiles and apparel are by far the biggest line items of Honduran exports, with 89 percent of these products going to the U.S. market.¹ Its success can be explained by the existence of export incentives² which have allowed companies to achieve efficient linkages to the global value chain and to perform a “complete package” and multi-style production with the capacity to deliver quickly. Unilateral trade preferences from the United States have further reinforced this trend.³

To help other industries improve competitiveness, the government launched *Honduras Compite* in 2003. Following several analyses of the country’s competitiveness, the government approached both the WB and the IDB for a funding mechanism for these ambitious reforms. These conversations took place around the time of negotiations for CAFTA-DR, one of the IDB project’s key support areas.

OBJECTIVES PURSUED

To foster strategic sectors with the greatest export potential, *Honduras Compite* seeks to:

- Improve general productivity and the business climate in Honduras;
- Prepare the national economic platform to take advantage of market access opportunities in free trade agreements (FTAs)
- Prepare the country’s productive sectors to take advantage of growing regional economic integration, especially within the context of the Mesoamerica Project (MP).

The IDB’s specific objectives were twofold: 1) to build government institutions’ capacity to formulate and implement its trade policies and to encourage the development of export operations; and 2) To build consensus among the government, the private sector and labor unions for implementing competitiveness strategies and projects.

DESIGN AND IMPLEMENTATION

In order to support the program’s competitiveness and trade policy component, the IDB worked closely with the Foundation for Investment and Export Development (FIDE), an independent no-profit organization, as well as the program’s technical secretariat. The IDB focused on four areas:

1. Reduction of logistical and production costs in transportation and energy;
2. Development of production linkages;

¹ Honduras is the seventh largest provider of textiles and apparel to the United States, after China, Mexico, Vietnam, Indonesia, India and Bangladesh, all of which have much larger populations and total output by volume.

² The temporary import law of 1984 was especially created to favor the development of assembly industries, most notably the textile sector.

³ In 2000, the U.S. adopted the Caribbean Basin Trade Partnership Act (CBTPA), which improved preferential treatment of outward processing apparel from countries under the Caribbean Basin Initiative (CBI). The act eliminated all tariffs on textiles, which averaged 5.8 percent in 1998-99.

3. Financial intermediation and business development services for MSMEs;
4. Support for implementation of trade agreements.

Accordingly, the IDB developed two sub-programs:

1. *International Trade*, which aimed at strengthening the public sector's capability to negotiate and manage trade agreements, to prepare and implement in coordination with the private sector a national strategy for export promotion, and to establish public participation mechanisms for the formulation of the export strategy.
2. *Strengthening Entrepreneurial Competitiveness* was designed to facilitate dialogue and consensus-building between the government, the private sector and the labor market to encourage a more competitive business climate.

PROBLEMS ENCOUNTERED

- **Changes in Administration:** The IDB project was implemented during various administrations and therefore had to encounter several strategic and ideological differences. With FIDE in charge of the execution of the project, it was possible to minimize the risk of political transition. Nevertheless, part of the responsibilities of the sub-program on trade was transferred to the Secretariat for Industry and Commerce (SIC), which was able to successfully finalize the CAFTA-DR negotiations.
- **Inexperience with public-private partnerships:** Honduras has had only limited experience with projects co-financed with the private sector. Therefore, the implementation of some project components was delayed in the beginning, as there were no baselines or indicators of performance, quality or timelines. In addition, the evaluation process was time and cost intensive, as there had been no clear communication channels between the small business involved and the government.
- **Limited national funds:** In 2005-2006, the government was forced to introduce budget ceilings which negatively impacted the financial administration of the program. Several undertakings had to be postponed due to insufficient funds.
- **Weak customer service culture:** The biggest barrier to improve competitiveness in the country was companies' lacking orientation towards customers. Companies frequently appeared to be uninterested in adapting their products to the customers' needs.

FACTORS FOR SUCCESS

- **Preliminary studies to select production clusters ripe for intervention:** Following the successful example of the textile and apparel sector, the program first aimed to identify and define productive clusters. Supply-side research studies carried out early on aided in the selection of such clusters and helped the project develop a focused approach.
- **Program's flexible structure:** Assistance from FIDE was essential for rapidly commencing the execution of the project. The flexibility of the project design and of the executing institution was also essential in the program's success. Providing the personnel of the SIC with the opportunity to administer components of the international trade sub-program allowed them to acquire and improve capacities essential for the successful negotiation of trade agreements. The personnel received professional training and advice from national and international experts in the area of trade negotiations, which allowed them to successfully complete the CAFTA-DR negotiations.
- **Documentation process:** The program included an extensive documentation process for the

mechanisms of negotiation, management, and administration of international trade. This documentation allowed the formation of methods for successful dialogue and consultation, and will be very valuable in future negotiations.

RESULTS ACHIEVED

- **Competitiveness strategy:** Most importantly, the joint WB/IDB assistance enabled Honduras to develop a national competitiveness strategy that draws support from both the public and private sectors, highlighting areas of cooperation and synergies that should be conducive to a more robust export capacity.
- **Effective participation in CAFTA-DR negotiations:** Honduran negotiators received strategic advice and training throughout the process. In addition, the program included activities carried out to increase awareness among private sector representatives, members of civil society, and legislators of the benefits of the treaty and of swift ratification among private sector
- **Reduced transaction costs:** Puerto Cortés, the country's main sea port, is today a high-volume port, arguably the most efficient in Central America. Its location is ideal, as average transit time between San Pedro and Miami is about three days. Since 2006, Puerto Cortés is security-certified by the U.S. Department of Homeland Security. The Container security Initiative (CSI) signed by Honduran and U.S. authorities accelerates the entry of cargo from Puerto Cortés into the U.S.
- **Simplified administrative process:** A program to simplify administrative processes has served around 30,000 SMEs. The procedures for accessing credit and social benefits have been streamlined. The time to open up a new business was significantly reduced, from 62 days in 2005 to 20 days in 2008, including registration and obtaining an operation permit.
- **Higher export volumes:** During the project's effective execution period, Honduran exports rose around 23 percent, with products like coffee registering increases of up to 30 percent.
- **Creation of a national quality system:** Under the new national quality system, which operates in accordance with international standards, 30 companies received ISO 9001⁴ certification in 2009. The companies received training, technical assistance and funding to meet the requirements of the ISO certification.
- **SME's capacity building:** The Institution for Professional Training (*Instituto de Formación Profesional*) offered skill-building activities to 418 SMEs, mainly producers of beans, coffee and shrimp. A center for innovation and technology in tourism and crafts was established to support craftsmanship. The main focus of this center is in the west of Honduras, where the main tourist centers are located.
- **Valuing customer preferences:** The program created awareness among the participating companies of the importance of market orientation. Helping private companies to better understand customer preferences and to adapt their product ranges accordingly was an important component of the program, essential for successful businesses. The Customer Protection Law, passed in 2008, was also an important development in promoting customer orientation.

⁴ The ISO 9000 family of standards, published by the international Organization for Standardization, relate to quality management systems and are designed to help organizations ensure they meet the needs of customers and other stakeholders.

LESSONS LEARNED

- **High-level political commitment:** Building political consensus and institutionalizing the *Honduras Compite* itself has lent valuable momentum to the initiative. It also creates a long-term perspective when adopting and implementing reforms.
- **Value of flexible project implementation:** Having high levels of flexibility for the project's implementation was pivotal, as throughout the project it was necessary to adapt to the changing needs of the beneficiaries of the project.
- **Competitiveness activities:** More activities are needed to promote a competitive business culture. The private sector needs to shift focus and its approach to the market. The Global Competitiveness Report of the World Economic Forum indicates that Honduras shows very low values in business sophistication, which is one of the biggest weaknesses in increasing the country's competitiveness.
- **Participation of trade associations:** A key issue to address in new operations is to strengthen the participation of the Chamber of Commerce and other trade associations. These organizations serve as facilitators for entrepreneurial development services such as innovation, technical adaptation, and product design, among others.
- **Creating ownership:** To increase the sustainability of the project's initiatives, the level of involvement of the benefiting parties has to be increased, for example by giving them tasks in the execution of the project.
- **Promoting institutional reforms:** Creating private sector awareness of planned institutional reforms and their potential benefits is essential to create momentum for the program's objectives.

CONCLUSION

Though domestic competitiveness problems can be specific, tackling structural problems on a broader base is essential for creating conditions that will foster competitiveness and allow Honduras to replicate the success of textiles and apparels in other industries. As this case study has shown, the government, the IDB and the WB have acknowledged this necessity. The Honduran government will thus continue its broad set of reforms to ensure long-term economic growth and better opportunities for its citizens.