CLASSIFICATION: PD-ABC-063

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number: 521-0207 61106	2. Country: HAITI
3. Category: Cash Transfer	4. Date
5. To: Dwight Ink, AA/LAC	6. OYB Change Number: N/A
7. From: Gerald Zarr, Director, USAID/Haiti	8. OYB Increase — To be taken from: N/A
9. Approval Requested for Commitment of $ 27,000,000	10. Appropriation Budget Plan Code
11. Type Funding: ☐ Loan ☒ Grant	12. Local Currency Arrangement: ☐ Informal ☒ Formal ☐ None
13. Estimated Delivery Period: FY 1987	14. Transaction Eligibility Date: N/A

15. Commodities Financed

N/A

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	$27,000,000
Limited F.W.		Industrialized Countries	
Free World		Local	
Cash	$27,000,000	Other	

18. Summary Description

The purpose of this cash transfer is to continue the support the Government of Haiti's (GOH) economic reform efforts. During the delicate period of transition to democracy, support to the interim Government is crucial to enable it to improve the rate of economic growth and the provision of services to the people while preparing for elections and undertaking a major economic reform program. Although other donors are also supporting the reform program, the cash transfer is needed to help bridge the fiscal and balance of payments gaps.

The cash transfer will be disbursed in two tranches, the first of $20 million in January 1987, and the second of $7 million in the third quarter of FY 1987. The first tranche will be conditioned on continued GOH compliance with quarterly fiscal and monetary targets established in consultation with AID and on a substantial reduction of quantitative restrictions on imports. The second disbursement will be conditioned on continued compliance with the monetary and fiscal targets; elimination of all remaining export taxes; the initiation of management and/or fiancnial audits of at least four governmental entities; completion of a plan to implement an on-going program of audits and management reviews for al GOH institutions; and compliance with the covenants. The GOH will covenant to develop FY 198 monetary and fiscal targets consistent with financial stabilization; continue with its program of liberalizing Haiti's trade regime; and continue and expand upon efforts to carry

(continued on next page)

19. Clearances	Date
REG/DP	
REG/GC	
AA/PPC	
M/FM	
SER/COM	
AA/PRE	

20. Action

☐ APPROVED ☐ DISAPPROVED

Authorized Signature | Date

Title

AID 1120-1 (5-82) CLASSIFICATION:

Facesheet for Haiti Economic Recovery Program (521-0207)

(Continuation)

out financial management and control reviews of parastatal organizations and to improve financial management and control of Ministries. The Haitian private sector will import raw materials, intermediate goods, spare parts, machinery and equipment from the U.S. and other Code 941 countries in the 12 month period following execution of the agreement in an amount at least equal to the total U.S. dollar disbursement. Local currency counterpart will be deposited in a special account and will be utilized for budget support, on OE Trust Fund and mutually agreed project activities.

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I. SUMMARY AND RECOMMENDATIONS

A. Background

After years of graft and excessive public spending financed largely by the Central Bank, Haiti's international reserves were depleted, inflation was rampant, and the parallel foreign exchange market discounted the gourde by up to 20 percent. The new government, which assumed power in February 1986, began a fiscal and monetary program designed to achieve financial stability. Remarkable progress has been achieved. At the same time, the government has introduced a set of measures that will increase the efficiency of the economy and set the basis for long-term growth. These structural adjustment measures can be classified in three broad areas: 1) government efficiency and accountability which include the auditing and reform of key state-owned enterprises, increased control over treasury expenditures, and the rationalization of current and investment expenditures; 2) tax reform, including the reduction of the coffee tax, and the implementation of a far reaching tax reform designed to increase economic efficiency through the reduction of marginal tax rates; and 3) trade and price policy which includes the elimination of a large proportion of quantitative restrictions on imports, and their substitution with a system of low and relatively uniform ad valorem tariffs.

The U.S. has supported the economic reform effort of the GOH through a $18 million ESF program (Economic Recovery Assistance, ERA I) which was authorized in July 1986, and with a policy based grant of $2 million (Coffee Sector Assistance, CSA), which was authorized in September 1986. The CSA and the three tranches of ERA I were disbursed on schedule on the basis of policy measures in the areas of financial stabilization, government efficiency and accountability, trade and price policy, petroleum reforms, and coffee tax reductions. While the GOH has been up to now successful in maintaining fiscal and monetary restraint, this policy has contributed to a decline in GDP at a time when the government is undergoing a delicate transition towards democracy. Although the GOH has initiated a coherent structural adjustment program designed to increase economic efficiency and to accelerate growth, there will be a time lag before the policies have their full effect. Therefore, growth in the next few years will have to be fueled, to a large extent, by fast disbursing foreign assistance and increased availability of foreign exchange to the private sector.

The IMF and the World Bank are supporting the GOH's reform effort with a Structural Adjustment Facility (SAF) and with a structural adjustment loan from IDA (Economic Recovery Credit, ERC) respectively; negotiations between the GOH and those two institutions are proceeding smoothly. However, even with IMF and World Bank assistance, unfinanced balance of payments and fiscal gaps remain.

B. <u>The Proposed Program</u>

The Mission is proposing to continue the support of the GOH's economic reform efforts with a second ESF program (Economic Recovery Assistance II). Conditionality will include the continuation of fiscal and monetary restraint; efforts to increase government efficiency and accountability, principally through financial and management audits; liberalization of trade through further reduction in the number of imports subject to quantitative restrictions; and the elimination of all remaining export taxes.

The proposed use of local currency counterpart funds is as follows: 1) the equivalent of $1.35 million for a trust fund to be used by USAID/Haiti for operating expenses; 2) the equivalent of $20.0 million to support priority areas of development Ministries budgets; and 3) the equivalent of up to $5.65 million to finance incremental spending for mutually determined project activities.

C. <u>Grantee</u>

The Grantee will be the Government of Haiti represented by the Ministry of Finance.

D. <u>Recommendations</u>

The U.S. Mission recommends authorization of an Economic Support Fund grant of $27 million, disbursed in two tranches, the first for $20 million in January 1987, and the second for $7 million in the second quarter of CY 1987.

II. BACKGROUND

A. <u>Political Situation and U.S. Interests</u>

On February 7, 1986, President-for-Life Jean-Claude Duvalier fled Haiti, ending almost 30 years of autocratic government under the Duvalier family. He left behind an impoverished people with the lowest per capita GDP in the Western Hemisphere, a bankrupt government, a faltering economy and an almost complete lack of institutions capable of participating effectively in a democracy. The Conseil National de Gouvernement (CNG), the transitional government which replaced him, eliminated the repressive symbols and practices of the Duvalier regime and set in motion a process of political institution building. This is expected to culminate in the inauguration of a freely-elected president scheduled for February 1988. Several steps already have been taken to implement the calendar of political reforms which the new government issued in June 1986. At the same time, the government has acted in several ways to insure the protection of basic human and civil liberties. It has also implemented a number of economic reforms to improve the economy's functioning and the lot of the poorest Haitians.

The U.S. Government has a vital interest in seeing that the transition to democracy succeeds and that the groundwork is laid for a stable, moderate and freely-elected regime which will take its place in the regional community. Strong social and economic links between our two countries, peripheral USG involvement in Duvalier's ouster and Haiti's proximity to the United States and centrality in the Caribbean region argue for steady and strong support to the far reaching program of the transitional regime.

The National Governing Council (CNG) has advanced since February 7 in all areas in which it made progressive commitments to the Haitian people. Its first measures reversed the human rights abuses of the Duvalier regime. All political prisoners were liberated and the "Volunteers for National Security" (Tonton Macoutes) militia was dissolved. The press was immediately freed of all restrictions, as were political and other organizations. Exiles were allowed to return without hindrance. The CNG has moved further in recent months. Liberal press and political parties laws were decreed at the end of July. Several notorious human rights offenders of the Duvalier era were tried and convicted and more trials are being planned. Much more remains to be done, but a solid track record has been established.

The CNG has pursued the political transition to an elected successor regime. The press and political parties laws were two components of a political calendar which has seen the selection of an advisory "consultative council," election of rural section councils and the national election of a "constituent assembly" to write a new constitution. The constitution will be submitted to popular review in a February 1987 referendum. The calendar also calls for local elections in May 1987, presidential and legislative elections in November 1987, and the inauguration of the new government in February 1988.

The CNG has repeatedly proclaimed its absolute commitment to the transition and has maintained this stance in the face of the numerous obstacles it has encountered. Popular expectations of change in all spheres have been exploited by extremists of the right and left to create repeated periods of unrest. The CNG has generally handled these with restraint in line with its human rights commitments. Perhaps more difficult has been the task of encouraging public involvement in the democratization process. The elections for the bodies mentioned above garnered little public involvement. The CNG, political activists, leaders in all spheres of Haitian life and the Haitian people themselves have much work ahead if the legacy of dictatorship is to be surmounted and the transition to democracy is to succeed.

The recent change in government offers new opportunities as well as challenges for Haiti's political and economic development. The U.S. Mission believes the prospects for addressing Haiti's long-term socio-economic problems are considerably improved as a result of political changes over the past year. Events have demonstrated, however, that economic constraints play an important role in the CNG's ability to implement its commitments successfully. In the early period, frequent and severe unrest was traced not only to the activity of extremist agitators but also to the bankrupt condition of the government. Its strained circumstances made the CNG unable to respond effectively and visibly to popular aspirations for improved living conditions and employment opportunity; it was working to stave off imminent exhaustion of foreign exchange reserves and basic commodity stocks. Prompt action by donors including the U.S. helped to overcome that crisis.

The need for basic economic support remains critical. Haitians have the lowest per capita income in the hemisphere and live in misery. They blame their ills on Duvalier and thirst for change now that he is gone. It is only with adequate donor resources that the CNG can accomplish what it must to tide the country over to an elected regime. Socio-economic stagnation will increase the likelihood of unrest, whether spontaneous or formented by agitators. The prospects for a successful transition to an elected government will diminish correspondingly. Aid assistance is indispensible to giving the CNG the economic credibility it requires to support its laudable political and economic initiatives.

B. Economic Background

1. Development Overview

With a per capita income of only $350 a year, Haiti remains one of the world's relatively least developed countries and is the poorest country in the Western Hemisphere. Some 80 percent of Haitians live below an absolute poverty level of $150 per year. Comparative indicators of health, nutrition, and education status dramatically show the effects of low incomes, inadequate diets, and poor social services. Haiti's infant mortality rate of 125/1000 children is one of the highest in the world. Over 25 percent of pre-school children suffer from severe malnutrition. The literacy rate is only 22 percent. Population growth is estimated at 1.7 percent per year, and the ratio of people to arable land is one of the highest in the world. The country's development has been held back by years of autocratic rule, low private investment levels, minimal public investment in infrastructure and social services, and high outmigration of many of Haiti's best trained and educated people.

2. Macroeconomic Trends

In the latter half of the 1970's, economic growth in Haiti averaged 4.5 percent per annum. Per capita income grew at 2 percent per annum. However, after this period of relatively rapid growth that ended in 1980, the Haitian economy moved into a recession in 1981 and 1982, when output dropped by 6 percent (see Table II.B.2). Output in those years was adversely affected by a slowdown in world economic activity, particularly in the United States, and by Hurricane Allen in 1980. Economic growth resumed in 1983 through 1985 albeit at a slow pace (averaging less than one percent per annum), spurred on by assembly manufacturing and supported by substantial increases in private investment. Real GDP fell 1.4 percent in FY 1986 due to depressed activity in the assembly sector, caused by civil unrest, labor disputes, and the resulting lack of business confidence; drought also caused reduced agricultural output. During the period 1981 to 1986, real GDP per capita fell by 15 percent.

In 1981 and 1982, the external terms of trade deteriorated by a total of almost 20 percent (see Table II.B.2). Although the terms of trade have improved marginally in more recent years, real income per capita has remained well below the levels reached in the early 1980's. The terms of trade increased in 1986, mainly due to lower petroleum prices and higher world market prices for coffee.

Real private investment dropped sharply in the early 1980's, regained some strength in 1982, but dropped again in 1983 and 1984. The area of greatest private investment has been in the assembly sector. Private sector investment gained ground in 1985 and remained at the same level in 1986. Real public sector investment has followed an unsteady path in recent years. It rose by almost one half in 1981 (mostly in connection with the construction of a new sugar mill), fell in 1982, rose in 1983 and 1984, and declined in both 1985 and 1986.

3. Production by Sector

The structure of output has remained relatively stable in recent years. The primary sector accounts for about one third of total output. This sector involves almost exclusively agricultural activities; bauxite mining operations were discontinued in 1982. Agriculture accounts for two-thirds of Haiti's employment and generates about 40 percent of merchandise export earnings. The sector has been in a long-term declining trend as a result of little or no advances in technology, soil erosion due to overutilization of limited arable land, and unfavorable climatic conditions, particularly in recent years. The agricultural sector can be divided into two sub-categories: export crops (coffee, cocoa, mangoes, and essential oils) and crops for domestic consumption (corn, sorghum, sweet potatoes, rice, bananas, tubers, and sugar cane).

TABLE II.B.2
SELECTED ECONOMIC INDICATORS
(annual percent change except where noted)

	1981	1982	1983	1984	1985	1986
GDP at current prices	0.5	0.4	9.7	11.5	6.5	11.0
Real GDP	-2.7	-3.4	0.8	0.3	1.1	-1.4
Real GDP per capita	-4.5	-5.1	-1.0	-1.5	-0.7	-3.1
Real consumption	..	-9.8	2.2	-2.2	2.6	1.6
Consumption per capita	..	-11.4	0.4	-3.9	0.8	-0.2
Gross Investment/GDP*	16.9	16.6	16.3	15.9	14.6	12.1
Public Sector	12.0	9.8	10.4	11.2	8.5	6.0
Private Sector	4.9	6.8	5.9	4.7	6.1	6.1
Gross National Saving/GDP*	0.7	5.3	4.4	5.7	5.4	5.0
Export Volume	-17.8	22.7	-9.5	6.2	-6 0	-9.2
Import Volume	5.4	-11.4	0.5	-0.9	-4.0	-5.7
Terms of Trade	-11.1	-9.3	5.5	-1.9	0.6	9.2
Consumer Price Index	8.2	9.0	8.8	8.0	8.4	8.5

SOURCE: International Monetary Fund estimates.

*Note: Ratio to GDP

Notwithstanding the rapid growth of the light assembly industry, the official figures show the share of the secondary sector unchanged at about one fifth of GDP. Of this, manufacturing comprises one sixth of GDP. This sector can be classified into firms producing for export and firms producing for the local market; the light assembly sector has performed better in recent years than have the firms producing for domestic consumption. Construction comprises the remainder of the secondary sector; this sector has stagnated in the last five years. The service sector, which accounted for approximately 42 percent of GDP in 1985, appears to have been less affected by the recession of 1981/82 than manufacturing or construction. There was a marked recovery in the two subsequent years, with transport and communications, housing, and government among the most dynamic subsectors.

4. Prices, Wages, and Employment

a. Prices

Because of the large share of income that is devoted to consumption of food, movement in food prices often plays a dominant role in determining changes in the overall cost of living. Similarly, because of unstable climatic conditions which affect domestic food production, food prices often display erratic behavior. Prices rose by an annual average of over 8 percent during the period from 1981 to 1986 (see Table II.B.2). Although the year-to-year behavior of prices in part reflects supply conditions, over the last 5 years, monetary expansion has been the main driving force. The resulting rate of price increases has exceeded that of Haiti's main trading partners.

b. Wages

Haiti's minimum wage law, dating from the 1961 labor code, applies to labor employed by all firms in the private sector. The law requires that the minimum wage is to be adjusted in response to cost-of-living increases in excess of 10 percent in any given year. While a number of these adjustments in the minimum wage were enacted during the 1970's, these did not compensate for the rise in the cost of living. The increase in October 1980 restored the real minimum wage to the level of 1971. The minimum wage was not raised again until October 1984, leading to a drop of about 20 percent in the real minimum wage over the previous 4 years. The October 1984 adjustment raised the minimum wage by 13.5 percent to G. 15/day for Port-au-Prince; for the rest of the country, the minimum wage remained at G. 13.20 per day. During that time the cost of living increased by 37 percent. Since the last minimum wage adjustment, the cost of living has increased by roughly 10 percent, causing a further erosion of wages.

c. Employment

The 1982 census, carried out by the Ministry of Plan, provided the most up-to-date statistics on employmnent in Haiti; according to these figures, the labor force participation rate (age 10 years and over) is 58 percent. About 70-80 percent of the labor force lives and is employed in rural areas. Of the remainder, 70 percent is concentrated in the Port-au-Prince metropolitan area, which attracts most of the population migrating from rural areas. As a result, unemployment is high, especially among the young. The unemployment rate is approximately 40 percent in Port-au-Prince. Urban and rural areas have a considerable degree of underemployment as well. Underemployment and unemployment combined have been estimated to total approximately 49 percent of the labor force, with open unemployment at 12 percent.

5. Public Sector Finance

The financial performance of the public sector worsened in recent years despite steady improvements in revenues. In relation to GDP, total public sector receipts went up from 10.5 percent in 1981 to an estimated 14 percent in 1985 (see Table II.B.5).

Despite the improvement in public sector revenues, Haiti's tradition of financial stability was disrupted by the pursuit of expansionary spending policies since the beginning of the 1980's. An attempt was made from 1982 to the beginning of 1984 to stabilize public finances but the gains achieved were later erased by renewed large-scale public spending, financed by monetary expansion.

Thus, public sector deficits peaked in 1984 at 10.6 percent of GDP, and declined in 1985 and 1986 to 7.5 and 5.2 percent of GDP respectively. The deficits have been financed in part by Central Bank credit expansions.

The government managed to significantly improve public sector finances in FY 1986. While tax revenue declines were avoided in spite of numerous tax rate reductions, the public enterprise surplus fell by almost 20 percent. Total receipts therefore fell by 3 percent. However, total expenditures were reduced some 10 percent through the elimination of wasteful expenditures (payments to nonexistent workers, Tonton Macoutes, and presidential palace expenditures). The resulting decline in the public sector deficit and the increase of grants reduced the overall deficit from 3.8 percent of GDP in FY 1985 to 1.2 percent in FY 1986. This improved performance allowed the public sector to reduce its domestic debt by 0.3 percent of GDP in FY 1986.

TABLE II.B.5
PUBLIC SECTOR OPERATIONS
(in millions of gourdes)

	1981	1982	1983	1984	1985	1986
TOTAL RECEIPTS	756.8	895.4	1035.6	1171.2	1382.5	1341.1
Government current revenue	659.6	749.3	846.5	914.1	1124.2	1129.0
Public Enterprise	97.2	146.1	189.1	257.1	258.3	212.1
Of which transfers		75.1	74.4	90.9	73.2	102.0
TOTAL EXPENDITURE	1708.5	1577.2	1798.5	2129.6	2105.0	1898.1
Government current expenditure	825.6	829.3	950.0	1114.7	1281.5	1237.0
Public Sector capital expenditure	882.9	747.9	848.5	1014.9	823.5	661.1
Of which treas.development budget	..	173.3	115.2	182.9	127.3	48.0
PUBLIC SECTOR DEFICIT	-951.7	-681.8	-762.9	-958.4	-722.5	-557.0
GRANTS-IN-AID	236.5	285.0	280.5	310.0	359.5	433.0
of which ESF	0.0	0.0	0.0	0.0	0.0	60.0
OVERALL DEFICIT	-715.2	-396.8	-482.4	-648.4	-363.0	-124.0
External Financing	469.0	156.0	385.6	313.8	146.8	161.2
Domestic Financing	246.2	240.9	96.8	334.6	216.2	-37.2

IN PERCENT OF GDP

	1981	1982	1983	1984	1985	1986
TOTAL RECEIPTS	10.4	12.1	12.6	12.9	14.3	12.5
Government current revenue	9.1	10.1	10.3	10.1	11.6	10.5
Public Enterprise	1.3	2.0	2.3	2.8	2.7	2.0
of which transfers	0.0	1.0	0.9	1.0	0.8	1.0
TOTAL EXPENDITURE	23.4	21.4	21.9	23.4	21.8	17.7
Government current expenditure	11.3	11.2	11.6	12.3	13.2	11.5
Public Sector capital expenditure	12.1	10.2	10.3	11.2	8.5	6.2
of which treas.development budget		2.1	1.4	2.0	1.3	0.4
PUBLIC SECTOR DEFICIT	-13.0	-9.3	-9.3	-10.6	-7.5	-5.2
GRANTS-IN-AID	3.2	3.9	3.4	3.4	3.7	4.0
OVERALL DEFICIT	-9.8	-5.4	-5.9	-7.1	-3.8	-1.2
External	6.4	2.1	4.7	3.5	1.5	1.5
Domestic	3.4	3.3	1.2	3.7	2.2	-0.3

6. The Financial Sector

The financial sector of Haiti is still at an early stage of development, both in terms of the diversity of institutions and with respect to the range of financial instruments available. Moreover, the expansion of the financial network has been sluggish and most institutions operate a small number of branches in or around the capital city. Most financial operations take place in the banking system, which includes the Central Bank (Banque de la Republique d'Haiti, BRH) and the state-owned commercial bank (Banque Nationale de Credit, BNC) which together are referred to as the monetary authorities.

Traditionally, both domestic and foreign banks have derived a large proportion of their income from fee-based activities related to foreign exchange operations. Since 1984, all export transactions have to be channeled through domestic banks. The credit operations of commercial banks are concentrated on short-term financing of export and import trade. Short-term credit needs of the rest of the economy are satisfied mainly through the informal credit market. Long-term and project financing is provided on a modest scale by the development finance institutions; most of these suffer from managerial inadequacies and a shortage of qualified personnel.

7. Balance of Payments

Haiti seldom experienced balance of payments problems in the past, principally because the GOH had a long tradition of conservative fiscal and monetary management (i.e., limited deficit financing through monetary expansion). Because of this, the official exchange rate of 5 gourdes to the U.S. dollar has been maintained since 1919. However, beginning in 1980 and 1981, Haiti experienced a major deterioration in its balance of payments, with the balance of payments deficit reaching $57 million in 1981 (see Table II.B.7). Increased reliance on Central Bank credit to finance excessive government deficits, together with a recession-induced weakening of export earnings in 1981, were the basic causes of the crisis.

In 1982, the GOH adopted a stabilization program which was supported by a SDR 34.5 million IMF stand-by arrangement extending through September 1983. The austerity program successfully increased public sector revenues, controlled expenditures, and reduced the deficit and the need for Central Bank financing. The overall balance of payments deficit was reduced to $21.6 million in 1982 and $17.8 million in 1983, the external payment arrears were almost liquidated and the 10 to 15 percent discount on the value of the gourde that had emerged in 1981 virtually disappeared by the end of 1983.

TABLE II.B.7
HAITI: SUMMARY OF BALANCE OF PAYMENTS
(in millions of U.S. Dollars)

	1981	1982	1983	1984	1985	1986
CURRENT ACCOUNT	-174.7	-118.1	-151.7	-139.0	-130.8	-102.2
Trade Balance	-215.1	-123.6	-139.6	122.5	-116.7	-81.1
Exports f.o.b.	158.2	195.3	195.1	229.5	217.2	212.3
Coffee	33.1	35.9	52.5	54.0	48.0	55.0
Light Assembly	79.6	98.9	100.4	124.7	126.9	124.1
Other	45.5	60.5	42.1	50.9	42.3	33.2
Imports c.i.f.	373.3	318.9	334.6	352.0	333.9	293.4
Services (net)	-24.4	-44.2	-54.6	-61.5	-62.2	-71.2
Of which: travel	43.8	39.5	33.3	28.0	25.1	19.6
interest	-9.4	-13.4	-16.4	-18.3	-13.1	-12.4
other	0.0	0.0	0.0	-71.2	-74.2	-78.4
Private transfers	64.8	49.7	42.5	45.0	48.1	50.1
CAPITAL ACCOUNT	118.2	96.5	133.9	118.6	116.5	129.9
Official Grants	66.1	69.2	69.3	78.2	87.3	117.2
Of which ESF	0.0	0.0	0.0	0.0	0.0	12.0
Official capital (net)	103.7	30.3	75.8	60.3	17.0	23.9
Multilateral and bilateral	43.4	39.1	65.7	67.8	45.0	34.4
Commercial	50.4	-8.7	10.6	-5.6	-25.2	-6.7
Publicly guaranteed debt and other official /2	9.9	-0.1	-0.5	-1.9	-2.7	-3.8
Monetary capital	-1.3	-8.1	-5.6	-8.1	-13.6	-10.0
Private capital and errors and ommissions	-50.3	5.1	-5.6	-11.8	-1.4	-1.2
OVERALL BALANCE	-56.5	-21.6	-17.8	-20.4	-14.3	27.7
Changes in net international reserves (increase -)	56.5	21.6	17.8	20.4	14.3	-27.7
Fund purchases (+) and repurchases (-)	13.8	28.9	25.8	21.8	-9.4	-17.4
Other (net) (increase -)	22.2	-7.6	4.0	4.9	14.1	-12.7
Arrears (decrease -)	20.5	0.3	-12.0	-6.3	9.6	2.4

SOURCE: Bank of the Republic of Haiti, IMF, and USAID.

Despite the progress achieved, however, Haiti's balance of payments and external debt position remained weak and needed to be strengthened through a continuation of tight fiscal and credit policies for several years. To this end, the GOH and IMF negotiated a new SDR $60 million stand-by arrangement for 1984 and 1985. However, because of excessive expenditures, the GOH was not able to make drawings under the stand-by after April 1984. Domestic financing of the public sector deficit equivalent to 3.7 and 2.2 percent of GDP in FY 1984 and FY 1985, respectively, increased the pressure on the gourde and the parallel market discount on the gourde reached 20 percent by the end of 1985.

The outbreak of civil disorders beginning in November 1985, the fall of the Duvalier government in February 1986, and subsequent events, including growing labor disputes both in the public and private sectors, airport closures, and intermittent looting of residences and businesses exacerbated the balance of payments crisis. As a result, the FY 1987 balance of payments gap requiring financing was projected, in the spring of 1986, to be $86 million.

However, it is currently estimated that the balance of payments was, in fact, $27.7 million in surplus in FY 1986. This turn-around was due to a drastic fall off of imports from an assumed level of $354 million to an actual level of $293 million. The assumed level was the level required to maintain real per capita income, where in reality real per capita income fell 3.1 percent in FY 1986. In addition, there was a $30 million increase in grant disbursements, including $12 million in ESF and $7.6 million increase in PL 480.

The international reserve position of the monetary authorities (Central Bank and National Credit Bank) deteriorated up through FY 1985 but registered some improvement in FY 1986. Net foreign assets declined from $-2.0 million in September 1981 to $-92.9 million in September 1985 and then increased to $-75.9 million by September 1986. Even with the improvement, gross foreign assets as of September 1986 were only $22.2 million. This would cover only 3 weeks of imports, far short of the usually recommended 2 months level. The low level of international reserves constrains the orderly finance of foreign trade and debt servicing.

C. Major Development Problems

Haiti's economy has stagnated since 1980. Unemployment and underemployment have increased; per capita income has fallen. The low level of per capita income contributes to one of the main structural problems confronting the economy: gross national savings are very low, averaging only about 5 percent of GDP since 1980 (see Table II.B.2). Major development problems are low productivity in the agricultural sector, environmental degradation due to deforestation and soil erosion, increased pressure on wage levels from high food prices, and unemployment.

The agricultural sector suffers most severely from declining incomes and stagnating, if not decreasing, production. Public policies have exacerbated this situation. By restricting imports of cereals and maintaining export taxes on important commodities, relative prices have tended to encourage soil-erosive annual grain crops, while discouraging more environmentally sound perennials such as coffee. As a result, soil erosion and deforestation have worsened, severely lowering yields and damaging the natural resource base. Recent moves by the government to lower or eliminate several export taxes should correct some of these imbalances.

High food prices and the wage level: Until now, the attractiveness of Haiti as an investment opportunity has been largely attributable to the low wage level. However, pressure continues to be put on this wage level due to high food costs in Haiti. Food prices in Haiti are well-above world market prices. In the past, the government has maintained a position of supporting food self-sufficiency. Import quotas and monopolies existed for several important food commodities, keeping internal food prices at an artificially high level. As a result, consumers have suffered. Pressure on wages is mainly fueled by increasing food prices, the major item (64%) in the consumer basket of goods. A continued upward pressure on minimum wages will seriously undermine the favorable position of the light assembly sector. If economic growth in Haiti is to be export-led by the assembly sector, food prices will need to be brought more in line with world market levels Non-food prices will also need to be reduced from their high levels if farmers' real incomes are to be protected.

Unemployment: The high rate of unemployment is one of the most difficult problems the government must deal with in coming years. Clearly, the scarcity and over-utilization of land make it difficult to absorb the unemployed in the agricultural sector. Employment expansion can most readily be achieved through industrial development, particularly in the light assembly sector.

III. THE ECONOMIC REFORM PROGRAM

Since February, 1986, the GOH has embarked on a comprehensive economic reform program which is receiving the support of the major multilateral and bilateral donors, principally AID, the World Bank and the IMF. Advanced negotiations are underway with the IMF, on a Structural Adjustment Facility (SAF) for $26 million; the first tranche of $10.6 million will be disbursed in December, 1986. Negotiations with the World Bank for a structural adjustment credit of approximately $40 million are also proceeding on schedule; a first tranche could be disbursed as early as the second quarter of CY1987. The GOH's economic reform program is based on a set of measures designed to achieve financial stability, and on a set of measures designed to increase the efficiency of the economy, thus accelerating economic growth. The program began almost immediately after the change in government, and as shown in Section II, very impressive progress has been achieved.

The first priority of the new government has been to reach financial stability. After years of graft and excessive public spending which was financed to a large extent by the Central Bank, international reserves were depleted, non-concessionary debt had increased rapidly, inflation exceeded the inflation of Haiti's main trading partners, and the parallel foreign exchange market discounted the gourde by up to 20%.

The present government is committed to a reversal of these trends through fiscal and monetary restraint. The overall deficit of the public sector (before grants) will be about 7% of GDP, compared to an average of about 9% in the period 1981-85. The deficit will be more than offset by foreign grants, thus allowing the public sector to reduce its indebtedness to the domestic banking system and to foreign commercial creditors.

Fiscal austerity will allow the government to pursue a less expansionary monetary policy while at the same time permitting a sufficient expansion of credit to the private sector. Additionally, the GOH intends to improve the allocation of credit and the functioning of the domestic monetary system. Controls over interest rates have been relaxed and the present limits are not binding, so that market interest rates now prevail.

The government is committed to a fixed exchange rate policy and recognizes that this requires a tight monetary policy. Although the gourde had been appreciating in real terms, the depreciation of the U.S. dollar over the last eighteen months has brought about a decline in the real effective value of the gourde of about 12%. In FY 1986 there was a surplus in the overall balance of payments of $27.7 million. A similar surplus next year is required to begin to increase Haiti's gross international reserves from its current inadequate level which is equivalent to only three weeks of imports to a recommended minimum level of two months. Increased reserves would renew confidence in the value of the gourde and would provide an increased incentive for the repatriation of capital. Additionally, increasing international reserves to an adequate level would facilitate foreign trade, and may allow the GOH to reduce the foreign exchange surrender requirement which is set presently at 50 percent.

Although the first priority of the GOH was to achieve financial stability, the government already has enacted a number of economic policy measures designed to set the basis for export-led economic growth; the enactment of additional measures is planned. The objectives of the structural adjustment program are to generate a rate of growth of real GDP of 4.5% per annum, mainly through faster growth in assembly industry and coffee exports, while at the same time containing inflation to 4%, and steadily rebuilding net international reserves. This ambitious structural adjustment program seeks to increase economic efficiency by changing policies in three broad areas which are: a) government efficiency and accountability; b) tax reform; and c) trade and price policy.

A. Government Efficiency and Accountability

A major effort is being made to increase government efficiency and accountability, and significant progress has been made to date. The effort to improve the management of public funds began with the audit of the Minoterie (flour mill), and the on-going audits of TELECO (the telecommunications company) and BNDAI (National Agricultural and Industrial Credit Bank). Two of these audits were financed by AID. Several other audits are planned, including APN (Port Authority), OAVCT (National Vehicle Insurance Agency), Loterie de l'Etat (State Lottery), Ciment d'Haiti, Darbonne (sugar mill), ENAOL (edible oil refinery), Ministry of Finance, and BNC (National Credit Bank). In order to assure that a continuing audit program of state-owned enterprises is carried out, the Ministry of Finance plans to establish a unit within the Ministry to coordinate audits and to exercise financial control over the enterprises. Additionally, the Ministry of Finance is considering the implementation of a longer term project designed to strengthen the Cour Superieure des Comptes, the institution responsible for auditing central government institutions, i.e., the ministries.

The GOH is committed to a reduction in the relative importance of the public sector within the economy, and has begun a retrenchment program that has led to the closure of the state-owned edible oil refinery and of the sugar mill at Darbonne. There are plans to reduce the operating costs of Ciment d'Haiti by ceasing the production of clinker and importing it instead. There are also plans to loosen flour import requirements, thus eliminating the monopoly power of the government flour mill.

The government-owned Banque Nationale de Credit will continue a cautious lending policy in terms of both the magnitude of credit extended to the private sector and the quality of its loan portfolio. The access of the agricultural sector to credit presently is constrained by the concentration of commercial bank branches in Port-au-Prince. The government plans to close down the existing Bureau de Credit Agricole and the Banque Nationale de Developement Agricole et Industriel, and to merge their performing portfolios with a new agricultural development bank being established with the assistance of international agencies.

Control over treasury expenditures has increased markedly after the new government assumed power. According to World Bank calculations, between February and September 1986, wasteful expenditures and graft equal to 3% of GDP at an annual rate were eliminated. An important proportion of the savings have resulted from the elimination of salary payments to non-existent public employees and payments to the VSN (Tonton Macoutes) and the presidential palace.

In the 1986/87 budget, funds have been reallocated to favor development activities such as agricultural services, irrigation maintenance, road maintenance, health and education, thus ensuring that existing investments yield the highest returns.

The public investment budget is being financed with concessional aid, enhanced with technical assistance. The government is concentrating on the completion of on-going projects, mostly in the areas of agricultural production, export promotion, and improvement of human capital. The World Bank has carried out a thorough analysis of the investment budget, and has approved the overall program.[1] The government is preparing a series of quick-disbursing, labor intensive projects that would be financed if additional foreign assistance becomes available. These projects are designed to improve the economic infrastructure.

B. Tax Reform

The previous government, particularly in the 1980's, introduced new taxes basically designed to increase government revenue, without regard for economic efficiency. The present government has begun a tax reform program designed to increase the efficiency of the tax system, and at the same time it plans to improve collection performance.

A first step in tax reform has been the lowering of the coffee tax from 19.5%, to 10%, and its total elimination is planned for 1987. This is expected to increase coffee production and exports, and to have important economic as well as ecological benefits. The elimination of other export taxes is also planned.

On October 1, the government enacted far reaching tax reform legislation that reduces marginal tax rates and enlarges the tax base. The number of tax rates has been reduced from ten to four, and the maximum rate has been fixed at 30%. Rates are the same for individuals and corporations. Additionally, numerous low yield taxes, as well as earmarked taxes, are being eliminated.

A major effort to improve tax collection procedures has begun, particularly through a system of cross-checks between income, sales, and foreign trade taxes. Also, plans are being implemented to improve the customs valuation procedur and to have more strict enforcement. Several of these measures were recommended by an AID financed technical assistance team.

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[1] While the Bank expressed some concern over the Cap-Haitien airport, an acceptable compromise was reached limiting GOH expenditures to $2.5 million in FY 1987, to be financed by airport authority taxes.

C. Trade and Price Policy

In order to improve the allocation of resources and to increase consumer welfare by the lowering of prices for basic commodities, the government has been breaking import monopolies by allowing their exposure to competition from imports. As discussed above, the ENAOL monopoly on vegetable oils has been terminated. Additionally, the number of products subject to import quantitative restrictions (qrs) has been reduced from 112 to 35, and there are plans to further reduce their number to less than ten. The qrs have been replaced by low tariffs. Before the end of 1986, all specific tariffs will be replaced by ad valorem tariffs averaging about 20%, and never exceeding 40%. This would reduce average tariffs as well as their dispersion.

IV. MACROECONOMIC IMPLICATIONS

The economic reform program of the GOH has been formulated in the context of a set of fiscal and monetary parameters which are consistent with financial stability. This section describes the fiscal, monetary, and balance of payments implications of the program, and quantifies the levels of balance of payments and budget support assistance which would be required. Additionally, quarterly fiscal and monetary targets consistent with financial stability are established.

A. Fiscal Implications

Projections of the operations of the consolidated public sector are presented in Table IV.A.1. The current revenue of the public sector is expected to decline from G.1,129 million in FY 1986 to G.1,090 million in FY 1987. The decline in revenue is a consequence of two factors. First, the tax reduction and parastatal price reduction program which began in FY 1986 will have its full impact in FY 1987. Second, the comprehensive tax reform program being undertaken will eliminate several taxes and reduce marginal tax rates. While some of the resulting revenue shortage will be compensated through increases in the tax base, it is expected that during the transition period there will be a reduction in total tax collections.

The operating surplus of state-owned enterprises has been estimated at G. 200 million. This is a rough order of magnitude estimate as the enterprises are undergoing substantial structural changes.

Government current expenditures, which declined in FY 1986 with respect to FY 1985, are expected to decline further in FY 1987. This is the result of a conscious effort by the GOH to reduce the role of the government. The reduction in total current expenditures has been accompanied by a reallocation of funds towards high priority development activities such as those of the ministries of health, education, and agriculture. The effort to identify and eliminate payments to nonexistent personnel continues, and this has resulted in large savings in payroll expenditures. Some of the savings have, however, been compensated by the long-overdue salary increases granted to army personnel and teachers; these salaries had been eroded in real terms as a consequence of inflation.

The budget of the public sector envisages public sector capital expenditures of G. 930 million. In addition to that, it is assumed that ESF assistance would enable an expansion in capital expenditures of G. 28 million, and that this would be used for labor intensive activities and in support of private sector activities. The total capital expenditure budget has been analyzed by the World Bank. As mentioned above, the World Bank agrees with the projects being financed.

Grants to the public sector would amount to G. 480 million including the disbursements in FY 1987 of ESF obligated in FY 1986, anticipated FY 1987 PL 480 and DA disbursements, and other donor grants. The proposed FY 1987 ESF level is not included.

The overall deficit is estimated at G. 338 million. Given that the reform program calls for the GOH to repay G. 40 million to the Central Bank, and that G. 40 million is required to make principal payments on existing external debt, the gross financing requirement is G. 418 million.

The proposed financing is as follows (in million of gourdes):

Concessionary loans (project lending)	130
SAF (IMF)	53
ERC (World Bank)	100
ESF (AID, FY 1987)	135
TOTAL	418

TABLE IV.A.1

SUMMARY OF PUBLIC SECTOR OPERATIONS

(in millions of gourdes)

	ACTUAL			PROJECTION
	1984	1985	1986	1987
TOTAL RECEIPTS	1171.2	1382.5	1341.1	1290.0
Government current revenue	914.1	1124.2	1129.0	1090.0
Public Enterprise surplus	257.1	258.3	212.1	200.0
TOTAL EXPENDITURE	2129.6	2105.0	1898.1	2108.0
Government current expenditure	1114.7	1281.5	1237.0	1150.0
Public Sector capital expenditure	1014.9	823.5	661.1	958.0
PUBLIC SECTOR DEFICIT	-958.4	-722.5	-557.0	-818.0
GRANTS-IN-AID	310.0	359.5	433.0	480.0
of which ESF (FY1986)	0.0	0.0	60.0	30.0
OVERALL DEFICIT	-648.4	-363.0	-124.0	-338.0

E. Monetary and Price Impacts

The macroeconomic reform program will reduce monetary expansion and limit domestic inflation to 4 percent. The program provides for a G. 40 million or 2 percent decline of Central Bank credit to the public sector. To stay within this constraint, a Central Government borrowing increase of G. 100 million is projected to be offset by a G.140 million increase in other government deposits with the monetary authorities. Credit expansion to the private sector by the National Credit Bank (BNC) is limited to G. 24 million, or 8 percent. Net domestic assets of the monetary authorities are targeted to decrease 4 percent or G.63 million. The projected increase in net foreign assets of G. 162 million swamps the decline in net domestic assets and is consistent with a 8.5 percent increase in the money supply (M2). This coupled with a projected 4.5 percent increase in real GDP implies that inflation will be limited to around 4 percent in FY 1987, the projected rate of Haiti's main trading partners. This level of inflation may even be a high projection given recent reductions of commodity prices brought about by tax reductions, trade liberalization, and the decline in the parallel market rate for foreign exchange.

C. Balance of Payments in FY 1986

The GOH's reform program objective of an overall balance of payments surplus of equivalent to almost 1.5 percent of GDP in FY 1987 anticipates significant increases in exports, imports, official grants, and concessionary loans (see Table IV.C.1). The resulting ex ante unfinanced balance of payments gap of $66.6 million is projected to be partially financed in FY 1987 by an IMF Structural Adjustment Facility (SAF) of $10.6 million, a World Bank Economic Recovery Credit (ERC) of $20 million, and AID FY 1987 ESF of $27 million.

Exports are projected to recover from the previous two years of decline, increasing from $212 million in FY 1986 to $229 million in FY 1987. This expansion is based upon the expectation that the light assembly sector will recover from the decline in FY 1986 and grow by some 8.5% in FY 1987. Coffee export volume, which is characterized by a cycle, is projected to increase by about one-sixth to return to its average level over the last five years (320,000 bags of 60 kilos). This increase will offset a projected moderate decline in coffee prices and cause the value of coffee exports to increase by 7% to almost $59 million in FY 1987. Tourism is anticipated to pick up somewhat with the reopening of the largest tourist facility (Club Med) and the resumption of tourist

TABLE IV.C.1
HAITI: SUMMARY OF BALANCE OF PAYMENTS
(in millions of U.S. Dollars)

	ACTUAL			PROJECTION
	1984	1985	1986	1987
CURRENT ACCOUNT	-139.0	-130.8	-102.2	-158.5
Trade Balance	122.5	-116.7	- 81.1	-133.1
Exports f.o.b.	229.5	217.2	212.3	228.6
Coffee	54.0	48.0	55.0	58.7
Light Assembly	124.7	126.9	124.1	134.7
Other	50.9	42.3	33.2	35.2
Imports c.i.f.	352.0	333.9	293.4	361.7
Services (net)	- 61.5	- 62.2	- 71.2	- 76.6
Of which: travel	28.0	25.1	19.6	21.8
interest	- 18.3	- 13.1	- 12.4	- 11.9
other	- 71.2	- 74.2	- 78.4	- 86.5
Private transfers	45.0	48.1	50.1	51.2
CAPITAL ACCOUNT	118.6	116.5	129.9	134.3
Official grants	78.2	87.3	117.2	94.6
Of Which: ESF	0.0	0.0	12.0	6.0
Official capital (net)	60.3	17.0	23.9	39.7
Multilateral and bilateral	67.0	45.0	34.4	36.0
Commercial	- 5.6	- 25.2	- 6.7	8.0
Publicly guaranteed debt and other official	- 1.9	- 2.7	- 3.8	- 4.3
Monetary capital	- 8.1	- 13.6	- 10.0	0.0
Private capital and errors and ommisions	- 11.8	- 1.4	- 1.2	0.0
OVERALL BALANCE	- 20.4	- 14.3	+ 27.7	- 24.2
Changes in net international reserves (increase -)	20.4	14.3	- 27.7	- 42.4
Fund purchases (+) and repurchases (-)	21.8	- 9.4	- 17.4	- 22.9
Other (net) (increase-)	4.9	14.1	- 12.7	- 5.1
Arrears (decrease -)	- 6.3	9.6	2.4	- 14.4
UNFINANCED GAP				- 66.6
Proposed balance of payments financing				
SAF				10.6
ERC				20.0
ESF FY 87				27.0
Unfinanced				9.0

Source: Bank of the Republic of Haiti, IMF, and USAID ship arrivals in Cap-Haitien. In spite of this projected growth of foreign exchange earnings, the current account balance is expected to deteriorate as a result of a 23% increase in imports in FY 1987 over the very depressed level of FY 1986 imports. This increase of imports is required to meet the macroeconomic reform program GDP growth target of 4.5%.

The capital account, which includes FY 1986 ESF but excludes the proposed FY 1987 ESF, SAF, and ERC, will increase slightly, from $129.9 million in FY 1986 to $134.3 million in FY 1987. Capital flight is assumed to be eliminated in FY 1987. The resulting overall balance of payment deficit is $24.2 million.

The macroeconomic reform program objective of an increase in net international reserves equivalent to almost 1.5% of GDP is based upon the need to rebuild Central Bank official reserves back toward normal operating levels to facilitate foreign trade and the timely settlement of international debt obligations. This targeted $42 million increase of net international reserves includes net Fund repurchases of $23 million and the elimination of over $14 million in arrears.[2]

The resulting unfinanced balance of payments gap is $66.6 million. Anticipated other donor financing of this gap include a late 1986 $10.6 million first tranche of the IMF SAF and a mid-Spring 1987 $20 million first tranche of the World Bank's ERC. Of the remaining unfinanced gap of $36 million, $27 million is proposed to be financed by FY 1987 ESF.

This level of ESF is necessary to jointly attain the macroeconomic reform program objectives of GDP growth and the rebuilding of international reserves. GDP growth is essential if Haiti is to maintain economic and political stability so that there can be an orderly transition to an elected government in February 1988. Increased international reserves is needed to rebuild Central Bank holdings of gross reserves to handle normal trade and debt service needs, to eliminate arrears, and possibly to allow the authorities to reduce foreign exchange surrender requirements, thereby increasing foreign exchange availabilities to the private sector.

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[2]The IMF treats the SAF as a net Fund purchase, and hence with the SAF, the increase of net international reserves will be $31.8 million and net fund repurchases will be $12.3 million.

D. Performance Targets

Targets for the quarterly revenues and expenditures of the Treasury have been established. They are (in millions of gourdes):

	Oct-Dec 86	Oct-March 87	Oct-June 87	Oct-Sept 87
Treasury Revenues	320	620	920	1190
Treasury Expenditures	330	656	970	1290

The reform program allows for the increase in the expenditure targets if Treasury revenue or foreign concessionary financing exceeds budget projections.

Additionally, quarterly targets consistent with financial stability have been developed for the monetary aggregates. The targets are (in millions of gourdes):

	Dec 86	March 87	June 87	Sept 87
Arrears	- 66	- 14	- 7	0
Net domestic assets	1603	1446	1425	1440
Credit to public sector	2014	2010	1984	1994
Credit to private sector	310	312	316	316

V. THE ECONOMIC RECOVERY ASSISTANCE PROGRAM

A. The On-Going Program

Financial support by AID of Haiti's economic reform program began in August 1986 with the signing of the first ESF program (Economic Recovery Assistance, ERA I). The total funding was $18 million, and all funds were disbursed in three tranches. The following conditions were attached to ERA I:

a) Continued compliance with monetary and fiscal targets;

b) Continuation of the program to liberalize the trade regime;

c) Continuation of a program to initiate audits of key parastatals and of the Ministry of Finance;

d) Purchasing petroleum from least cost sources;

e) Provision to AID of foreign exchange budgets on a monthly basis;

All conditions were met on schedule and the third tranche was disbursed in December 1986.

Parallel to the ERA I program, a DA project (Coffee Sector Assistance) providing a $2.0 million policy based grant to the GOH to increase coffee production was authorized in September, 1986. This project was conditioned on the elimination of the coffee export tax before October 1, 1987.

B. The Proposed ESF Program

1. Rationale

After nearly 30 years of dictatorship, Haiti is undergoing a delicate transition towards democracy. Elections are scheduled for November 1987, with the then elected Government taking office in February 1988. Expectations for change among the Haitian people are high. Support to the interim regime is crucial to enable it to improve the rate of economic growth and the provision of services to the population while preparing for elections and managing the transition to an elected Government, as well as undertaking a major economic reform program. Without significantly expanded assistance from the international donors, Haiti is unlikely to be able to meet these objectives during the critical period. The economic program of the present government aims to implement the economic policy measures described in Section III, thus handing to the elected government a policy framework that would set the basis for long term economic growth. However, most of the economic reform measures, because of their very nature, will not result in economic growth immediately. Some may temporarily worsen the situation; for example, the tax reforms being implemented are crucial but will result in a reduction of total tax collections during the transition period. Therefore, growth in the next two to three years will have to be fueled, to a large extent, by increased levels of foreign assistance. This assistance must be quick disbursing, and generally targeted at labor intensive productive activities, which result in much needed infrastructure improvements as well as create employment. It must also increase the availability of foreign exchange for the private sector and provide the resources for the government to maintain public investment at an adequate level while staying within the monetary and fiscal targets required for economic stability. A number of donors, including the IMF and the World Bank, are supporting the economic reform program with increased assistance levels. However, as shown in Section IV, increased levels of support from the USG are required to finance the public sector and balance of payments gaps.

2. Conditionality

The economic reform program is far reaching, and includes a myriad of measures, some of them very difficult to implement from a technical as well as a political point of view. The success of the program cannot be judged in terms of specific measures undertaken but rather in terms of the overall direction of the program. This has been an important consideration in determining the Mission's negotiating strategy.

At this point, the Government has already implemented several important measures including: a) implementation, beginning in FY 1986, of a fiscal and monetary program consistent with financial stability; b) elimination of 77 quantitative restrictions on imports; c) passage of an important income tax reform; d) reduction and elimination of several export taxes; e) auditing of several public entities and enterprises; and f) closing down of two state-owned enterprises. Given the obvious progress already achieved by the GOH, the U.S. Mission proposes that the first tranche of ESF be based, to a large extent, on the substantial reforms already carried out. Support of this on-going program is essential to minimize the short run economic and political costs of the program and thus increase the probability that the policy reforms are not later reversed. Two conditions precedent to the first disbursement will be required. First, the GOH will be required to be in compliance with the quarterly fiscal and monetary targets established in consultation with the IMF, World Bank and USAID. Second, quantitative restrictions on imports will be substantially reduced. This first disbursement of US$ 20 million should be scheduled for January 1987.

The second tranche for $7 million should be disbursed during the second quarter of calendar year 1987. The proposed conditions precedent to that second disbursement would be:

a) continued compliance with the quarterly fiscal and monetary targets;

b) elimination of all remaining export taxes;

c) initiation of management and/or financial audits of at least four of the following governmental entities, which are listed in order of their priority and planned timing:

i) APN (the port authority).

ii) Ciment d'Haiti (the state-owned cement factory);

iii) Ministry of Finance;

iv) Loterie de l'Etat (the state run lottery);

v) OAVCT (the state vehicle insurance agency);

vi) Darbonne (state-owned sugar mill);

vii) ENAOL (the state-owned edible oil refinery);

viii) Banque Nationale de Credit (BNC, the state-owned commercial bank);

d) completion of a plan to implement an ongoing program of audits and management reviews for all GOH institutions. The plan will present a broad scope of work for audits/reviews; identify the institutions that the GOH will audit on a regular basis; describe the steps the GOH intends to take to develop its own institutional capability to carry out effective audits and management reviews and planned dates for the implementation of those steps. The GOH will also commit itself to initiate audits of the development ministries (public works, education, health and agriculture), which carry out the bulk of the GOH's investment program.

e) compliance with the covenants.

The following covenants will be included in the Grant Agreement:

a) Monetary and Fiscal Performance

The GOH will take such measures as are necessary to ensure continued compliance with the monetary and fiscal targets it has established for FY 1987, and shall consult with the IMF, World Bank, and AID on its progress in meeting those targets. With respect to FY 1988, the GOH will agree to develop fiscal and monetary targets in FY 1988 that are consistent with financial stabilization, in consultation with the

IMF, World Bank and AID. The GOH will also agree to provide monetary and fiscal performance data to AID for fiscal years 1987 and 1988 on a monthly basis.

b) Trade Regime Liberalization

The GOH agrees to continue its program of liberalizing Haiti's trade regime. The Government will continue with its program of replacing all import quotas with moderate ad valorem tariffs, will study the elimination of the remaining quantitative restrictions and the types and levels of tariffs with which they could be replaced, continue with its ongoing studies of industrial incentives and taxation, and inform AID on its progress in implementing the recommendations of these studies.

c) Improvement of Government Operations

In order to improve government operations and enhance accountability of the public sector, the Government agrees to continue and expand upon its present efforts to carry out financial management and control reviews of parastatal organizations, and improve financial management and control of Ministries. The government will develop a detailed plan for the implementation of audits and management reviews and the improvement of financial control of the Ministries. During FY 1987, the government will continue with the program initiated last year to undertake financial management and control reviews of all major parastatals and of the Ministry of Finance. The Government will also begin to develop an institutional capability to perform financial and management audits of the Ministries. In addition, the Ministry of Finance will take the necessary steps to provide adequate payment verification of project expenditures financed from the local currency counterpart of the grant.

3. Dollar Disbursement Procedures

The funds will be disbursed via electronic funds transfer to the account of the Haitian Central Bank in the U.S. Federal Reserve Bank. The dollars will increase the Central Bank's free foreign exchange assets. A special account for the funds will be established. The GOH will provide documentation on the use of the dollar funds in a form acceptable to AID.

The GOH will agree that Haiti will import raw materials, intermediate production inputs, spare parts, machinery and equipment from Code 941 countries over the 12 months following signing of the Grant Agreement in an amount at least equal to $27.0 million.

4. Local Currency Uses

a. Special Account

The Central Bank of Haiti will create a special account into which it will deposit the gourde equivalent of the grant disbursement immediately following each disbursement.

b. Uses of Local Currency

The Mission expects that local currency counterpart funds of the grant will be used for activities similar to those described below:

i) U.S. Trust Fund. The equivalent of $1.35 million will be paid into a U.S. Trust Fund to be used by USAID/Haiti for operating expenses.

ii) Budget Support. In order to help bridge the fiscal deficit while maintaining an adequate level of public investment and monetary stability, the equivalent of $20.0 million will be used for budget support. This will be attributed to expenditures of the development ministries (Agriculture, Health, Education and Public Works).

iii) Project Activities. The equivalent of up to $5.65 million will be used for mutually agreed upon project activities, with highest priority given to labor intensive public works projects. These could include:

(1) Labor intensive public works projects.

(2) Leogane Plain agricultural development.

(3) Administration of justice.

(4) Literacy Programs.

(5) Support to private voluntary organizations.

(6) In-country technical and vocational training programs.

(7) Support to credit institutions.

(8) Counterpart costs, not funded from other sources, of AID, IBRD, IBD and other donor financed investment programs which are consistent with AID's development strategy in Haiti.

(9) The costs of contracting and training payment verification officers, auditing firms for the audit of parastatals, and financial management professionals to enhance the Government's capability to carry out financial control and management reviews.

c. Programming of Local Currency

For all uses except the U.S. Trust Fund, the Mission and the GOH, represented by the Ministry of Finance, will jointly agree on the specific uses of local currency and confirm their mutual understanding by project implementation letters. The activities programmed will proceed only to the extent that planned expenditures do not conflict with adherence to the overall fiscal and monetary targets that the Government establishes in consultation with the IMF, World Bank and AID. The procedures developed for Economic Recovery Assistance I will be utilized. Internally, initial programming will be carried out by the ESF Local Currency Implementation Sub-Committee. Its recommendations will be reviewed and approved by the Local Currency Policy and Coordination Committee, chaired by the Deputy Director.

d. Disbursement and Monitoring of Local Currency Expenditures

Disbursement of local currency budget support will be effected by the Ministry of Finance following normal GOH procedures. The Ministry of Finance will report to AID on the attributions of these funds. Disbursements to and monitoring of local currency funded projects will be carried out by the Title III Management office, following the procedures successfully utilized in the Title III and the Title II Emergency Programs. The GOH will be fully accountable for the end use of these funds and will ensure that proper disbursement procedures are followed and that end use checks are performed.

The Trust Fund Agreement will be signed prior to the first disbursement of the Grant, using the standard OE Trust Fund text. The Central Bank will deposit the equivalent of $1.35 million to the Trust Fund within seven days of the disbursement of the first tranche to the Special Account. The USAID Controller's Office will approve expenditures from the OE Trust Fund, account for the funds according to relevant AID and Treasury policies, and provide periodic reports to the GOH on Trust Fund uses.

ANNEX A: Summary of 1986 Fiscal Reforms

I. INTRODUCTION

On February 25, 1986 the National Council of Government headed by Henri Namphy outlined its political and economic reform program which includes the reduction of prices of basic commodities, the introduction of a new and more equitable tax system and the improvement in the management of public funds. The Minister of Finance, Leslie Delatour, has given especially strong leadership to the reform program since he was installed in April 1986.

II. PRICE DECREASES OF BASIC COMMODITIES

A. Petroleum Products

On February 27, the GOH reduced retail prices for gasoline, diesel and kerosene: for gasoline, the price per gallon went from $2.25 to $2.13; for diesel, from $2.00 to $1.70; for kerosene, from $1.78 to $1.50. For diesel and kerosene the price decreases were obtained by tax reductions. For diesel, of the $0.30 reduction in the pump price, $0.20 was a result of a tax reduction ($0.89 to $0.69 per gallon). For kerosene, of the $0.28 per gallon reduction in the pump price, $0.20 was the result of a tax reduction. On April 10, the Ministry of Commerce announced another price reduction of petroleum products which reflected the low cost of these products on the international market. For gasoline, the price per gallon went from $2.13 to $1.91; for diesel, from $1.70 to $1.55; for kerosene from $1.50 to $1.36. This second reduction does not affect GOH revenues. The first price reduction of February 27, which was brought about in part by tax reductions, was estimated to potentially cause a yearly loss of approximately $8.5 million in revenue for the GOH. However, the introduction of a variable tax on petroleum products by decree in July offset the projected loss. In fact, in August and September, the variable tax generated over $1 million in revenue for the treasury. The variable tax was recommended by a USAID financed petroleum expert. The variable tax was designed to vary with the actual CIF cost of gasoline, kerosene and gasoil on a cargo-by-cargo basis, and thus maintain at a constant level income from existing taxes, company margins and pump prices.

B. Flour

On January 7, 1986, the GOH reduced the price of flour from $26.61 per sack of 100 lbs. to $25.61. The price decrease reduced the gross revenue of the Minoterie. Prices of flour were also reduced on February 27. The ex-factory price of a 100 lb. sack went from $25.61 to $22.61. Of the $3 reduction per sack, $1.23 represented taxes; $0.93 had been deposited in non-treasury accounts and was not budgeted. On a yearly basis, and with production of approximately 2.6 million sacks, this tax represented $2.5 million. This has been transferred to the consumers in the form of lower flour prices. The remaining $0.30 cents per sack represents the reduction of the value-added tax on flour. On a yearly basis, this reduction brings about a loss of approximately $0.75 million for the GOH. This loss for the Treasury and the reduction in price supported directly by the flour mill, ($1.77 per sack or $4.4 million per year) will be offset by the reduced operating costs of the mill. The administrative structure of the Minoterie was changed by decree on October 9. The new structure brings about the separation of the most important offices, namely that of the president of the board and the director general, no longer permitting the concentration of authority and power in the hands of a single person. In a parastatal where control by shareholders is not possible, a system of checks and balances can only be insured by such a separation. In addition, an audit financed by USAID identified a number of cost saving management reforms. It is anticipated that the operating surplus this fiscal year will increase and therefore offset the above-mentioned loss.

C. Edible Oil and Iron

On March 18, 1986, in a joint communique, the Ministry of Finance and Economy and the Ministry of Commerce and Industry announced the end of the monopolies on edible oil and iron. A few months later, ENAOL, the parastatal involved in the production of semi-refined edible oil, was closed.

Movements in the retail price of edible oil in Haiti have since become closely correlated with world prices. Refiners may now import refined and unrefined oil with a license from the Ministry of Commerce. A new tax structure for edible oil was established on April 1986. Custom duties are 20 percent ad valorem. In addition there is a 10 percent value-added tax. Unless there are PL 480 Title III oil imports, it is anticipated that the new tax structure for edible oil will generate at least $1.5 million in customs duties and $0.9 million in value-added tax per year. Moreover, the GOH is saving a substantial amount of funds with the closure of ENAOL since the firm was not profitable. Total losses after depreciation and financial charges reached almost $6.5 million in the period 1981-1985. This had to be covered by the GOH budget.

The dissolution of the monopoly for the local steel mill (Acierie) in March 1986 resulted in a price reduction of 20 percent. A new tax strucutre was also decreed for iron bars produced by the Acierie: 2 percent on imported raw materials and 10 percent value-added tax. The value-added tax applied with the new structure will generate approximately $0.7 million per year. Importers of iron bars will pay a 35 percent tariff in addition to the value-added tax.

III. NEW TAXATION SYSTEM

A. Imports

In June, trade was liberalized as the list of products subject to quotas was reduced from 112 to 35. In July, a new tariff system was established replacing the old one. Under the new system, rates are ad valorem and vary between 0 percent and 40 percent, whereas the old system had rates higher than 100 percent. This encouraged contraband. The new system will bring domestic prices closer to world prices and make contraband less profitable. In addition, tax revenues will be higher given the bigger quantity imported officially assuming the level of contraband declines. Revenues from import duties are anticipated to increase by $6 million (13 percent) in FY 1987.

B. Exports

Export taxes on essential oils were eliminated in early 1985. The coffee tax was reduced from 26 percent to 23.4 percent in 1984 and then to 19.5 percent in September 1985. In September 1986, the tax was further reduced to 10 percent of the FOB price of coffee. The GOH has agreed to eliminate it completely by September 1987. On October 9, 1986 all export taxes on cocoa were also abolished. Export taxes on sisal are expected to be eliminated in the near future. Before these reductions, export taxes represented between $8 and $12 million per year. For this fiscal year, taxes on coffee exports will generated between $5.7 and $6 million. Taxes on sisal are very low and amount to no more than $2000 per year. Losses in GOH revenue as a result of these tax reductions will be approximately $5 million this year.

C. Income Tax

The cornerstone of the fiscal reform is the new income tax on individuals and corporations which became law on October 1, 1986. The new decree on income provides for lower marginal rates as well as a smaller number of rates (four instead of ten). The highest rate on taxable income above $150,000 is 30 percent instead of 50 percent. Rates are the same for individuals and corporations. Revenue from the new tax is projected to be $28 million for FY 87, a reduction of 6.5 percent compared to the previous year. This reduction reflects the difficulties in implementing the new tax and the lack of technical personnel. In the medium term, however, the projected revenues from the tax are expected to increase.

D. Consular Fees

The fiscal reform applies also to consular fees. A decree published in "Le Moniteur" of October 9, 198C, calls for the transfer to the Public Treasury of the two (2) percent consular fees paid to overseas consulates on all imports. These fees represented between $6 and $7 million per year, 50 percent of which were previously deposited by law in a special Central Bank account controlled by the Ministry of the Interior. The fees which were previously paid abroad in foreign currency will be charged, after October 9, by customs on the FOB value of all imported goods. The above-mentioned Central Bank account, called "Special Fund for the Security of the State" and created by a 1972 decree, was abolished with a decree published in "Le Moniteur" cn August 7, 1986.

E. Value Added Tax

Revenues from the value-added tax reached $35.6 million in FY 1986. For FY 1987, receipts are projected to be $36 million. As part of the fiscal reform, methods of tax collection will be improved and training will be given to employees. A taxpayer identification number has been introduced for everybody dealing with the Direction Generale des Impots (DGI), the tax collection office.

IV. IMPROVEMENT IN MANAGEMENT

More efficient and honest management of public funds has been called for by the CNG. Most of the illegal transfers of funds from the parastatals have been abolished as well as the "zombie" checks. In addition, institutions working on the budget are being strengthened and made more operational. False budget accounts have been almost completely abolished as have double salary payments. Waste is being eliminated slowly, although it is a very long process. To date, the Minoterie has been audited; Teleco and BNDAI are currently being audited. Several other public entities will be audited shortly, including the following: APN (port authority), OAVCT (state car insurance office), Loterie de l'Etat, Ciment d'Haiti, Darbonne (sugar mill), ENAOL (edible oil plant), Ministry of Finance, and the state-owned Commercial Bank (BNC).

ANNEX B
PAGE 1 OF 2

Port-au-Prince, December 12, 1986

Mr. Gerald Zarr
Director
United States Agency
for International Development
Port-au-Prince

Dear Mr. Director:

During the delicate transitional period towards democracy, besides the difficult task of preparing for elections, the Haitian Government strongly desires to improve the economic growth rate and the quality of the various services offered to the nation. In that context and in order to proceed with the policy of reforms begun since February 7, the National Council of Government (NCG) requests, herein the release of an "Economic Support Fund" (ESF) in the amount of $27 million. The NCG takes this opportunity to express the particular interests it has in improving public finances and in the formulation of a continuous control plan of the management of Government institutions. The NCG expresses also its interest in fiscal and monetary discipline as well as the elimination of international trade barriers.

We remain at your disposal to discuss the modalities of a control and monitoring mechanism of the expenditures to be made in the context of ESF.

While thanking you in advance for following up on the present request, please accept, Mr. Director, the assurance of our sincere regards.

Leslie Delatour
Minister of Finance

REPUBLIQUE D'HAITI

MINISTERE

DE L'ECONOMIE ET DES FINANCES

Le Ministre

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PORT-AU-PRINCE, LE 12 DEC. 1986 198...

Monsieur Gérald ZARR
Directeur
Agence pour le Développement International
EN SES BUREAUX.-

Monsieur le Directeur,

Durant la période délicate de transition à la démocratie, à part la difficile tâche de préparation des élections, le gouvernement Haitien désire fermement améliorer le taux de croissance économique et la qualité des différents services offerts à la population. Dans ce contexte, en vue de poursuivre la politique de réformes déjà entamée depuis de 7 Février dernier, le Conseil National de Gouvernement sollicite, par la présente, la mise en train d'un "Economic Support Fund" (ESF) pour un montant total de $27 millions. Le CNG profite de l'occasion pour signifier l'intérêt particulier qu'il porte à l'assainissement des finances publiques et à l'élaboration d'un plan de contrôle continu de la gestion des institutions gouvernementales. Le CNG signifie également son intérêt pour une très grande discipline fiscale et monétaire ainsi que l'élimination des contraintes au commerce international.

Nous nous tenons à votre entière disposition pour envisager les modalités d'un mécanisme de contrôle et de suivi des montants à dépenser dans le cadre du ESF.

En vous remerciant des suites que vous voudrez bien donner à la présente requête, nous vous prions d'agréer, Monsieur le Directeur, l'assurance de notre considération distinguée.

MINISTERE DE L'ECONOMIE ET ... Haïti

Leslie DELATOUR
Ministre

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