Concepts Paper

Economic Recovery Assistance III

USAID/Haití

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TABLE OF CONTENTS

I. SUMMARY AND RECOMMENDATIONS

A. Background

After years of graft and autocratic rule, the transitional government, which came to power in February 1986, inherited an unstable and faltering economy and a lack of institutions capable of participating in a democracy. Since that time, the new government has set in motion a process of institution building to effect a transition to democracy while putting in place a fiscal and monetary program to regain financial stability.

At the same time, the government has introduced a set of measures to improve the efficiency of the economy and the climate for economic growth. These economic reform measures can be classified in three broad areas:
1) government efficiency and accountability, which include the auditing of key state owned enterprises, increased control over treasury expenditures, the rationalization of current and investment expenditures, and divestiture;
2) tax reform, including the elimination of all export taxes and the implementation of a far reaching income 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 almost all quantitative restrictions on imports, and their substitution with a system of relatively low and uniform ad valorem tariffs.

The U.S. has supported the democratic transition and the economic reform program through a $51 million ESF program during FY 1986 and FY 1987. The 1986 program (Economic Recovery Assistance, ERA I) of $18 million and a policy based grant of $2 million (Coffee Sector Assistance, CSA) 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. The FY 1987 ESF program (totaling $33 million) has provided additional support for the democratic transition as well as the stabilization and structural adjustment program. Under the latter, significant additional progress has been made on trade liberalization, the elimination of all export taxes, income tax reform, and improved financial accountability. However, full compliance with FY 1987 fiscal and monetary targets has proven difficult largely as a result of revenue losses associated with the tax and price reform program and disappointing economic performance. In sharp contrast to the robust 4.5 percent GDP growth originally projected under the reform program, the economy remains stagnant as a result of coffee export declines, contraband, and the disappointing performance of assembly exports and foreign assistance disbursements caused by the political and civil disruptions this summer.

Fiscal balance without increased foreign assistance will be an even greater problem in FY 1988 as a result of continuing revenue shortfalls as the economy reacts to the uncertainties of the transition to an elected and functioning government and to contraband. Growing pressures to increase government expenditures only compound the fiscal problem. Given the weak administrative structures within the government, the comprehensive economic reforms may require a number of years and be accompanied by revenue enhancement measures, before having their full beneficial effect. Therefore, Haiti will need increased fast disbursing foreign assistance over the next few years to fuel growth, close the fiscal gaps, and provide increased availability of foreign exchange to the private sector.

The IMF and the World Bank are expected to continue to support the GOH's reform effort with a Structural Adjustment Facility (SAF) disbursement of $17 million and a structural adjustment loan from IDA (Economic Recovery Credit, ERC) that will provide a disbursement of $21 million this coming fiscal year. These are premised on the development of a FY 1988 fiscal and monetary program compatible with financial stabilization and resolution of a number of implementation delays associated with state owned enterprise reforms. However, even with both IMF and World Bank assistance, major unfinanced balance of payments and fiscal gaps must be closed if the comprehensive reform program is to be passed intact to an elected government.

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

The Mission proposes to continue the support of Haiti's transition to a functioning democracy and the GOH's comprehensive economic reform efforts with a third ESF program (Economic Recovery Assistance III). It is essential that full support be provided for continued implementation of the reform program during this difficult period of transition so that the significant progress that has been achieved can be consolidated under the new government. Conditionality will include continuation of fiscal and monetary restraint; increased government efficiency and accountability, principally through implementation of the audit and financial accountability plan developed under the FY 1987 agreement; government revenue enforcement and enhancement reforms to close the fiscal gap; and continued liberalization of trade through elimination of exemptions to existing tariffs and reform of the existing system of quantitative restrictions, licensing and excessive tariffs affecting agricultural imports.

The proposed use of local currency counterpart funds is as follows: 1) the equivalent of $2.0 million for a trust fund to be used by USAID/Haiti for operating expenses; 2) the equivalent of $20.0 million to support development Ministries current budgets; 3) the equivalent of up to $10 million to support mutual agreed upon projects in the GOH's development budget; and 4) the equivalent of at least $8.0 million to finance incremental spending for mutually determined project activities.

C. Grantee

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

D. Recommendation

The U.S. Mission recommends authorization of a FY 1988 Economic Support Fund grant of $40 million, disbursed in three tranches, the first for no more than $10 million in November 1987, the second for $15 million in April 1988, and the third for $15 million in July 1988. The disbursement schedule will provide minimal support to the transition government to effect the transition and will provide significant tangible reward to the elected government's acceptance and continued implementation of the reform program.

II. BACKGROUND

A. Political Situation and U.S. Interests

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 which will culminate in free election of a successor regime in November-December 1987 and inauguration of the new president on February 7, 1988.

The United States has a vital interest in the success of this process, not only in seeing elections take place on schedule and the new government inaugurated, but also in seeing it and the democratic system of government entrenched and able to grapple with the multitude of socio-economic challenges which define the Haitian political climate. Strong social, economic and human links between our two countries, Haiti's proximity to our southern shores and its centrality in the Caribbean region argue for steady and strong support to the government of Haiti, both the CNG and its successor. Without support from ourselves and the donor community, the prospects are bleak. Massive increases in illegal migration and a breakdown of the internal economic structure with consequent human catastrophe are only two of the probable outcomes which would counter U.S. national interests.

The CNG's degree of success in keeping its commitments to the Haitian people has varied from area to area as a function of fluctuating internal order and of resource availability. Having stopped the systematic flouting of human rights which characterized the Duvalier regime, the CNG has worked in several ways to ensure that such abuses do not re-enter official practice. The public debate has continued unfettered in a vigorous and highly colored press. There has been a proliferation of public association in every sphere of activity and dozens of political parties and pressure groups, human rights, business, professional and labor groups jostle for popular attention.

The CNG had doggedly implemented the political calendar which it promulgated in June 1986. Having decreed liberal political parties and press laws, the CNG oversaw the election of a Constituent Assembly to write a new constitution. The election was ill-prepared and garnered minimal public participation, but the Assembly succeeded in winning popular confidence as it prepared a charter which was widely perceived as protecting human and civil rights, barring a return to dictatorship and establishing a government system of checks and balances. The new Constitution was overwelmingly approved in a March 1987 referendum. The referendum was free of political interference and generally well-run. The many technical problems which international observers noted were judged not to have interfered with the expression of the popular will.

The post-referendum period was marked by conflict over the responsibility for running the 1987 elections between the CNG and the new Provisional Electoral Council (CEP) established by the Constitution. The populace clearly preferred that the CEP have this role. The CNG's embodiment of a differing interpretation in its mid-June electoral law stimulated broad-based unrest.

However, the CNG conceded its error and, as unrest faded slowly (though not without further incident) the electoral process gradually got back on track. The CEP produced and the CNG decreed a new electoral law. The CEP received CNG funding (with support from the U.S. and other donors) and is currently organizing the November national election. The CNG has promised to give all support the CEP requires and requests. The majority of Haitians have turned away from criticism of the CNG's continued tenure and toward making elections work on time. Much time was lost in unrest and there is a great deal to be done in a very short period. Haitians need to be sensitized to the meaning of the choices they have to make, and the CEP is just beginning to organize its major logistical effort.

The CNG has consistently supported a broad range of economic policy reforms originated and implemented by the Ministries of Finance and Economy and of Commerce and Industry. Many of the reform measures, reviewed in Section III, have been controversial and resulted in political problems for the CNG and its Ministers. The GOH has also been buffeted by economic phenomena related to the political situation, notably a growth in labor-management disputes and of contraband commerce. Unrest has impacted negatively on both foreign investment and government revenues.

The United States and other donors moved fast to buttress the CNG when it assumed office. That effort was augmented in succeeding months by significant increases in regular aid levels. That spirit continues to reign in the face of foreign assistance funding constraints, and is reinforced by the continued commitment of the CNG to policies it has put in place since February 1986.

This will continue to be the right policy if the new elected government is to be buttressed and United States national interests in Haiti are to be protected. Pressures are likely from many fronts for a reversal of certain CNG policies which are essential to Haiti's future prospects. USG financial and technical support are, in turn, indispensable to those policies. With such support, the CNG can stay the course during the transition period; the new regime will be better able to improve public living standards without reversing the present government's economic reforms; and the continued flow of multilateral and other donor support can be maintained.

B. Economic Background

1. Development Overview

With a per capita income of approximately $300 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 124 per 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 1.9 percent per year, and the ratio of people to arable land is one of the highest in the world. The country's development was 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. Economic Trends

In the latter half of the 1970's, economic growth in Haiti averaged 4 1/2 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 7 percent. Economic growth resumed in 1983 through 1985 albeit at a slow pace (less than one percent per annum), spurred on by assembly manufacturing and supported by substantial increases in private investment. 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. Real GDP growth in FY 1987 is estimated to be only 0.5 percent. During the period 1982 to 1987, real GDP per capita fell by 12 percent.

TABLE II.B.1.
SELECTED ECONOMIC INDICATORS
(percent change except where noted)

	1982-86 (average)	1987 (estimate)
GDP (current prices)	8.4	- 3.1
Real GDP	- 0.1	0.5
Real GDP per capita	- 1.9	- 1.3
Export volume	- 0.9	-12.7
Import volume	- 1.7	2.8
Terms of trade	0.8	- 1.0
Inflation (GDP deflator)	8.5	- 3.6
Money supply, percent growth of M2	8.7	8.5
Central Gov't Deficit (percent of GDP)		
Before grants	- 8.4	- 7.1
After grants	- 5.4	- 2.6
Balance of Payments (percent of GDP)		
Current Account Deficit	- 7.3	- 6.3

The poor performance of the economy during the 1980's has been marked by only marginal improvements in the terms of trade (following a 20 percent decline in 1981-82) and sluggish export performance. In the two most important export sectors, coffee production has suffered from several poor harvests as well as declining international prices: the output of the light assembly industry has also been disappointing as political uncertainty and a loss of confidence has inhibited orders and investment.

a. Production and Employment.

The structure of output has remained relatively stable in recent years. Agriculture accounts for about one third of Haiti's output and two-thirds of its employment. The sector has been in a long-term declining trend as a result of little or no advances in technology, overutilization of limited arable land, and unfavorable climatic conditions, particularly in recent years.

Other sectors have shown virtually no growth or only slight growth during the 1980's. Manufacturing and construction, accounting for about one-fifth of output, have stagnated. The services sector, accounting for approximately 42 percent of GDP in 1985, has had an only slightly more favorable performance, with transport and communications, housing and government among the most dynamic subsectors.

With continuing migration from rural areas and no major stimulus to job creation (as was the case earlier with the assembly sector), unemployment has increased. Port-au-Prince, which attracts most of the rural migrants, has an unemployment rate of approximately 40 percent. Urban and rural areas have a considerable degree of underemployment and unemployment combined that have been estimated to approximate 50 percent of the labor force, with open unemployment at about 12 percent.

b. Prices and Wages

Until 1987, Haiti had relatively high price levels, particularly for food, combined with low wage rates. Prices had risen by an annual average of more than 8 percent during the period from 1981 to 1986.

As a result of recent economic reforms, as well as a sharp growth in contraband, 1987 saw a significant decline in prices. Inflation (as measured by the GDP deflator) has, in fact, declined, from about 8 percent in 1986 to a negative 3.6 percent in 1987. The consumer price index fell some 15 percent during the first three quarters of FY 1987.

Price reductions have been especially significant for basic food commodities such as rice, flour and sugar. The contraband price of rice, for example, has been well under 50 percent of previous levels. In turn, the official prices of many basic commodities have declined some 20 to 35 percent.

As a result, food prices, that had been kept artificially high through import quotas and monopolies, have moved much closer to world market prices. With reductions in the price of food (which previously made up about two-thirds of the consumer market basket), real wages and income (for the urban consumer, in particular) have improved.

This has alleviated pressures for minimum wage increases. In fact, there have been no adjustments to the minimum wage since October 1984, and the level, in real terms, is less than three-quarters of the 1981 level. Overall, during the past two years, private sector wages do not appear to have increased much, even though there have been significant selective wage increases (by more than 20 percent) in the public sector (for teachers, health workers, and some public enterprise employees).

3. Public Sector Finances

Until 1980, the financial performance of the public sector reflected Haiti's tradition of conservative fiscal management. Beginning in fiscal years 1980 and 1981, however, public spending picked up considerably and the public sector began to rely heavily on central bank financing. Despite efforts during 1982-84 to stabilize public finances, the public sector deficits before grants averaged around 10 percent of GDP, considerably higher than the under 8 percent rates that prevailed during the previous five-year period. During 1985 and 1986, the deficits (before grants) were reduced considerably -- to some 7.9 and 5.1 percent of GDP, respectively. By FY 1986, reductions in outlays and a new fiscal package were sufficient to ensure that the deficit was fully financed with concessional external financing. Under the new government, and despite significant tax reductions (and a reduction in the public enterprise surplus by more than 20 percent) as well as a reordering of spending priorities, the fiscal picture continued to improve. Total expenditures were reduced 10 percent through an elimination of wasteful expenditures.

With increases in grants, the overall public sector deficit was reduced from 4.1 percent of GDP in FY 1985 to less than one percent in FY 1986. This permitted the public sector to also reduce its domestic debt (by some 0.3 percent of GDP) for the first time since the 1970's.

TABLE II.B.3.
Summary Public Sector Operations
In millions of gourdes

	Fiscal Years Ended September 30					
	1982	1983	1984	1985	1986	1987
Total receipts	895.4	1035.6	1171.2	1382.5	1325.2	1185.1
Treasury current revenue	749.3	846.5	914.1	1123.2	1129.9	1020.5
Public enterprise	146.1	189.1	257.1	258.3	195.3	164.6
of which transfers	75.1	74.4	90.9	73.2	104.6	88.5
Total Expenditure	1577.3	1789.0	2129.7	2142,3	1897.7	1975.1
Treasury current outlays	848.5	939.9	1114.7	1318.9	1271.4	1219.0
Public Sector Capital Expenditure	728.8	849.1	1014.9	823.5	626.2	756.1
Public Sector Deficit	-681.9	-753.4	-958.5	-759.8	-572.5	-790.0
Grants-in-aid	285.0	280.5	310.0	359.5	470.0	497.0
Overall public sector deficit (after grants-in-aid)	-396.9	- 472.9	-648.5	-400.3	-102.5	-293.0
	(In Percent of GDP)					
Total receipts	12.1	12.7	12.9	14.3	11.8	10.6
Treasury current revenue	10.1	10.4	10.1	10.1	11.6	9.1
Public enterprise	2.0	2.3	2.8	2.7	1.7	1.5
of which transfers	1.0	0.9	1.0	0.8	0.9	0.8
Total expenditure	21.2	22.0	23.4	22.1	16.9	17.7
Treasury current outlays	11.4	11.5	12.3	13.6	11.3	10.9
Public sector capital expenditure	9.8	10.4	11.2	8.5	5.6	6.8
Public sector deficit	-9.2	-9.2	-10.6	-7.9	-5.1	-7.1
Grants-in-aid	3.8	3.4	3.4	3.7	4.2	4.4
Overall public sector deficit (after grants-in-aid)	-5.3	-5.8	-7.1	- 4.1	-0.9	-2.6

During 1987, the government's ambitious economic reform program, exacerbated by growing contraband, began to have significant adverse effects on the government finances. As a result of tax and tariff reforms and parastatal price reductions described in Section III and Annex A, Treasury receipts declined some 5 percent and were about 8 percent below projected levels.

Customs and corporate income tax collections were particularly disappointing. Customs receipts are expected to be down about 20% (G 60 million) as compared with projections. Corporate tax revenues were also some G 15 million lower (20%) than projected.

Treasury current expenditures also declined during the year (by about 4 percent), but were in excess of previously planned targets by about 7 percent. Despite the reduction in current outlays, there was a significant expansion of public sector capital expenditures with a resulting increase in the overall deficit to 7.1 percent of GDP (before grants) and 2.6 percent of GDP after grants.

Of more concern, the current deficit is expected to be about twice as high (G200 million) as originally projected. These 1987 results, which also reflect some of the transitory effects of the recent civil disturbances, augurs poorly for 1988 which will reflect the full year fiscal impacts of the 1987 tax and tariff reforms. The projected fiscal situation is set forth in detail in Section IV A.1.

4. Balance of Payments

Haiti's long tradition of conservative fiscal policy has also applied to 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 FY 1981, there was significant expansion of credit to the public sector. Between FY 1981 and FY 1986 domestic credit expansion averaged about 15 percent per year. This credit expansion together with a recession-induced weakening of export earnings in 1981, were the basic causes of the balance of payments crisis that emerged in FY 1981 and resulted in a $57 million FY 1981 balance of payments deficit. Net international reserves of the banking system declined over $130 million between 1981 and 1986.

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

TABLE II.B.4
HAITI: SUMMARY OF BALANCE OF PAYMENTS
(in millions of U.S. Dollars)

Fiscal Year ending September	1981	1982	1983	1984	1985	1986	Est. 1987
CURRENT ACCOUNT	-174.7	-118.1	-151.7	-139.0	-130.8	-96.4	-130.7
Trade Balance	-215.1	-123.6	-139.6	-122.5	-116.7	-82.2	-115.8
Exports f.o.b.	158.2	195.3	195.1	229.5	217.2	216.2	199.2
Coffee	33.1	35.9	52.5	54.0	48.0	57.5	34.4
Light Assembly	79.6	98.9	100.4	124.7	126.9	130.1	130.2
Other	45.5	60.5	42.1	50.9	42.3	28.7	34.6
Imports c.i.f.	373.3	318.9	334.6	352.0	333.9	298.4	315.0
Services (net)	-24.4	-44.2	-54.6	-61.5	-62.2	-66.2	-71.1
Of which: Travel	43.8	39.5	33.3	28.0	25.1	19.6	19.0
Interest	-9.4	-13.4	-16.4	-18.3	-13.1	-15.1	-14.7
Other	0.0	0.0	0.0	-71.2	-74.2	-70.7	-75.4
Private transfers	64.8	49.7	42.5	45.0	48.1	52.0	56.2
CAPITAL ACCOUNT	118.2	96.5	133.9	118.6	116.5	125.2	159.9
Official Grants	66.1	69.2	69.3	78.2	87.3	106.7	121.8
Of which ESF	0.0	0.0	0.0	0.0	0.0	12.0	29.0
Official capital (net)	103.7	30.3	75.8	60.3	17.0	27.3	43.7
Multilateral and bilateral	43.4	39.1	65.7	67.8	45.0	29.3	52.8
Commercial	50.4	-8.7	10.6	-5.6	-25.2	-2.0	-9.1
Publicly guaranteed debt and other official capital	9.9	-0.1	-0.5	-1.9	-2.7	--	--
Monetary capital	-1.3	-8.1	-5.6	-8.1	-13.6	-7.1	-8.4
Private capital and errors and omissions	-50.3	5.1	-5.6	-11.8	- 1.4	-1.7	2.7
OVERALL BALANCE	-56.5	-21.6	-17.8	-20.4	-14.3	28.8	29.2
Changes in net international reserves (increase -)	56.5	21.6	17.8	20.4	14.3	-28.8	-29.2
Fund purchases (+) and repurchases (-)	13.8	28.9	25.8	21.8	-9.4	-17.4	-13.2
Other (net) (increase -)	22.2	-7.6	4.0	4.9	14.1	-13.8	-13.1
Arrears (decrease -)	20.5	0.3	-12.0	-6.3	9.6	2.4	-2.9

SOURCE: Bank of the Republic of Haiti and IMF.

financing. The overall balance of payments deficit was reduced to $21.6 million in 1982 and $17.8 million in 1982. The external arrearages were almost liquidated and a 10 to 15 percent discount on the value of the gourde that had emerged in 1981 was reduced to around 5 percent by the end of 1983.

Despite the progress achieved, however, Haiti's balance of payments and external debt position remained weak and needed to be strengthened through continued 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 and eliminated all export growth in FY1986. Imports, however, also fell-off, from $334 million in FY 1985 to $298 million in FY 1986. This decline coupled with a $30 million increase in grant disbursements, including $12 million in ESF and a $7.6 million increase in PL-480, prevented a further deterioration of the balance of payments and generated an overall balance of payments surplus of $29 million in FY 1986.

It had been anticipated that FY 1987 would see significant expansions in exports. However, civil and political unrest during the summer months and the fall-off in coffee exports frustrated the expectation for expansion and instead produced a $23 million decline in exports. The projected 8.5 percent growth of the assembly export sector has had to be revised down to a virtually zero growth rate for FY 1987. Coffee exports suffered from both a 17 percent decline in price and a 28 percent decline in volume exported.

The political uncertainty and civil unrest were also partially responsible for explaining the disappointing levels of foreign aid disbursements in FY 1987. As a result, the capital account is currently estimated to be only $160 million compared to the $190 million projected earlier by the GOH's economic reform program and the IMF. The revised estimate includes some $29 million in ESF actually disbursed in FY 1987.

The decline of exports and the limited expansion of foreign aid disbursements largely explain the modest expansion of imports, which only increased from $298 million in FY 1986 to an estimated $315 million in FY 1987. This import level contrasts sharpely with the $362 million FY 1987 imports the GOH Economic Reform Program and the IMF had previously forecasted, which had anticipated a robust growth of real GDP of 4.5 percent. The economic stagnation and the resulting low level of imports largely explain the balance of payments surplus of $29.2 million in FY 1987.

Consistent with the balance of payments surplus and the underlying economic stagnation in FY 1987, the paralled market discount on the dollar remained below ten percent up through June 1987. However, the political instability and civil unrest which ensued in July and August generated significant capital flight and increased the parallel rate to the 15-20 percent range in August and September 1987.

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 and FY 1987. Net foreign assets declined from $-2.0 million in September 1981 to $-92.9 million in September 1985 and then increased to $-73.6 million by September 1986 and an estimated $-48.8 million in September 1987. Even with this improvement, gross foreign assets as of September 1987 were only $36.0 million. This would cover only one month of imports, short of the usually recommended 2 months level. The Central Bank's liquid gross foreign assets (cash and dollar denominated demand deposits) are only $12 million as of September. These levels of international reserves are insufficient to cover normal fluctuations in the availability and needs for foreign exchange needed to finance foreign trade and debt servicing. The restoration of a satisfactory international reserve position is important to the continued maintenance of exchange rate stability. Given recent adjustments of the exchange rate in real terms (see following section), sound reserve policies should permit the GOH to continue to adhere to its objective of maintaining the fixed parity of the gourde to the dollar.

III. THE ECONOMIC REFORM PROGRAM

Since the transitional government took over in February 1986, a systematic economic reform program has been initiated with the support of the major multilateral and bilateral donors (principally USAID). The economic reform program is based on a set of measures designed to achieve financial stability, and another set of measures designed to increase the efficiency of the economy and enhance the prospects for growth.

The first priority of the new government was 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, the commercial 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 percent.

The transitional government committed itself to a reversal of these trends through fiscal and monetary restraint. It set as an objective the reduction of the overall deficit of the public sector (before grants) to 7% of GDP, compared to an average of near 10 percent in the period FY 1981-85. The deficit was to be more than offset by foreign grants, thus allowing the public sector to reduce its debt to the domestic banking system and to foreign commercial creditors.

Fiscal austerity has permitted the government to pursue a less expansionary monetary policy while providing a sufficient expansion of credit to the private sector. The government is also committed to a fixed exchange rate policy and recognizes that this requires a tight monetary policy. It believes that, in the transition to new democratic institutions, the maintenance of the fixed exchange rate provides a firm anchor for fiscal and monetary policy and that growth of the export oriented assembly industries requires a climate of confidence that is best engendered by the maintenance of the fixed parity.

The appreciation of the U.S. dollar against other major currencies and an inflation rate in Haiti that exceeded that of its trading partners resulted in a significant real appreciation of the gourde, measured in terms of relative price movements, between 1979 and 1985. However, the competitiveness of the assembly industries did not deteriorate to the same degree as wages continued to be largely market determined and fell in real terms. From the end of FY 1985 to April 1987, the gourde depreciated in real effective terms by about 26 percent. In addition, pressure for higher wages has been mitigated by the recent sharp reduction in the consumer price index, and the Government believes that the current competitiveness of the economy can be maintained without moving from the fixed parity.

While the first priority of the GOH has been to achieve financial stability, the government has also enacted a number of economic policy measures designed to increase economic efficiency and generate growth in real GDP. Policy changes have been made in three broad areas; a) government efficiency and accountability; b) tax reform; and c) trade and price policy.

A. Government Efficiency and Accountability

To date significant progress has been made to increase government efficiency and accountability. Financial and/or management audits of public owned enterprises financed from ESF local currency proceeds were initiated in January 1987. Audits have been completed for ENAOL (the edible oil plant), DARBONNE (the sugar mill), CIMENT D'HAITI (the cement plant), LOTERIE DE L'ETAT (the State lottery), OAVCT (the state vehicle insurance agency) AAN, (the Airport Authority), COMMISSION CONTROLE JEUX DE HASARD (office for control of games of chance) and the Ministry of Finance.

The Port Authority (APN), the State owned Bank (BNC), and TELECO (Telecommunication) were audited with funds provided by these state owned enterprises. BNDAI's (state owned agricultural and industrial bank) audit was completed with USAID project funding.

The audits found that an important number of enterprises were in weak financial situations with poor or non existent financial control systems and very weak accounting systems. With the assistance of auditing firms, actions were taken in order to develop improved accounting systems.

In most cases, the audits showed that "zombie" checks had been eliminated. In addition, as the audits were being completed, the Directors of three of the most important state owned enterprises (the Minoterie, Teleco and EDH) were dismissed.

The audits also uncovered areas of waste and inefficient operations. As a consequence, all new budgets presented to the Ministry of Finance for the FY 1988, have been carefully analyzed in order to avoid waste and improve efficiency.

The GOH contracted with an international audit firm in August 1987 to develop a plan to implement an ongoing program of audits, management reviews and improved financial accountability for all GOH institutions. The audit firm is carrying out a review of financial control systems currently implemented by the Cour Superieure des Comptes, the Ministry of Economy and

Finance and its unit for control of State owned enterprises, the major development Ministries (Health, Education, Agriculture, Public Works) and the newly created election commission (Conseil Electoral Provisoire, CEP). In addition, the study will review the audit reports on various agencies and state enterprises. In consultation with officials of the Cour Superieure des Comptes, the Ministry of Economy and Finance and USAID/Haiti, the consulting team has developed a comprehensive plan to increase financial management efficiency and accountability in the public sector.

Under the economic reform program, steps have also been taken to close inefficient state owned enterprises. Two of the most important and costly (for the Treasury) state owned enterprises, Darbonne and ENAOL, were closed in May 1986. The GOH assumed the debt of the two enterprises but has eliminated the annual subsidy that covered their losses.

A significant recent innovation with regard to improved state owned enterprises management is the creation in the Ministry of Finance of a unit in charge of their financial control. This unit is under the direct control of the Minister and addresses issues which could not be addressed under the previous regime. For instance, it supervised audits of 15 state owned enterprises. The unit is also gathering basic information on each state owned enterprise such as labor force composition, value of yearly sales, contribution to GDP, investment, etc. The unit is considering various alternatives that would improve the efficiency and management of the enterprises.

B. Tax Reform

Under the Duvaliers during the first half of the 1980's, the government introduced a number of new taxes basically designed to increase government revenue, without regard for economic efficiency or equity. Starting in 1986, the transitional government began a systematic tax reform program in order to improve collection performance and at the same time to create more efficiency in the overall tax system.

The most important step in the tax reform is the income tax legislation passed in October 1986. The tax base was enlarged significantly. Under the provisions of an amnesty program, a large number of professionals and small businesses who had previously been outside the income tax system were induced to comply. The number of tax rates were reduced from ten to four, and the maximum rate was reduced from 50 percent to 30 percent. Rates are the same for individuals and corporations. Additionally, numerous low yielding taxes, as well as earmarked taxes, were eliminated.

Another step of the tax reform program was the lowering of the coffee tax in September 1986. Consistent with Coffee Sector Assistance project and the FY 1987 agreement, the tax is expected to be completely eliminated in early fiscal 1988.. This is expected to increase coffee production and exports, to increase coffee farmer incomes, and have major environmental benefits on Haiti's deteriorating watersheds. The new government abolished all other export taxes on agricultural as well as on industrial products in August 1987. The government also eliminated the excise tax of $3 per 100 lbs. for popular sugar and reduced from $8 to $4 per 100 lbs. the excise tax on refined sugar.

A major effort to improve tax collections procedures was begun, on October 1, 1987, to be implemented in part through a system of cross-checks between income, sales, and customs receipts. At the request of the GOH, USAID has undertaken a thorough evaluation of problems with customs valuation procedures and the GOH has requested follow-up technical assistance to implement needed improvements in this area.

C. Trade and Price Policy

Trade policy reform has been a third area where the transition government has taken major steps to improve consumer welfare. Among its major accomplishments has been the elimination of import monopolies, allowing their exposure to competition from imports. The ENAOL monopoly on vegetable oils, the MINOTERIE monopoly on flour, and the CIMENT D'HAITI monopoly on cement, have all been eliminated. In June 1986 the GOH passed a law reducing the number of quotas from 111 to 35. Furthermore, in December 1986, the number of products subject to quotas was reduced to seven including rice, millet, corn, bean, sugar, poultry and pork parts. These products cannot be imported without first obtaining an import license from the Ministry of Commerce.

A new tariff code became effective in March 1987. The new code reduced tariffs levels with rates averaging 20 percent for finished products. Ad valorem tariffs informally replaced specific tariffs. Pharmaceutical products, industrial and agricultural inputs not produced locally are tariff exempt. However, the widely used cereals such as corn, rice, millet and sorghum became subject to an ad valorem tariff of 50 percent.

For the industries producing for the local market, temporary relief from the tariff law has been combined with an industrial restructuring program which will include approximately 75 industries that will be able to obtain subsidized loans through World Bank financing. The tariff exemptions will expire December 31, 1987, at which time they will be subject to the new tariff law.

Although the new tariff code is the cornerstone of Haiti's trade liberalization program, institutional problems and contraband have presented considerable implementation problems and previously unanticipated impacts. For example, Customs Valuation Service operations have little effectiveness and are subject to long delays. This impedes the rigorous application of the new tariff code.

In addition, contraband accounts currently for at least 20 percent of all imports into Haiti. The result has been considerably lower than anticipated customs revenue and a loss of the ten percent sales tax (TCA) which is not recovered from contraband sales.

Contraband has jeopardized the trade liberalization program and is also impeding the restructuring of industry. Some industries (such those producing pasta, detergents, tomato paste, shoes, biscuits) are suffering considerably from contraband and a number of firms have even closed down.

The problem of contraband is essentially political rather than technical and will be difficult to bring under control. It is also having some significant positive short-term effects. It has, for example, revived commercial activity in the provincial ports and border regions as well as created thousands of marketing jobs. In addition, contraband has also reduced substantially the cost of basic consumption items, especially food, and has improved the welfare of the urban consumer, especially the poor for who basic food commodities constitute a large proportion of household expenditure.

Annex A provides further details of the price and tax reduction accomplishments, during 1986 and 1987, under the Economic Reform Program. The following two sections describe continued policy implementation needs, and IMF/World Bank support of the reform program.

D. Continued Policy Implementation Needs

Despite the major accomplishments of the economic reform program, further improvements to properly implement the reforms must be made over the next several years in order to fully realize the beneficial impacts of the program.

1. Trade Liberalization

Over the next year, primary emphasis should be placed on successful termination of the transitional regime for industries affected by trade liberalization. The GOH is expected to abide by its previously announced intention to terminate exemptions for the 75 industries by the end of calendar 1987.

The beneficial effects of trade liberalization should also be carefully but expeditiously applied to the agricultural sector. This means that the government should move forward with a program to replace grain import licenses with tariffs and/or import threshold prices. Despite the difficulties of effecting these changes, a thorough study will be completed in 1988 with the assistance of the World Bank that will lay the basis for implementation.

2. Fiscal Stabilization and Government Revenues

De facto trade liberalization through contraband is jeopardizing the overall program of fiscal stabilization program through lost customs and internal tax revenues. The reform program which has made considerable progress in effecting beneficial tax and price reductions (including those affecting parastatal transfers) also has had the effect of sharply reducing Tresury revenues. To address the revenue problem will require some combination of more adequate enforcement and/or revenue enhancement measures. In order that the new government does not inherit a situation that will require excessive central bank financing of the deficit and emergency revenue measures that would reverse the efficiency-based tax reforms of the last two years, it is imperative that the government begin to properly implement actions for which the basis has been laid through donor supported efforts in customs and tax administration. For example, a recently sponsored USAID study of Customs valuation procedures could provide the basis for further customs service enforcement improvements. The Minister of Finance has subsequently requested that USAID provide the needed technical assistance for the effort.

Careful attention should be given to revenue enhancement measures. These would include, for example, extending coverage of the value added tax by removing many exemptions (e.g. such as those applied to beverages) and by lowering the threshold turnover level at which companies become liable for the tax.

3. Government Efficiency and Accountability

The ultimate success of the reform program will also hinge on actions to improve the performance (including divestiture) of State owned enterprises, the efficiency of public investment, and in overhauling public agencies (through appropriate governmental staffing reforms). Of particular importance to the overall reform program over the next one to three years will be:

a. State enterprise reforms, including:

-continued efficiency improvements in several of the largest enterprises (e.g. the Minoterie and Ciment d'Haiti) to reduce unit costs.

-the replacement of the state owned agricultural and development bank (BNDAI) and the agricultural development bank (BCA) with a new agricultural development bank.

-Gradually eliminating public enterprise arrearages to the Treasury while ensuring that all public enterprises operate in a fully competitive environment, subject to taxation.

b. Public sector efficiency:

The GOH needs to continue with institutional changes that will permit the efficient preparation of the public investment budget. These institutional changes are essential to ensure adequate support for expansion of the productive sectors, particularly for increased agricultural production and for export, and for ensuring adequate and efficient public investment in the social sectors.

Finally, an essential element of medium-term reform is responsible action on government staffing and the wage bill. Starting with a thorough program of audits in the central ministries and a World Bank study of government staffing reforms, the basis can be laid for the new government to reduce governmental operating expenditures over the next several years.

E. IMF and World Bank Support of Reform Program

The IMF and World Bank have supported the GOH's reform efforts with a Structural Adjustment Facility (SAF) and an Economic Recovery Credit (ERC). The first $11 million tranche of the SAF was disbursed in December 1986 and the second tranche of $17 million had been tentatively scheduled for December 1987. The first $20 million tranche of the ERC was disbursed in early Spring 1987 and the second tranche of $21 million had been scheduled for release in October 1987. However, both the IMF and the World Bank Missions which visited Haiti in September 1987, raised serious questions about policy reform implementation shortfalls and the future timing of the second tranches of the SAF and ERC. The primary focus of concern was the proposed fiscal program of the GOH. The problem of a projected shortfall in revenues due to both tax and customs rate reductions and a continued contraband problem is compounded by expansion in budgeted current expenditures. The budgeted deficit, unless it can be largely financed by foreign assistance, is inconsistent with financial stabilization and hence release of the second tranche of the SAF and ERC. While budget cutting will be extremely difficult to do, it is expected that through a combination of cuts in both current and development expenditures and increased donor support, the GOH will be able to come acceptably close to closing the fiscal gap. Assuming this is soon resolved, the SAF should be released in December, 1987.

The World Bank has expressed further concern about limited progress with a number of other policy reforms, including cost reductions at the state owned flour mill and cement plant and closure of the state industrial and agricultural development bank (BNDAI). There remain some differences with the government concerning the appropriate scope of these reforms and the tactics of implementation. It is anticipated, however, that these remaining issues will be resolved by the Ministry of Finance and the World Bank in the near future and that the ERC will be disbursed within the next six months.

IV. MACROECONOMIC IMPLICATIONS

During FY 1986 and 1987, the economic reform program was formulated and implemented within a framework of fiscal and monetary parameters which were largely consistent with financial stability. The reform programs overall objectives were to generate a GDP growth rate of at least equal to 4 1/2 percent a year while reducing inflation to the level of Haiti's main trading partners and achieving an annual overall balance of payments surplus equivalent to at least 1 percent of GDP over the next three years. This section describes the fiscal, monetary and balance of payments implications of the FY 1988 program and quantifies the levels of balance of payments and budget support assistance which will continue to be required in FY 1988. The revised program objectives remain the same, except that the growth target has had to be reduced to 2.5 percent for FY 1988 in light of fairly optimistic but realistic expectations for FY 1988 that have been tempered by the disruptions that occured in 1987.

A. Fiscal Implications

Projections of the operations of both the consolidated public sector and Treasury are presented in Table IV.A.1. Since the FY 1988 budget has not been finalized, these projections are very tentative. For the public sector, which includes parastatal operations and donor funded projects, total expenditures are projected to increase some $29 million in FY 1987, with almost two thirds going to a capital expenditure increase. In spite of these increases, total public sector expenditures remain below both the FY 1985 level and the FY 1987 program level.

Total receipts of the public sector, including Treasury revenue and public enterprise operating surpluses, are only projected to increase $5 million in FY 1988, from $237 million in FY 1987 to $242 million in FY 1988. Revenue growth will be constrained by the loss of the flour mill transfers to the Treasury, the limited growth of GDP, contraband, and weak administrative structures within tax and customs administration. The resulting deficit before grants is projected to increase from $148 million in FY 1987 to $172 million in FY 1988. Grants, including FY 1987 and 1988 ESF, are projected to increase from $99 million in FY 1987 to $117 million in FY 1988. The deficit after grants, which increases from $49 million in FY 1987 to $55 million in FY 1988, will largely be financed by concessionary financing. However, some $6 million is projected to be covered by Central Bank financing.

Table IV.A.1.
Public Sector Operations
(In dollar millions)

A. Consolidated Budget	1985	1986	Prog. 1987	Est. 1987	Proj. 1988
Total receipts	277.0	265.0	258.0	237.0	242.0
Expenditures	428.4	378.4	421.6	385.0	414.0
of which capital	164.7	125.2	190.6	161.2	180.0
Deficit (before grants)	-151.4	-113.4	-163.6	-148.0	-172.0
Grants	89.0	94.0	96.0	99.4	117.0
Deficit (after grants)	-62.4	-19.4	-67.6	-49.4	-55.0
B. Treasury Operations					
Treasury Receipts	239.4	258.9	266.0	245.0	250.0
Tax Revenue	224.8	225.8	218.0	204.1	210.0
Transfers from Public Enterprises	14.6	20.8	20.0	17.7	10.0
Cash grants	-	12.0	28.0	23.2	30.0
Treasury expenditures	295.8	272.8	258.0	267.4	280.0
Current expenditures	260.4	263.2	238.0	252.2	262.0
Development budget	25.4	8.4	20.0	15.2	18.0
Treasury deficit (surplus)	- 46.6	- 13.9	8.0	- 22.4	-30.0

A clearer picture of the projected fiscal situation is provided by the Treasury accounts. For Treasury operations, FY 1987 will result in a significantly higher Treasury deficit than anticipated, as compared with an $8 million surplus originally planned. Treasury receipts are expected to be some $21 million below target. This is the result of higher than anticipated revenue shortfalls, mainly from income and tax and price reductions, contraband, reduced transfers from public enterprises, as well as slower than anticipated disbursements of cash grants.

In addition, Treasury expenditures, which had declined significantly in FY 1986 and were scheduled to be reduced further in FY 1987, will show an expected increase (over program levels) of more than $9 million.

Although the budget outlook for FY 1988 is subject to a good deal of uncertainty, initial projections show some further weakening of Treasury receipts and increased expenditures. Within constraints to be agreed upon by the IMF and the GOH, that will require further expenditure reductions and revenue enhancements, there is a clear need for increased levels of budget support.

Initial IMF projections show a level of budget support consistent with the $10 million programmed for FY 1987 ESF to be disbursed in FY 1988 plus $20 million FY 1988 ESF budget support. This leaves an additional $30 million budget deficit for 1988. It is assumed that a portion of this shortfall will require additional ESF budget support or appropriate reprogramming of the World Bank's Economic Recovery Credit.

B. Monetary and Price Impacts

The proposed macroeconomic reform program would maintain monetary restraint and limit domestic inflation to 4.5 percent. The program provides for a $6 million or 1.3 percent increase of Central Bank credit to the public sector. Credit expansion to the private sector by the National Credit Bank (BNC) is limited to $ 4 million, or 7 percent. Net domestic assets of the monetary authorities are targeted to remain constant. The projected increase in net foreign assets of $18.7 million and the increase of net domestic assets are consistent with a 7.0 percent increase in the money supply (M2). This coupled with a projected 2.5 percent increase in real GDP implies that inflation will be limited to around 4.5 percent in FY 1987, the projected rate of Haiti's main trading partners.

C. Balance of Payments in FY 1988

The economic reform program objective of an overall balance of payments surplus of equivalent to almost 1.0 percent of GDP in FY 1988 anticipates significant increases in exports, imports, official grants, and concessionary loans, including an IMF Structural Adjustment Facility (SAF) disbursement of $17.1 million and a World Bank Economic Recovery Credit (ERC) disbursement of $21 million (see Table IV.C.1). The remaining ex ante unfinanced balance of payments gap of $46.0 million is proposed to be partially financed by FY 1988 ESF of $40 million.

Exports are projected to recover from the previous three years of decline, increasing from $199 million in FY 1987 to $219 million in FY 1988. This expansion is based upon the optimistic expectation that the light assembly sector will recover from the stagnation in FY 1987 and grow by almost 8 percent in FY 1988. Coffee export volume is projected to increase by about 10 percent to 220,000 bags of 60 kilos. This increase will add to a projected moderate increase in coffee prices and cause the value of coffee exports to increase by 20 percent to $41 million in FY 1988. Tourism is not anticipated to increase given the expectations for periods of political uncertainty and civil unrest during FY 1988. In spite of this projected growth of foreign exchange earnings, the current account balance is expected to deteriorate as a result of a 22 percent increase in imports in FY 1988 over the very depressed level of FY 1986 and FY 1987 imports. This increase of imports is required to meet the revised macroeconomic reform program GDP growth target of 2.5 percent.

The capital account, which includes the second tranches of the FY 1987 ESF, SAF, and ERC, will not increase over the FY 1987 level and is projected to be $157 million in FY 1988. Capital flight is assumed to be eliminated in FY 1988. The resulting overall balance of payment deficit is $22 million.

The macroeconomic reform program objective of an increase in net international reserves equivalent to approximately 1.0 percent 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 $25 million increase of net international reserves includes net Fund repurchases of $23 million and the elimination of over $11.5 million in arrears.

TABLE IV.C.1
HAITI: SUMMARY OF BALANCE OF PAYMENTS, FY 1986-1988
(in millions of U.S. Dollars)

	FISCAL YEARS ENDED SEPTEMBER 30		
	rev. 1986	est. 1987	proj. 1988
CURRENT ACCOUNT	- 96.4	-130.7	-178.7
Trade Balance	- 82.2	-115.8	-166.2
Exports (f.o.b.)	216.2	199.2	219.1
Manufactures	130.1	130.2	140.6
Coffee	57.5	34.4	41.2
Other	28.7	34.6	37.3
Imports (c.i.f.)	298.4	315.0	385.2
Services (net)	- 66.2	- 71.1	- 72.5
Tourism	19.6	19.0	19.0
Interest	- 15.1	- 14.7	- 12.0
of which: Fund	- 6.2	- 4.9	- 4.1
Other	- 70.7	- 75.4	- 79.5
Private transfers	52.0	56.2	60.0
CAPITAL ACCOUNT	125.2	159.9	157.1
Official grants	106.7	121.8	92.6
Of Which: ESF	6.0	29.0	10.0
Official capital (net)	27.3	43.7	64.8
Multilateral and bilateral	29.3	52.8	58.5
Commercial	- 2.0	- 9.1	6.3
Monetary capital	- 7.1	- 8.4	--
Private capital and errors and ommisions	- 1.7	2.7	--
OVERALL BALANCE	28.8	29.2	- 21.7
OVERALL BALANCE TARGET	--	--	24.7
Changes in net reserves	- 28.8	- 29.2	- 24.7
Fund	- 17.4	- 13.2	- 6.4
Other	- 13.8	- 13.1	- 6.8
Arrears	2.4	- 2.9	- 11.5
UNFINANCED GAP			- 46.0
Proposed FY 1987 ESF financing			40.0
Unfinanced			6.0

Source: Bank of the Republic of Haiti, IMF, and USAID

The resulting unfinanced balance of payments gap is $46 million.[1] This assumes other donor balance of payments financing, including a late 1987 $17 million second tranche of the IMF SAF and $21 million second tranche of the World Bank's ERC. It is proposed that most of the remaining balance of payments gap be financed by $40 million FY 1988 ESF.

This level of ESF is necessary to jointly attain the macroeconomic reform program revised objectives of GDP growth of 2.5 percent[1] and the rebuilding of international reserves equivalent to 1 percent of GDP. This minimal level of 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 and a continuation of the economic reform program by the new government. 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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[1]The balance of payments gap of $46 million is consistent with a revised FY 1988 GDP growth target of 2.5 percent, rather than the original economic reform target of 4.5 percent. If the higher growth target were used to generate required level of imports and BOP financing, the unfinanced gap would increase to approximately $70 million.

D. Performance Targets

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

	Oct-Dec 87	Oct-March 88	Oct-June 88	Oct-Sept 88
Treasury Revenues*	55	110	165	220
Treasury Expenditures*	70	140	210	280

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 dollars):

	Dec 87	March 88	June 88	Sept 88
Net domestic assets	300	300	300	300
Credit to public sector*	400	402	404	406
Credit to private sector	60	61	63	64

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) Compliance with monetary and fiscal targets;

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

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*Preliminary only, to be revised in consultation with IMF staff.

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 reduction of the coffee export tax to 10 percent in September 1986 and its total elimination before October 1987.

The FY 1987 ESF program (Economic Recovery Assistance, ERA II) was signed in January 1987. Total funding was $27 million. The first tranche of $20 million was disbursed in February 1987 based on compliance with the following conditions precedent:

a) Compliance with the monetary and fiscal quarterly targets previously set in consultation with the IMF, World Bank and AID;

b) substantial reduetion of quantitative restrictions on imports.

The conditionality for three million of the second tranche was waived in September to provide urgently needed budget support for the elections. The grant agreement was subsequently amended in September 1987 to add $6 million which increased the FY 1987 ESF grant to $33 million. USAID disbursement of the remainder of the second tranche of the FY 1987 ESF was conditioned upon GOH satisfactory performance of the following conditions precedent: compliance with fiscal and monetary targets, removal of all export taxes (including the coffee tax), initiation of management/financial audits, and completion of an audit and financial accountability plan. It is anticipated that all conditions except the fiscal and monetary targets will be fully satisfied.

The GOH was in substantial compliance with the quarterly fiscal and monetary targets up through June 1987. However, revenue shortfalls are anticipated to be significant in the fourth quarter ending September 1987 (approximately 6 percent short of target). This is largely explained by revenue shortfalls associated with customs, flour mill transfers to the Treasury, and the new corporate income tax, all of which have been adversely affected by contraband, consumer price declines, and economic stagnation, factors largely outside the GOH's control.

Expenditure controls have been significantly improved by the Minister of Finance but there has been some slippage (estimated to be 3 percent over the budget target) largely as a result of the civil disturbances this summer and preparations for the elections.

The resulting fiscal deficit has adversely affected monetary targets including credit to the public sector and the reduction of arrears. However, the GOH did meet the September, 1987 target for net domestic assets.

Overall, USAID believes that substantial efforts on the part of the GOH to attain the monetary and fiscal targets have been made and that factors largely out of the Ministry of Finance's control are responsible for the shortfalls. The joint IMF-World Bank Mission to Haiti share in this overall assessment and are currently assisting the GOH in the development of FY 1987-88 financial stabilization program on the assumption that the second tranche of the ESF will be disbursed in October. USAID therefore recommended that the fiscal and monetary condition be waived for disbursement of the second tranche of FY 1987 ESF so that the funds could be disbursed in October. AA/LAC approved this request in September and the PAAD was amended.

B. The Proposed ESF Program

1. Rationale

Haiti is undergoing a delicate transition to 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 and the elected governments is crucial to enable an improvement in the rate of economic growth and the provision of services to the population while effecting the transition to an elected government, as well as continued implementation of the major economic reform program. Without significantly expanded assistance from the international donors, Haiti is unlikely to be able to meet these objectives during this critical period. The economic program of the transition government aims to continue 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 have resulted in a reduction of government revenues. 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 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. This will be especially difficult this fiscal year with the revenue shortfalls and the growing demands for improved economic and social conditions. 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 ESF from the USG are required to finance the public sector and balance of payments gaps.

2. Policy Dialogue and Conditionality

The Mission's negotiating strategy will aim at a combination of conditionality and continuing policy dialogue, both with the transitional and the newly elected government, to maintain the direction of the economic reform program and to strengthen its implementation. The Mission believes that given the political uncertainties and difficulties of making a successful transition to a functioning democratic government and the associated pressure put on financial stabilization and the economic reform program, this is not the time to be calling for a myriad of new policy reforms. Rather it is a time for reinforcement of continued and improved implementation of policy initiatives developed by the transitional government. It will also be a time to articulate the long-run benefits of the reform program to the new government's leadership so as to minimize pressures to retrogress toward the inappropriate policies of the past. The proposed ESF tranching would provide minimal foreign exchange and local currency to the transitional government so that it can meet its obligations, including IMF repayments required to obtain the SAF, thereby helping to ensure an economic climate conducive to a succesful transition. However, the bulk of the ESF funds would be disbursed after the new government takes over to provide immediate and tangible rewards for continued compliance with the overall reform program. The Mission believes it is essential that the grant agreement be signed by the transitional government that developed and fully understands the reform program. The new government probably would not be in a position to negotiate an agreement until late in the fiscal year and after it had already fallen out of compliance with the economic reform program. It would be much easier for the new government to deal with the economic reform program if an agreed to policy package was left by the transitional government.

For the first tranche of no more than $10 million during the first quarter of FY 1988, two conditions precedent will be required. First, the GOH will have developed in consultation with the World Bank, IMF, and USAID FY 1988 fiscal and monetary quarterly targets which are consistent with continued financial stabilization. (Compliance with this condition is also required by the IMF to release the $17 million second tranche of the SAF). The second condition precedent to the disbursement will require the GOH to provide evidence that it has developed and approved a detailed implementation schedule for the comprehensive audit and financial accountability improvement program. Following development of a comprehensive audit plan as a condition of the second disbursement of the FY 1987 ESF agreement, the GOH will be required to develop and approve an implementation schedule. The schedule will provide detailed implementation plans for audits and financial management reviews and organizational and procedural reforms as well as needed training, budgeting and staffing reforms on an agency specific basis. The implementation schedule will not only describe the steps necessary for the GOH to improve the institutional capability to carry out effective audits and financial accountability reforms, but also provide for an agreed upon time schedule.

The second tranche of $15 million should be disbursed in April 1988 after the elected government has taken power and after fiscal and monetary data for the second quarter of FY 1988 become available. The proposed conditions precedent to that second disbursement are:

a) Continued compliance with the quarterly fiscal and monetary targets.

b) Evidence that all temporary exemptions to the tariff code have been removed. These exemption were originally scheduled for removal by the end of 1987, but there is growing pressure to extend them.

The third tranche of $15 million should be disbursed in July 1988 after fiscal and monetary data for the third quarter become available. This level could be modified if USAID determined that it would be advisable to disburse part of this amount later in the fiscal year. The proposed conditions to disbursement are:

a) Continued compliance with the quarterly fiscal and monetary targets.

b) Evidence that the GOH has been taking appropriate revenue enforcement and enhancement measures to respond to revenue shortfalls, including full cooperation with and support of donor supported technical assistance in customs and tax administration; review of tax policy reforms; and study of agricultural tariffs to determine an appropriate level of tariffs that would be enforceable, generate needed revenue and protect farmers without increasing food prices paid by low income consumers.

c) Evidence that the GOH is in 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 1988, and shall consult with the IMF, World Bank, and USAID on its progress in meeting those targets. With respect to FY 1989, the GOH will develop a FY 1989 public sector budget and monetary program which are compatible with financial stabilization in consultation with the IMF, World Bank, and USAID. The budget should explicitly address: 1) reforms to enhance revenue collections, including customs and tax administration; tax policy; and agricultural tariffs; and 2) reforms to increase governmental efficiency, including audits and financial accountability improvements, the avoidance of any Treasury financial support of state owned enterprises, and governmental staffing reforms proposed by the World Bank study to be conducted in early FY 1988. The GOH will also agree to provide monetary and fiscal performance data to USAID for fiscal years 1988 and 1989 on a monthly basis.

b) 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 on-going efforts to carry out financial management and internal control reviews of state owned enterprises, and improve financial management and control of Ministries. The government will develop and implement a detailed schedule of audits and management reviews and the improvement of financial control reforms of the Ministries. The Government will also develop the institutional capability to perform financial and management audits of the Ministries. The financial control reforms including audits and management reviews of state owned enterprises will continue and will be strengthened by the Ministry of Finance with implementation of reforms to lower costs and increase efficiency implemented. No Treasury subsidies, loans, or credit guarantees or tax or customs exemptions will be provided to the state owned enterprises. The possibilities for privatization of the state owned enterprises will be reviewed.

c) Revenue Enhancement

The GOH agrees to study and implement a program of revenue enforcement and enhancement that will include cooperation with technical assistance provided in customs and tax adminstration, tax policy reform, and agricultural tariff reforms. The GOH will only pursue revenue reforms that enhance economic efficiency and equity.

d) 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 eliminate all temporary exemptions to the tariff code, will study the elimination of the remaining quantitative restrictions and the types and levels of tariffs with which they could be replaced, and inform USAID on the results of the study and progress in implementing the study's recommendations.

3. Uses of Dollars

Haiti has a relatively liberal foreign exchange system. The GOH directly provides only limited amounts of foreign exchange to the private sector (other than for petroleum imports) and uses most of its foreign exchange holdings to pay external debt, government and parastatal imports and petroleum. While the maintenance of this relatively free market is highly desirable, it makes Haiti different from most other LAC cash transfer recipients and limits the potential uses of cash transfer dollars.

The estimated foreign exchange budget for FY 1988 projects total foreign exchange uses of $185.8 million, of which $70.0 million is for payment of debt, $62.3 million for public sector imports and $53.8 million for petroleum imports. Given this budget, it would be difficult to follow the guidance on the use of cash transfer dollar provided in State 108466. Foreign exchange is not allocated by the Central Bank to the private sector for private sector imports of essential goods and services from the U.S. and foreign exchange is not auctionned, so these uses are not feasible. Some of the dollars will be used for public sector imports, particularly raw materials for parastatals. Many public sector imports are not appropriate for ESF funding, however, and raise accountability problems. Petroleum imports (currently sourced in Curacao, a code 935 country, with origin in code 941 countries) used a major portion of the ERA I and II dollars and will be utilized for ERA III to the greatest extent possible. A large portion of the ERA III dollars will also be used for this purpose. The size of projected total oil imports (minus petroleum used for military purposes) and likely discrepancies between cash flow requirements for oil and ESF disbursement, however, would make it difficult to utilize all the cash transfer for petroleum imports. The Mission believes that some portion of the cash transfer will, therefore, have to be used for public sector debt repayment. Following the LAC guidance the debts will generally be U.S. (Eximbank and Title I) and multilateral development bank (IDB and IBRD).

It is important to note that using the cash transfer for public sector debt indirectly provides foreign exchange for the private sector to import from the U.S. The provision of foreign exchange to the Central Bank by the U.S. and other donors enables the GOH to maintain its relatively free foreign exchange system and not have to obtain additional foreign exchange from the private sector to meet its debt obligations.

It might be possible for the Mission to concoct some arrangements under which dollars flowed from the specific account to the private sector for U.S. imports. We believe, however, that this would be a sub-optimal use of foreign exchange reserves and would raise extremely difficult accountability and audit problems for the Mission.

4. Dollar Disbursement Procedures

The dollars for each tranche will be disbursed upon satisfaction of the pertinent conditions precedent via electronic fund transfer to the Federal Reserve Bank of New-York. The funds will be placed in the separate account in the Federal Reserve established for Economic Recovery Assistance II. The dollars will not be commingled with other GOH funds and will be utilized for the uses discussed above, which will be specified in the Grant Agreements. The GOH will report to the Mission on the uses of these funds in quarterly reports and documentation on there uses will be available for examination by AID.

5. Local Currency Uses

a. Special Account

The Central Bank of Haiti will deposit the gourde equivalent of the grant disbursement into the special account established for previous ERA local currency 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 $2.0 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 support of the current budget. This will be attributed to operating expenditures of the development ministries (Agriculture, Health, Education and Public Works).

iii) Development Budget Support. In order to further help bridge the fiscal deficit as well as permit funding of worthwhile development projects, up to the equivalent of $10.0 million will be utilized for mutually agreed upon projects in the Development Budget, including counterpart to other donor projects. The exact amount of funding available for this category will depend upon the composition of the development budget and the identification of activities appropriate for ESF local currency funding.

iv) Project Activities. The equivalent of at least $8.0 million will be used for mutually agreed upon project activities. Priority will be given to labor intensive public works projects, local currency costs of Mission infrastructure projects and credit institutions.

The following activities are currently under consideration for local currency funding:

(1) Continuation of Urban Infrastructure Rehabilitation.

(2) Continuation of support to the Haitian Development Foundation.

(3) Continuation of support to the Secondary Roads Development Project.

(4) Support to the Community Water Systems Project.

(5) Continuation of support to administration of justice activities

(6) Support to basic education and literacy programs.

(7) Continuation of support to GOH audits and management reviews.

(8) Continuation of support to private voluntary organizations.

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. 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. This initial programming will be negotiated with the Ministry of Finance and reflected in the Grant Agreement budget. Modifications with this programming are developed internally as described above, discussed with the Ministry of Finance and formalized in a countersigned project implementation letter (PIL). When specific activities listed in the budget are ready to begin implementation, a PIL is transmitted to the Ministry of Finance for countersignature which records USAID/Haiti - GOH approval of the activity, describes the project, earmarks funds and provides implementation instructions.

d. Disbursement and Monitoring of Local Currency Expenditures

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 $2 million to the Trust Fund account 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. Disbursement of local currency operational 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 in its quarterly reports. The Ministry of Finance will be directly accountable for the audits and other administrative reform activities which it carries out and will report to AID on these. Disbursements to and monitoring of local currency funded projects, including activities in the development budget will be carried out by the PL 480 Title III Management Office, a GOH entity in the Commissariat of National Promotion and Public Administration, following the procedures successfully utilized in the Title III program, the Title II Emergency Program and Economic Recovery Assistance I and II. The Title III Management Office will be fully accountable for the uses of these funds and will ensure that proper disbursement procedures are followed and that end use checks are performed.

Mission monitoring of ESF local currency is coordinated by the project manager, a project development officer in the DRE Office assisted by a senior FSN recently recruited to work in ESF local currency management. Individual technical officers are responsible for monitoring activities which fall in their technical expertise. The ESF Local Currency Implementation Sub-Committee meets frequently to monitor and review progress of the program and reports to and advises the local Currency Policy and Coordination Committee, which is responsible for programming and monitoring all Mission local currency.

In exceptional cases, where particularly close mission monitoring and control are essential for the successful implementation of the project, certain ESF local currency projects are managed and accounted for directly by the Mission. These are usually cases where local currency is essentially substituting for DA funds in on-going Mission projects or where there are particularly sensitive political considerations. These cases are individually negotiated with the Ministry of Finance which mutually agrees that direct USAID management is the most appropriate implementation mechanism for the project in question. This agreement is formalized in the countersigned PIL approving the project. The local currency for that project is then transferred to a trust fund and treated as if it were DA dollars, with full Mission accountability and application of AID rules and procedures. Because of the added burden on the Mission in establishing trust funds, documentation, contracting, monitoring, voucher approval, and disbursing which this mechanism entails, it is approved only where special needs of the project justify this additional burden. Thus far, it has been approved only in two cases.

The Mission anticipates that the only non-operating expense trust fund will be for the Haitian Development Foundation (HDF). This will continue the arrangements initiated in FY 1987 for supporting the HDF from ERA II local currency. In this case, the Mission has had to maintain very close control and tight management over the organization. This policy has been remarkedly successful in turning the HDF around over the last three years. The Mission believes, however, that this level of management control must continue for the next two years even though funds for lending capital and operating costs now exclusively come from ESF local currency. It would be much more difficult to exercise this control if funds were administered by the Title III Office rather than USAID. The Mission, therefore, recommends continuing the current arrangement where the Ministry of Finance transfers local currency.to a Misssion trust fund for disbursement directly to the HDF.

ANNEX A: SUMMARY OF FY 1986 AND 1987 TAX AND PRICE REFORMS

I. INTRODUCTION

In February 1986 the National Council of Government headed by Henry 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, a new harmonized tariff 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, 1986 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, 1986 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 did not affect GOH revenues. The first price reduction of February 27, 1986, 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 1986 offset the projected loss. In fact, in August and September 1987, the variable tax generated over $1 million in Treasury revenue. The variable tax was recommended by a USAID financed petroleum advisor and 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, company margins and pump prices.

Effective August 8, 1987, the pump price of gasoline was increased from $1.91 to $2.05 per gallon. The $0.14 (7.32 percent) increase reflects only a part of much higher cost increases of petroleum products on the world market during the last nine months. The CIF price of gasoline went from 47.34 cents/gallon in April to 64.73 cents/gallon in August 87. A full pass-through would have translated into a 37% increase in pump prices. The difference between price increases on the world market and increases in domestic pump prices (approximately 30%) has been absorbed by (a) Treasury (which loses the proceeds of the variable tax) and (b) the companies which reduced their margins by 3 cents per gallon (21 cents instead of 24).

Two weeks later, under tremendous pressure by truckers, the price of gasoline was reduced to $1.99 a gallon. On September 10, 1987, the pump price of gasoline was further decreased by 4 cents a gallon to $1.95.

With the newly introduced tariff system in March 19, 1987, a new tax structure for gasoline (and petroleum products) has been established: a new ad valorem custom duty of 57.8 percent of the C.I.F. value of the product is collected by Customs. The other component of the tax is an excise tax of 69 cents per gallon for gasoline and gasoil and 50 cents per gallon for kerosene. The variable tax, which was equal to zero for many months, has been abolished.

The new taxation system for gasoline will have a net favorable effect on GOH revenues as compared with the old system. The latter was composed of an excise tax of $1.05 per gallon and a variable tax (which was equal to zero) under prevailing CIF prices. The new system is expected to generate higher revenue in a market of rising world prices and also compensate, in part, for the demise of the variable tax.

With the new petroleum tax sytem, the Petroleum Bureau, the Department of Commerce and the petroleum importing companies have also agreed that from now on pump prices will fluctuate on a monthly basis. The fluctuations of pump prices will reflect the fluctuations of the petroleum prices on the world market. However, pump prices will change only if price changes represent more than 2 cents per gallon.

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 in February 1986. The ex-factory price of a 100 lb. sack was reduced to $22.61. Of the $3 reduction per sack, $1.23 represented taxes; $0.93 had been deposited in non-treasury accounts and had not been 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 results in a loss of approximately $0.75 million for the GOH. This loss to the Treasury and the reduction in price supported directly by the flour mill ($1.77 per sack or $4.4 million per year) was expected to be offset by the reduced mill operating cost.

An audit of the Minoterie financed by USAID identified a number of management reforms. Consequently, the administrative structure of the Minoterie was changed by decree on October 9, 1986. The new structure brought 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 addition, the audit identified a number of cost saving management reforms, including staffing reductions, which have in part been implemented.

Notwithstanding the changes, the situation of the Minoterie has deteriorated as a result of contraband. Monthly sales which were averaging 200,000 sacks of 100 lbs. a month went down to 181,000 in March and 172,000 sacks in April. In the following three months, the situation deteriorated further. By June they had declined to 90,000 sacks. The government reacted slowly and followed USAID technical consultants recommendations to lower the price of flour. This was done in August 87. In August the ex-factory price of flour was reduced from $22.61 to $18.00 per sack, close to the price of the smuggled flour. During August, the price reduction generated increased sales of 110.000 sacks. Sales are projected to reach 160.000 sacks in September. This amount will allow the Minoterie to cover its costs, even though it will no longer be able to make transfers to the Treasury. These transfers had, in fact, reached $0.95 million monthly, but were not made after May 1987. The loss incurred by the Treasury for the rest of the fiscal year will then be $3.8 million.

C. Edible Oil and Iron

In March, 1986, the Ministry of Finance and the Ministry of Commerce announced the end of the monopolies on edible oil and iron. A few months later, ENAOL, the state owned enterprise 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 and have declined by some 35 percent as a result of the increase competition. Refiners may now import refined and unrefined oil without a license from the Ministry of Commerce. A new tax structure for edible oil was established in April 1986 and reconfirmed by the

42

new tariff system in March 1987. Customs duties are 20 percent ad valorem. In addition, there is a 2 percent consular fee. It is anticipated that the tax structure for edible oil will generate at least $1.5 million in customs duties per year. Tax revenue PL 480 oil imports is transferred to the PL 480 local currency account rather than the Treasury.

The GOH is saving a substantial amount with the closure of ENAOL since the firm was operating with considerable deficits. Total losses after depreciation and financial charges reached almost $6.5 million in the period 1981-1985 and had to be covered by the GOH budget. In May 1987, the GOH leased the plant to a private cooperative (COPAIOL).

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 structure was decreed for iron bars produced by the Acierie: 2 percent on imported raw materials and 10 percent value-added tax. The value-added tax generates approximately $0.7 million per year. Importers of iron bars pay a 35 percent tariff in addition to the value-added tax.

D. Sugar

The GOH abolished the $3 (on 100 lbs. sacks) excise tax on raw (popular) sugar and reduced by $4 (from $8 to $4) the excise tax on refined sugar in August 1987. In addition, the Department of Commerce abolished price control on both raw (popular) and refined sugar in September 1987.

Prices of sugar have decreased considerably under the pressure of contraband and reached $17 per 100 lbs. bag for raw sugar, $7 less than the official price of $24. This forced HASCO, a private sugar mill, to close until September 21, 1987. In order to allow HASCO to resume its activities, the Ministry of Finance and the Ministry of Commerce decided that the GOH would provide HASCO with an in kind subsidy of some $2 million worth of sugar which the GOH had previously imported but had been unable to sell on the local market. HASCO will sell its raw sugar at $17 the 100 lbs. sack and compete with contraband sugar.

III. NEW TAXATION SYSTEM

A. Imports

In June 1986, a first step towards liberalization was taken and the list of products subject to quotas was reduced from 111 to 35. Furthermore, in December 1986, the number of products to be imported by license was reduced to seven (7). The new tariff code entered into force in March 1987. Under the new system, rates are ad valorem and generally vary between 0 percent and 40 percent, whereas the old system had rates higher than 100 percent. The new system was expected to bring domestic prices closer to world prices and to generate higher tax revenues. When the new tarif code was being prepared, import duties were anticipated to increase by $6 million in FY 1987. However, provisional estimates show FY 1987 customs receipts for FY 1987 customs receipts declining by approximately 20 percent or $10 to $15 million compared to the previous fiscal year, largely as a result of contraband.

B. Exports

In September 1986, the coffee tax was reduced from 19.5 percent to 10 percent of the FOB price of coffee. The coffee tax was eliminated in September 1987. In August 1987 all the export taxes were eliminated by Government decree.

Before these changes, export tax revenues were between $8 and $12 million per year. In FY 1987, taxes on coffee exports generated approximately $3.5 million.

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 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 personal income tax for FY 1987 are somewhat higher than anticipated. They will reach at least $12 million whereas the projected target was $10.6 million.

D. Corporate Tax

The Ministry of Finance miscalculated the amount to be generated by the new corporate tax The government had assumed that some of the larger corporations were not declaring the full amount of their income under the old law. This appears to have been a largely erroneous assumption. Given that the new tax law has lower rates and that the tax base has not increased significantly revenues are lower. Revenue from the corporate tax were anticipated to reach $16.6 million for FY 1987, in contrast to the approximately $13 million actually collected.

E. Consular Fees

The fiscal reform applies also to consular fees. An October 1986 decree provided for the transfer to the Treasury of the two (2) percent consular fees on imports previously paid to overseas consulates. 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 above-mentioned Central Bank account, called "Special Fund for the Security of the State" created by a 1972 decree, was abolished by a decree published in August 1986. The FY 1987 Treasury revenue from the consular fees reached almost $4 million whereas the projected amount to be collected was only $1.5 million.

F. Exit Visa

Each Haitian citizen leaving or coming back to Haiti previously had to obtain an exit visa and pay a fee of $7. The exit visa as well as the fee were abolished in April 1987. The loss of this revenue will cost the Treasury some $1.2 to $1.5 million per year.

G. Value Added Tax

Revenues from the value-added tax reached $35.6 million in FY 1986. For FY 1987, receipts were projected to be $36 million. This amount will not be realized largely because of contraband. As part of the fiscal reform, methods of tax collection are being improved through bilateral and multilateral technical assistance. A taxpayer identification number has been introduced for all Haitians dealing with the government's tax collection office.