

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/82

5:45 p.m., June 26, 1989

R. D. Erb, Acting Chairman

Executive Directors

Alternate Executive Directors

H. Ploix
G. A. Posthumus

C. Enoch
Yang J., Temporary
C. S. Warner
J. Prader
S. M. Hassan, Temporary
M. J. Shaffrey, Temporary
E. C. Demaestri, Temporary
G. Montiel, Temporary
N. Kyriazidis
N. Morshed, Temporary
M. A. Hammoudi, Temporary
K.-H. Kleine, Temporary
Hon C.-W., Temporary
L. E. N. Fernando
L. M. Piantini
D. McCormack
B. A. Sarr, Temporary
P. D. Péroz, Temporary
M. Pétursson, Temporary

N. Adachi, Temporary

L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant

1. Haiti - 1989 Article IV Consultation; and Overdue
Financial Obligations - Review of Decision on
Complaint Under Rule K-1, and Notice of Failure to
Settle Trust Fund Obligations Page 3
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Also Present

IBRD: H. Fazel, Latin America and the Caribbean Regional Office. Exchange and Trade Relations Department: S. Kanesa-Thasan. Treasurer's Department: J. E. Blalock, C. P. Blackwell, P. S. Ross. Western Hemisphere Department: M. Caiola, Deputy Director; J. Bonvicini, E. G. de la Piedra, O. Gronlie, C. M. Loser. Office of the Managing Director: P. Shome. Assistants to Executive Directors: S. Guribye, C. J. Jarvis, A. Napky, G. Serre.

1. HAITI - 1989 ARTICLE IV CONSULTATION; AND OVERDUE FINANCIAL OBLIGATIONS - REVIEW OF DECISION ON COMPLAINT UNDER RULE K-1, AND NOTICE OF FAILURE TO SETTLE TRUST FUND OBLIGATIONS

The Executive Directors considered the staff report for the 1989 Article IV consultation with Haiti (SM/89/92, 5/18/89; Cor. 1, 6/20/89; and Sup. 1, 6/21/89) and a staff paper on the further review of Decision No. 9078-(89/16), adopted February 15, 1989 on the complaint under Rule K-1 relating to Haiti's overdue obligations in the General Department and a notice of Haiti's failure to settle its Trust Fund obligations (EBS/89/124, 6/21/89). They also had before them a background paper on recent economic developments in Haiti (SM/89/101, 5/31/89).

The staff representative from the Western Hemisphere Department said that, as was noted in SM/89/92, Supplement 1, World Bank management had informed the Haitian authorities in May 1989 that the Executive Board's consideration of two project-related IDA credits for water supply and power in an aggregate amount of SDR 34 million had been postponed from May 1989 until June 27, 1989, while the authorities discussed understandings with the Fund staff on a program of action aimed at dealing with Haiti's imbalances and addressing the problem of the country's arrears to the Fund. The management and staff of both institutions had maintained close contacts on those matters. If the World Bank's Executive Board approved the two IDA credits on June 27, 1989, the loan agreements could be expected to be signed within a period of about one month thereafter and to become effective some three to four months later. Disbursements, which for the most part would cover the foreign exchange cost of equipment for the projects, would begin around that time but would proceed slowly over a period of years. Implementation of the two IDA projects would address urgent investment needs in the areas of water supply and energy and would help to strengthen over the medium term the operations of the two public enterprises involved. The staffs of the World Bank and the Fund expected to continue to be in close contact with a view to ensuring that a satisfactory economic program was developed and that the arrears problem would be solved.

It should be noted that within the payments made by Haiti to the Fund since February 15, 1989 mentioned in paragraph 3 of EBS/89/124, Haiti had made payments equivalent to those falling due in June 1989, including a small advance payment on account of interest charges falling due at the end of June, the staff representative from the Western Hemisphere Department explained. Finally, the staff had been informed of the recent change in the Governor and Board of Directors of the Bank of the Republic, Haiti's central bank; that change was not expected to affect the Government's policy stance.

Mr. Piantini made the following statement:

The situation in which Haiti finds itself is not only difficult but tragic. My authorities wish to thank the staff for

its helpful technical assistance. They broadly endorse the staff report and its supplement, which clearly describe this very trying economic and social situation.

During 1986-87, the Haitian authorities undertook a comprehensive economic program relying on far-reaching structural measures and strong macroeconomic policies designed to reduce internal and external imbalances and to increase the country's standard of living. This program was supported by an increased inflow of external assistance on concessional terms that helped maintain domestic and external financial stability while the process of reform was carried out. It was also supported by a three-year structural adjustment arrangement approved in December 1986. During the second half of 1987, external aid was suspended as a result of the outbreak of civil unrest, and Haiti's request for a second annual arrangement under the structural adjustment facility had to be postponed.

Despite the reduction of external financial assistance and a deterioration in the terms of trade, my authorities have been able to keep in place the major fiscal and trade reforms implemented since 1986. These reforms, combined with fiscal and wage policy restraints, have prevented a large deterioration in the country's payments position and have helped maintain the country's external competitiveness. A retrospective view of the performance of the main macroeconomic indicators before and after the implementation of structural and adjustment measures brings to light the bold efforts made by the Haitian authorities.

Between 1981-85 and 1986-89, inflation was reduced by more than two thirds to an annual average rate of 3.3 percent. The overall public sector deficit fell by 4 percentage points of GDP, resulting from a sharp decline in fiscal expenditures, and public sector domestic borrowing requirements were reduced by three fourths to 0.6 percent of GDP. Public sector total expenditures decreased 8 percentage points of GDP between 1984 and 1989. During the same period, the external current account deficit was reduced, as an annual average, by almost 3 percentage points of GDP, due to a decline in import volume of over 25 percent since the beginning of the 1980s. Nevertheless, real GDP per capita has continued to decline, and has exceeded 20 percent since 1981. GNP per capita, in terms of dollars, was approximately one fifth, on average, that of Latin America and the Caribbean at the end of 1988.

With respect to recent economic developments, the extent of the reduction in external assistance has been devastating. Grants in aid have fallen by nearly 50 percent, and total external financing of the public sector by over 30 percent, equivalent to (on average) nearly 3 percent of GDP in 1987-89. Nevertheless, my authorities have handled this lack of external

assistance by curtailing public sector expenditures by approximately the same magnitude. Thus, the public sector deficit, before grants, has been reduced by nearly 40 percent, at the expense of a dangerous fall in public sector investment. The Haitian authorities have taken a series of steps to reduce the public sector borrowing requirement. This merits commendation in the difficult circumstances of Haiti, even if it will not prevent the domestic public sector financing requirement from remaining at the 1 percent of GDP level, which is high. Equally remarkable, in the first year of the aid cut, and despite the use of additional domestic financing, net domestic assets rose only moderately and net international reserves increased; the external current account deficit declined; and price increases were moderate. In the second year after the aid cut, the growth rate remained weak and a higher inflation rate is expected. The discount rate on the gourde widened and external payments arrears have increased.

My authorities are aware that the economic stabilization of the country and the viability of the external sector depend on the elimination of fiscal imbalances, but they believe that the continuing cut in fiscal expenditures is severely affecting both the development needs of the country and the Government's ability to provide basic services required by most of the population, which suffers not only from extreme poverty, but also from a lack of proper nutrition and health and educational assistance programs. Therefore, given the low fiscal pressures in Haiti, they believe that there is enough room on the revenue side to tackle the fiscal imbalance and increase national savings, which would reach 2.7 percent of GDP by the end of 1989. In this context, my authorities are acting with strong determination to face the acute economic problems and have put into action a set of policies that provides an appropriate framework for strengthening the fiscal balance in order to eliminate overdue external obligations and to encourage the resumption of growth in an environment of price stability. A number of excise taxes and fees have been raised, and administrative measures have been implemented to improve tax collection by eliminating tax evasion, particularly in income tax and customs receipts. Among the most recent measures taken, the authorities have raised the retail price of gasoline by 13 percent to \$2.20 per gallon, and a program of intensified audits of large taxpayers has been put into effect, and actions are being taken to strengthen the control of state enterprises.

Between now and September 1989, the authorities will attempt to increase revenue collections by broadening the coverage of the value-added tax and eliminating tax exemptions for certain investments. To enhance efficient and better mobilization of domestic resources through appropriate pricing policies and operational procedures, all public enterprises will be placed

under the control of the Ministry of Economy and Finance and their annual budgets will be incorporated into the Treasury budget document. In addition, the authorities plan to streamline the cost structure and strengthen the income of public enterprises by avoiding any further increase in the wage bill and by increasing the prices of goods and services. The authorities have requested technical assistance from the Fund with the objective of improving tax administration.

In the monetary field, during the first half of this fiscal year, reserve deposits of commercial banks in the central bank declined to very low levels and credit to the private sector increased sharply by 15 percent, reflecting in large part political uncertainties, thus adding pressures on prices and the parallel market. To protect international reserves and reduce inflationary pressures, which could be fueled by rising official fees and prices, the authorities will tighten monetary controls by limiting the expansion of credit to the private sector through growth in money and quasi-money. With the reduction of public borrowing requirements from the banking system and domestic interest rates reflecting changes in inflation and external interest rates, it is expected that the banking system's liabilities to the private sector will continue to increase and allow a moderate rise in credit to the private sector.

In the external sector, the balance of payments continues to be weak, due mostly to the sharp decline in official capital and grants by 27 percent since FY 1986/87. This reduction has been offset in part by an improvement in the trade balance supported by a steadfast decline in real minimum wages, which help maintain a competitive real effective exchange rate; in 1988, the rate reached its lowest level in this decade. Since 1987, in spite of trade reforms, import value has remained at the same level, and export value has increased consistently. After extensive liberalization of the trade system, the authorities are working toward the modification of the Investment Code in order to foster foreign investment as a means of compensating for the lack of domestic savings and to increase exports. As part of their policy to stimulate exports, the authorities have decided to give up their previous plan to increase the surrender requirement for exports.

The staff's medium-term projections, which are based on assumptions that at present seem by no means pessimistic, would permit Haiti to do no more than maintain a very modest growth rate. This is not only a depressing but also, perhaps, even an unrealistic projection. If the per capita growth rate remains negative, it must be expected that the present phenomenon of destruction of productive factors (especially erosion of arable land) will continue and prevent any recovery of the growth rate of the economy with further damage to the health and efficiency of the population.

My authorities are combining the strong policy efforts set forth above with their full commitment to prevent any increase in their overdue financial obligations to the Fund during June to September 1989, and intend to make all possible efforts to settle arrears to the Fund as they are doing now. This set of policies has been designed to facilitate a prompt fulfillment of Haiti's external obligations in order to allow it to negotiate a financial arrangement with the Fund at the beginning of the next fiscal year. But, given the severity of Haiti's developmental problems and its low level of gross official reserves, the success of this approach will be endangered by the lack of external support on concessional terms. Haiti deserves and requires special treatment from the international community. No major improvement is possible until external concessional aid is resumed. This external assistance should be timely as well as sufficient to allow the country to restore its growth and external viability. This is not only a problem of making resources available. As we have insisted many times, it will be necessary to supply, simultaneously, far-reaching technical and executive assistance to supplement local availability. This is a task for the UNDP, the World Bank, and the Inter-American Development Bank, perhaps even more than the Fund. But it is also an urgent task for the Fund.

Mrs. Ploix made the following statement:

As the staff has emphasized, the present situation is worrisome in many respects: economic activity remains stagnant, with an important loss of productivity in both the agricultural and industrial sectors; the lack of efficiency in the management of public enterprises has induced a misallocation of the country's financial resources; pressures on public wages and a shortfall in the main commodities have pushed the rate of inflation upward; the spread between the official and the parallel exchange rates has widened once again; and, reflecting these various imbalances, the external position has continued to be extremely weak. In this context, it is worth noting that the Haitian authorities have made every effort to repay the Fund, as attested by the settlement that was reached in February 1989 and their renewed commitment to making further payments.

Therefore, we are pleased that, with the assistance of the latest staff mission, the authorities have elaborated policies that could help restore normal relations with the international financial community and address the present imbalances. I will comment on these two issues.

At this stage, there is no doubt that Haiti needs to receive multilateral and bilateral financial flows in order to arrest the deterioration of its economic base. Since there is a commitment

on the part of the authorities to prevent a further increase in overdue obligations to the Fund, we believe that external assistance must resume as soon as possible in order to meet the basic needs of the population and to rebuild the infrastructure. In sum, it is important to make a clear distinction between this urgent form of financing aimed at containing the deterioration of the economy, and other forms of external assistance.

Of course, this conclusion is based on the assumption that every effort will be made to settle the arrears to the Fund as quickly as possible. With these considerations in mind, we have no difficulty in supporting the procedural actions and the proposed decisions which appear in EBS/89/124. In order to be consistent with the objective of economic recovery, however, it is necessary to complement this assistance with rigorous actions that will lay the groundwork for a comprehensive adjustment program.

This leads me to emphasize the most important stabilization measures to be undertaken in order to re-establish the minimal smooth functioning of the economy. I fully agree with the staff that strengthening the public finances must be the main target of the authorities. Broadening and rationalizing the tax and customs base is indeed of the utmost importance. In this regard, we welcome the information provided by Mr. Piantini, particularly the fact that there is enough room for improving fiscal revenue, given the low fiscal pressure in Haiti. The staff could usefully comment on the possibility of sharing the tax burden more equally. Furthermore, on the expenditure side, we support the decision to strengthen the control over government spending within the established budget. Limiting the wage bill extension for the whole public sector is also of paramount importance, given the present inflationary pressures. We wish to stress the necessity of undertaking urgently the specific set of measures aimed at alleviating the weight of the public enterprise sector on the budget and rationalizing the functioning of that sector.

Adapting monetary policy to the goals of achieving balance of payments viability and reducing inflation is another essential component of the stabilization effort, as the staff has stressed. These measures must, however, be complemented by appropriate trade and exchange policies in order to improve overall resource allocation. In this respect, we welcome the authorities' willingness to change the legal environment for fostering foreign investment in order to offset the present lack of domestic savings, and their recent decision to reverse their plan regarding the surrendering requirement for export gains.

In concluding, we would like to emphasize that, in the present circumstances, Haiti needs adequate financial and technical assistance more than anything else. This assistance will

enable the authorities to pursue the policy actions that they are already engaged in and to undertake indispensable additional measures aimed at reducing economic imbalances while facilitating the settlement of the arrears to the Fund. We hope that the momentum of these actions will be maintained, and that they will lead to the adoption of a comprehensive program supported by the international financial community.

Mr. Warner made the following statement:

We welcome this opportunity to discuss Haiti's Article IV consultation and the occasion it provides to consider economic and policy developments as they bear upon Haiti's ability to clear its overdue obligations to the Fund. My authorities are very disturbed by the re-emergence of Haiti's arrears, the implications this could have for Haiti's ability to attract the support of the international community, the impact of these arrears on the financial integrity of the Fund, and the additional burden they place on other member countries. For these reasons, we attach the greatest importance to Haiti clearing its arrears as soon as possible.

We are therefore encouraged by the authorities' decision to seek the Fund's advice at this relatively early stage in an attempt to solve Haiti's arrears problem before the amount of the arrears becomes still more difficult to manage. The short-term financial measures agreed with the Fund, which would result in capping Haiti's arrears at their end-May 1989 level, represent a step in the right direction. We hope that this approach will lead to the rapid clearing of arrears and the adoption of a comprehensive Fund-supported program in the near future.

Nevertheless, we are acutely aware that the economic and financial situation in Haiti remains quite precarious, and that political conditions are far from settled. The staff documents amply illustrate that policy intentions have not always been carried out, resulting in a continued deterioration in the government's financial position. Thus, while we are supportive of the Fund and the authorities' efforts to regain sufficient financial control to enable Haiti to cap its arrears to the Fund, we recognize that there are significant risks in this approach. Unfortunately, our uncertainty is all the greater given the absence of an explicit cash-flow analysis in the staff documents showing on a monthly basis how Haiti is to obtain the foreign exchange necessary to fulfill its repayment obligations from now until September 1989.

With regard to the financial blueprint to be followed during the coming months, the decision to raise gasoline prices is a step in the right direction. Otherwise, however, the plan seems

to consist primarily of good intentions that have yet to be translated into effective policy action. Needless to say, it will be very important for the authorities to take prompt action to strengthen revenues, control expenditure by the public enterprises, and improve budget, tax, and customs administration. My authorities will be looking for convincing action in these areas as an important indication that a sufficient degree of commitment and administrative capacity exists to justify a future Fund-supported program. In this connection, we strongly support the authorities' request for Fund technical assistance in support of their efforts to improve tax administration.

Haiti's case is also important in the context of Fund-Bank collaboration. We are pleased that the two managements have made an initial attempt to coordinate new lending to a country that is in arrears to one of their sister institutions. So far, this coordination seems to have borne some fruit in encouraging Haiti to take immediate action to draw up a plan for tackling its arrears to the Fund.

I understand, however, that, following our discussion today, the World Bank's management expects to receive the green light from the Fund for consideration of two IDA project credits at tomorrow's meeting of the Bank Board. My authorities have great reservations about this approach. Given the uncertainty about Haiti's ability to carry out the financial measures needed to cap its arrears to the Fund, consideration should be given to asking the Bank's management to delay consideration of the IDA credits temporarily, until Haiti has had an opportunity to demonstrate that it is able to follow through on its commitment to cap the arrears. Should that step not be possible, we urge the management of the Bank to weigh carefully the risks assumed by the Fund and the high value placed on our agreement of collaboration.

I wish to emphasize that these particular comments on the management of our arrears strategy are not in any way directed at Haiti, which we recognize has made an effort to cooperate with the Fund, both in making partial payments in recent months and in seeking Fund advice on capping the arrears at an early stage and on becoming current in its obligations. Rather, my comments are intended to safeguard the effectiveness of the Fund's arrears strategy. Our concern is that the timing of the World Bank's consideration of the IDA project credits is such that Haiti has not had time to build any track record to speak of in capping its arrears to the Fund.

It is our strong view that a credible policy of Fund-Bank collaboration on arrears should, at a minimum, entail allowing sufficient time for a country to demonstrate its willingness and ability to cap its arrears to the institution concerned. In the case of Somalia, for example, agreement was reached in

January 1989 to cap the arrears at their end-1988 level, and there was no new Bank or IDA lending until June 1, 1989. This agreement provided a period of some five months for Somalia to demonstrate that its strategy to cap arrears was working. In the case before us today, however, this is not being done, and our arrears strategy may suffer.

As we look to the future, we note that there are other IDA credits in the pipeline. It is the strong view of my authorities that the Fund and World Bank managements will need to consult closely to ensure that Haiti is adhering to the plan for clearing its arrears to the Fund. They will also need to take appropriate steps, including the delay of future IDA credits, if the expected progress is not made, so as to maintain prudent standards in our arrears management system.

In conclusion, we fully support Haiti's efforts and hope that the short-term plan that it has worked out with the Fund will lead to a prompt renewal of normal relations with the Fund. As to the proposed decision on Haiti's arrears to the Fund, we support management's proposal to hold the next review within three months. By that time, we hope to see that Haiti has been successful in capping its arrears to the Fund, thereby providing the basis for the complete elimination of arrears and, subsequently, the beginning of a comprehensive Fund-supported program.

Mr. Kyriazidis made the following statement:

In fiscal year 1988, Haiti's economic performance continued to be unsatisfactory. After several years of only modest expansion, real GDP growth in 1988 was negative, having been heavily depressed by sluggish investment activity. An important factor in this poor performance is the substantial drop in external assistance, which adversely affected the volume of imports. At the same time, the political instability did not help the efforts to cope with the difficult circumstances.

As real economic activity declined, external arrears, including overdue obligations to the Fund, increased. Consumer prices also increased, by about 8.5 percent, after having registered a decline during the previous year.

I agree with the staff's analysis. The reiterated weak performance of Haiti's economy strengthens the need to promptly revive the reorientation process in economic policy that was started in 1986 and suspended in 1987. I agree with the staff that strong actions are needed to put Haiti's economy back on the right track. A stable environment would also be conducive to the smooth and consistent implementation of the necessary policies.

The public finance sector is certainly one area where major interventions are needed. Several bold actions are required particularly to improve tax administration and cope with the crisis of certain major public enterprises. Wage increases in state enterprises should be kept closely under control to avoid further deterioration of the public accounts and the spread of higher salary demands in the private sector, with its potential adverse effects on inflation. Weaknesses in these two areas are responsible for a significant portion of the imbalance in the public finances and for increasing the strain put on the financial system by the financing requirement of the public sector. Because of this continued pressure on the financial system, and in view of the rate of growth in credit last year triggered by the uncertainties in the period of rising inflation, monetary policy should be tightened.

In FY 1988, the overall balance of payments was positive. In fact, despite a significant reduction in foreign assistance, the surplus in the capital account was sufficient to offset the negative balance in the current account, which was notably smaller than the year before due to the compression of imports. However, the current account deficit is projected to increase, and, in the absence of a revival of external aid flows, the overall balance will also turn negative. In this situation, and given the low level of gross foreign reserves, the sustainability of the debt service, including arrears, appears difficult. The much needed stimuli to increase investments in export-oriented sectors to reverse this situation are unlikely to appear without a substantial reactivation of aid flows in the framework of a comprehensive adjustment program.

I share the view that, without the restoration of external aid, it would be very difficult for the country to implement the strong actions that are needed to reorient economic policy. At the same time, however, only a credible commitment of the authorities to a comprehensive adjustment program will create the favorable conditions for external assistance to be rekindled. The request for Fund assistance to start paving the way for the implementation of a comprehensive adjustment program in FY 1989/90 is therefore a step in the right direction. We welcome this step and encourage the authorities to continue along these lines.

It is certainly regrettable that, since our last discussion on Haiti, in February 1989, Haiti's overdue obligations to the Fund increased by SDR 3 million, reaching a total of SDR 9.4 million, which represents almost one third of Haiti's outstanding use of Fund credit.

We welcome the payments made by Haiti during fiscal year 1988/89 and the agreement reached with the staff on capping the

arrears at the May 30, 1989 level. We also welcome the willingness of the authorities to adopt corrective policy measures to address their economic problems and to establish a financial plan that will allow them to cap their arrears up to the end of September and thereafter to become current with the Fund.

Although there is no intention on our part to condone the persistence of overdue obligations, I believe that Haiti is showing a cooperative attitude in facing its arrears problem. While I again urge the authorities to give the settlement of obligations to the Fund the highest priority, I encourage them to persevere in their efforts and to continue their discussions with the Fund staff with a view to reaching an agreement on a comprehensive adjustment program.

I support the proposed decision; it is appropriate to further review Haiti's overdue financial obligations to the Fund within three months.

Mr. Demaestri made the following statement:

The current economic situation of Haiti is tragic: poverty is widespread; output is stagnant; and economic growth possibilities are limited. In fact, Haiti's per capita income has consistently declined since the beginning of this decade and is currently very low. In the past two years, inflationary pressures have emerged, and the external payments position has weakened. In addition, the country has been confronted with social unrest and political difficulties, and external assistance has been cut back. It is in this context that Haiti has incurred arrears to the Fund since November 1988.

To overcome Haiti's economic difficulties, the authorities intend to implement a set of policies over the next four months. Those policy measures will be followed by the implementation of a comprehensive adjustment program that, in conjunction with increased external assistance, should improve growth and external payments prospects and enable Haiti to meet fully its external payment obligations to the Fund.

The immediate actions are aimed at reducing the financial imbalances, mainly by strengthening public finances. Measures will be taken to strengthen the treasury's revenue performance and to improve the financial position of public enterprises as well. With the recovery of concessional aid flows, some recovery in public investment is expected.

In addition to financial policies, there is also room for promoting an efficient allocation of resources in the Haitian economy by means of structural reforms. In this connection, I

welcome the authorities' intention to undertake institutional and administrative reforms aimed at removing obstacles to investment and growth, and at stimulating a shift of resources toward export activities.

In the staff's view, the strengthening of the public finances would create the basis for addressing the problem of arrears to the Fund. It would also be a central component of the comprehensive adjustment program that we hope would be supported by Fund resources. I agree with the staff that, in the current circumstances, it would be very difficult for the authorities to implement a growth-oriented adjustment program without increased external assistance. As Mr. Piantini stated, the success of his authorities' efforts and major economic improvements will not be possible until external aid is resumed. It remains to be seen whether or not external assistance will arrive promptly and in amounts sufficient to allow the country to restore growth and external viability.

Mr. Kleine said that he welcomed the recent indications by the authorities that they were now willing to put in place a set of economic policy measures as the basis for a comprehensive adjustment program and eventual clearance of the arrears to the Fund. He also welcomed the payments that Haiti had made since February 1989 and the authorities' commitment to prevent, as a minimum, an increase in the overdue financial obligations to the Fund in the period through September 1989. The continued delay in full repayment was of course unsatisfactory and, strictly speaking, unacceptable. However, the recent assurances were a most welcome indication of the authorities' willingness to cooperate with the Fund to normalize their relations with the Fund.

There could be little doubt that strong and credible economic policy actions, sustained over an extended period, would be needed to reduce existing imbalances and restore credibility, Mr. Kleine continued. That task appeared all the more daunting because civil unrest and political instability in Haiti had severely aggravated the already difficult economic environment and had led to substantial shortfalls in external assistance. In view of that situation and Haiti's poor track record of policy implementation, it was perhaps premature to say that there was light at the end of the arrears tunnel. At the present stage, all that one could say was that the authorities had correctly identified the strengthening of the public finances as a prerequisite for the badly needed improvement in Haiti's economic situation. The measures to strengthen revenue performance and to improve the financial position of the public enterprises were in the right direction. However, apart from the decision to correct the retail price of gasoline, it appeared that other major policy measures had yet to be implemented. He urged the authorities to implement the policies without delay, because the international community wished to be convinced that Haiti was serious about tackling its financial imbalances and was deserving of external assistance. Finally, he supported the proposed decisions.

Mr. Shaffrey said that it was clear that Haiti faced some very severe economic and financial problems, and that Haiti's public finances needed to be the primary focus of the authorities' attention. As the staff had concluded, substantial progress in that critical area would be of considerable assistance in dealing with the arrears problem.

However, while he welcomed the authorities' plans for coming to grips with the deficiencies in the public sector, he was somewhat skeptical, given the failures of earlier efforts, particularly to improve revenue collection, Mr. Shaffrey went on. Nevertheless, he hoped that, with Fund technical assistance, the authorities could implement the tax revenue measures outlined in SM/89/92, Supplement 1.

With respect to the public enterprises, the recent large increases in wages and employment were very unfortunate, Mr. Shaffrey remarked. The proposed remedial measures appeared appropriate, but sustained implementation was essential, and the planned price increases should not be used to cover inefficiencies in the operations of public enterprises.

The authorities needed to take decisive actions in other areas as well, especially to rein in credit growth, Mr. Shaffrey considered. Those efforts would help to both strengthen the external position and restrain inflation. The staff's call for the authorities to resist any temptation to impose price controls and instead to address the basic causes of their economic problems should be underscored.

Despite his skepticism about whether the authorities could effectively tackle the fundamental imbalances in the economy, at least in the short term, he supported the draft decisions, Mr. Shaffrey stated. He trusted that the authorities would use the three-month period before the next review at least to restrain the level of their arrears to the level at the end of May 1989.

Mr. McCormack made the following statement:

There is no need to repeat the enormous difficulties Haiti has experienced over the past two years. For a country as poor as Haiti, the sharp curtailment of external aid flows was a crippling blow. Economic difficulties both reflected, and were compounded by, the prevailing social and political instability. The 1986 three-year medium-term economic program, supported by an arrangement under the structural adjustment facility, had to be abandoned in less than one year. Despite this development, over the past two years the authorities have taken a number of measures, admittedly partial and hesitant, to try to arrest further deterioration in their economic and financial situation. In addition, a number of payments were made to the Fund in an effort to limit the growth of arrears, with Haiti even becoming current for a short time in October 1988. I mention these points at this stage of the discussion solely to emphasize that, even in the extraordinarily difficult circumstances in which they found

themselves, the Haitian authorities tried to keep the economic and financial situation from getting completely out of hand. Mr. Piantini has stressed the authorities' achievements in this regard. Although I might not be quite as congratulatory as Mr. Piantini, the fact that it was possible to maintain even a modest and tenuous degree of economic management in such a difficult period is encouraging and gives us grounds for optimism, especially when more stable political and social conditions are established.

The key policy imperative facing the authorities must be the need to strengthen the public finances. The staff report discusses the required fiscal policy agenda in detail. Against the background of the staff appraisal, the information set out in SM/89/92, Supplement 1 is encouraging. The authorities have indicated their intention to introduce a number of critical measures aimed at improving revenue performance. These measures include broadening of the coverage of the value-added tax--a point on which the authorities had been reluctant to act earlier in the year. It would be interesting to learn somewhat more about the authorities' intentions in this regard and to have the staff's assessment whether the projected action matches the staff's or falls significantly short. A key defect in the revenue system is inadequate tax administration, and I warmly support the request for Fund technical assistance.

Two elements of the proposed package appear to be of particular importance. First, it is encouraging that the authorities intend to take immediate action to reduce the payroll of the public enterprises, and that steps are being taken to ensure a greater degree of accountability to the central authorities. Second, because it shows a degree of responsiveness by the authorities to the arguments of the staff, I attach importance to the decision not to carry out the previous plan to raise the surrender requirements on export receipts. To strike a more critical note, however, there is no mention of any intention to reverse previous decisions broadening the scope of price controls. In view of the distortions to which such controls can give rise, it would be helpful if the authorities were to declare their intention not to implement the controls in full and to move gradually toward their dismantlement. However, this may well be the sort of policy that can better be approached within the context of a full-fledged program rather than at this interim stage, and I will not press the matter further.

In the light of what I have said, I welcome the policy intentions of the authorities and agree that, if fully implemented, the proposed measures might form the basis for a comprehensive program. The measures being introduced over the next few months clearly point in the right direction. Also, it is encouraging that the authorities have declared at this stage

their intention to make payments to the fullest extent possible in the period through the end of September 1989 and, at a minimum, to prevent an increase in overdue financial obligations to the Fund. Of course, the authorities should aim for full settlement of their arrears--this is something that we must keep insisting on--but capping the arrears is a useful first step in the right direction and encourages us to believe that Haiti's arrears problem can, with further effort, become more tractable.

On the suggestion made by Mr. Warner, I wish to wait before taking a final position; any debate will likely raise a number of issues. As a first response, I have some reservations about this proposal, and I would like to hear the staff's comments and further argument before I remark on it. However, I am encouraged by the fact that there has been considerable and close collaboration between the World Bank and Fund staffs in coming to this situation. That is a helpful sign.

I support the proposed decisions. I see merit in encouraging the Haitian authorities to proceed with the policies they have mapped out over the next few months and believe that, in principle, they could help create the conditions for solving the arrears problem and constitute the basis for a comprehensive program supported by Fund resources. The latter would have to be judged on its merits at the time the program came before the Board.

Mr. Enoch made the following statement:

As other Directors have noted, Haiti clearly faces very serious problems. Public finances are in disarray, especially on the revenue side, and there are serious doubts about the ability of the authorities to implement new revenue-raising measures or, indeed, to collect revenue under existing measures. The drastic reduction in foreign aid has resulted in a curtailment of imports, but serious external imbalances remain. The discount between the official and parallel markets for the gourde has risen to alarming proportions. Arrears to foreign creditors, including the Fund, have grown.

The picture presented in the staff report of the increasing difficulties that the authorities are having in collecting revenue is a disturbing one. In these circumstances, the most important consideration in choosing appropriate revenue measures is collectability. With this in mind, the increase in the tax on gasoline and the planned broadening of the coverage of the value-added tax seem appropriate. While the Government's revenue difficulties remain, continued restraint on expenditure will also

be essential, and I am glad that the authorities' appreciation of this, as described in SM/89/92, Supplement 1, seems to be appreciably greater than it was even a couple of months ago.

On monetary and exchange rate policy, I very much agree with the staff's conclusions. The authorities should be prepared to raise interest rate ceilings if necessary to avoid an erosion of private financial savings. The authorities may also find that they need to devalue the gourde against the U.S. dollar if the discount in the parallel exchange market continues at its present level. Like Mr. McCormack, I am relieved that the authorities have decided not to carry out their previous plan to increase the portion of the surrender requirement on export receipts. In its current situation, such a tax on exports is the last thing that Haiti needs.

The progress that has been made in the most recent discussions between the staff and the authorities is encouraging. However, in looking at the medium-term balance of payments scenarios, one is conscious that medium-term viability depends critically on conditions for a resumption of flows of concessional aid.

As to Haiti's arrears to the Fund, I am somewhat disturbed to see that payments made to the Fund, as a proportion of all payments made, are less than the proportion of payments owed to the Fund; this would seem to indicate some discrimination against the Fund. However, the authorities' commitment to at least prevent arrears from growing larger over the next three months is welcome, and the payments that have already been made to the Fund are tangible evidence of the authorities' commitment. Bearing in mind these payments and the improved state of negotiations between the staff and the authorities, I support the proposed decisions.

I note from the supplement to the staff report that the World Bank management postponed its consideration of two project-related IDA credits last month and urged the authorities to reach an understanding with the Fund on a program that will address the issue of the arrears. As the staff reported at the start of the meeting, the Bank has rescheduled consideration of these project credits for tomorrow, given the further progress that has been made in discussions with the Fund. It seems to us that the World Bank's position may have played a significant role in encouraging the authorities to resume discussions with the Fund, and this seems to be a welcome instance of good collaboration between the Fund and the Bank on the arrears strategy. Like Mr. McCormack, I would welcome staff comments on this subject.

Mr. Adachi made the following statement:

The adjustment effort initiated in 1986 was curtailed in mid-1987. As a consequence, Haiti's economic performance has declined rapidly since then: real GDP shrank by 1 1/2 percent in FY 1987/88; inflation was rekindled; an 8.4 percent increase in the price level was recorded at the end of 1988; Haiti accumulated substantial external arrears, including arrears to the Fund; and Haiti's reserve position weakened significantly.

We wish to express our deep sympathy with the plight of Haiti, because exogenous factors, particularly the substantial decline of external financing, have exacerbated the economic difficulties of Haiti. In addition, the authorities are to be credited with making efforts to revamp the economy. More recently, the steps that they have decided to take seem to aim in the right direction. However, it should be emphasized that determined self-help efforts by the authorities will always be the foundation for successful growth-oriented adjustment. To this end, we wish to emphasize the major policy requirements that the authorities should undertake to meet. The thrust of the staff proposals is appropriate and we endorse it.

Reducing the fiscal deficit is the key to the adjustment of the economy. Therefore, the planned budgetary measures should be implemented vigorously, since the staff envisages a considerable improvement in public sector savings if the intended measures take their full effect. The staff projects a strong recovery of official grants to the public sector in FY 1989/90; however, we see a severe downside risk in this area. Therefore, we would welcome staff comment on the effect of the implementation of the intended measures on the reduction of the budget deficit in FY 1989/90 as well as on the background to the staff's projection. In any event, the authorities are to be encouraged to intensify their efforts and take bolder actions to strengthen the tax base and tighten expenditure management, and we welcome their intention to introduce budgetary measures to reduce the budget deficit. In this context, we warmly support the provision of technical assistance to Haiti.

A tighter rein on credit is essential to contain inflation as well as to protect Haiti's external position. In the area of structural reform, the authorities should be encouraged to streamline the public enterprises. Table 36 of the statistical appendix to the background paper clearly illustrates the recent sluggish performance of those public enterprises. Moreover, the large wage increases in some public enterprises at the end of 1988 are a worrisome development. A determined effort will be required to make public sector reforms on both the expenditure and the revenue sides.

With respect to external policies, we encourage the authorities to undertake a more flexible exchange rate policy.

Like other Executive Directors, we are seriously concerned about Haiti's overdue obligations to the Fund. Therefore, we welcome the authorities' intention not to increase Haiti's arrears to the Fund. In the supplement to the staff report, it is noted that "the resulting strengthening of the public finances would create the basis for addressing the problem of arrears to the Fund and would be a central component of a comprehensive adjustment program which could be supported by the use of Fund resources once arrears to the Fund are settled." We would welcome the staff's elaboration on the possible ways for Haiti to clear its arrears to the Fund.

The World Bank Board will consider IDA loans to Haiti tomorrow. We understand that the Managing Director's agreement with the President of the Bank requires that the Bank Board reflect the Fund's view on the appropriateness of providing Bank or IDA loans to a member in arrears to the Fund. Therefore, we would welcome the staff's comment on whether there are precedents for the Fund to acquiesce to a loan by the Bank to a member that has arrears to the Fund. Mr. Warner has referred to the case of Somalia; I wonder whether this is the only relevant case. We would also like the staff to describe the circumstances under which the staff would consider it appropriate for the Fund to agree to a Bank loan to a member in arrears to the Fund, because there have been several cases in which Bank loans exacerbated the situation involving the Fund and a member with arrears. In the case of Haiti, we are somewhat hesitant to acquiesce to an IDA loan, as we would first like to see further progress and commitment by the authorities to repay the Fund; in this context we share Mr. Warner's concerns and reservations.

Haiti has to proceed on a difficult adjustment path. We encourage the authorities to undertake a strong and comprehensive adjustment program to enable Haiti to clear its arrears to the Fund.

The staff representative from the Western Hemisphere Department said that, while the authorities had stated their intention to increase price controls, thus far they had decided only to maintain the price controls on goods that were already controlled, including petroleum products and basic foodstuffs, some of which--for example, flour--were sold by the public enterprises. In the fiscal area, the authorities felt that the tax burden could be more evenly distributed if they were to concentrate on the major taxes, such as the income tax; in that connection, they could intensify the audits of major taxpayers. In addition, studies of a possible expansion of the coverage of the value-added tax had been undertaken, partly as a result of technical assistance provided by the Fund, as a result of which

guidelines for possible action in that area had been set. The authorities intended to follow the guidelines closely, including a reduction of the minimum level of gross annual sales subject to the value-added tax and an expansion of the universe of items covered.

The question was raised of the extent to which the measures that the authorities intended to introduce on the revenue side would likely increase public sector saving and improve the public sector fiscal position in FY 1989, the staff representative recalled. Although it was difficult to make calculations, the extension of the value-added tax and the improvement in income tax collection, if successfully implemented, could yield on an annual basis about 0.6 percent of GDP, which would basically cover the domestic financing gap.

As to the arrears to the Fund, the staff representative from the Western Hemisphere Department remarked, the assumption was that, upon the successful implementation of the planned measures and the elaboration of an adjustment program, the level of arrears was such that it would not be difficult to arrange bridge financing that would enable Haiti to clear its arrears to the Fund; Haiti could subsequently repay the bridge financing after the initial purchase under an arrangement with the Fund. With the elimination of the arrears and the approval of an arrangement with the Fund, Haiti could have immediate access to the equivalent of 25 percent of quota.

Responding to a question by Mr. Warner, the staff representative from the Western Hemisphere Department said that, on the basis of the capital inflow to Haiti that was foreseen for the period June-September 1989, it would be difficult for Haiti to clear all its arrears to the Fund. At the same time, however, the staff expected that, on the basis of a sound policy performance in that period, including the implementation of the planned policy measures, a program could be established for FY 1989 and bridge financing could be arranged to clear Haiti's arrears to the Fund. Haiti would then be in a position to request an arrangement with the Fund.

The staff representative from the Exchange and Trade Relations Department remarked that it was difficult to define *ex ante* the particular circumstances in which it would be proper for the World Bank to approve loans to a member country that remained in arrears to the Fund. Each such situation would have to be examined on a case-by-case basis. In the case of Somalia, it had been felt that, in the context of the Fund's shadow program, it had been necessary to make World Bank resources available to Somalia in order to ensure that the country's program, which had been endorsed by the Fund, would be adequately funded. Another significant factor in the case of Somalia was that the World Bank's financial contribution had been part of a humanitarian effort to assist the country. Such factors could be taken into account in future cases. Of course, the most important factor would be whether or not the World Bank's financial assistance would further the process of the member country's implementation or strengthening of its policies and its movement toward the liquidation of the arrears to the Fund. In the case of Haiti, the staff had felt that the

World Bank's postponement of its discussion of the loan proposals for Haiti from May 1989 until June 27, 1989 had furthered that process. The factors that he had mentioned were not a complete inventory of all the possible factors that could conceivably be taken into account in future cases.

The Acting Chairman commented that there had been extensive discussions between the managements of the World Bank and the Fund in the context of the strengthened effort to improve collaboration on arrears in particular. The Bank Executive Board's delay in its consideration of Haiti's request for IDA financing had been helpful, because it had given the authorities greater incentive to conduct in-depth discussions with the Fund on their economic policies. The authorities had indicated that they were prepared to work closely with the Fund to put in place an economic program that could lay the basis for clearing Haiti's arrears. The authorities had indicated the policy measures that they intended to implement in the coming period, and staff and management would wish to keep track of their performance before taking the next step with the authorities, namely, putting in place a program that could be supported by Fund resources.

Ideally, of course, it would have been welcome to be able to have the Executive Board consider a possible Fund-supported program at the present stage, so that the World Bank and the Fund could move in parallel and their assistance to Haiti would be mutually reinforcing, the Acting Chairman continued. The World Bank had wished to move ahead with the proposed IDA credits for Haiti before the end of the Bank's current fiscal year in order to facilitate the Bank's scheduling of its various IDA projects. In addition, the World Bank's view--which was shared by the Fund--was that, given the steps that the Haitian authorities had taken, there were grounds for believing that the authorities would continue to act on the basis of the understandings that had been reached with the staff, and that going ahead with the IDA credits would give the authorities some further impetus to do so. At the same time, further postponing the World Bank's consideration of the IDA loans beyond June 1989 would have created some uncertainty as to when the discussion of the loans for Haiti could be fit into the overall schedule of discussions and would therefore have been an undesirable step backward. Fund management had indicated to the World Bank management that it hoped that the Bank would follow very closely the authorities' progress in implementing the planned policies, which would be important not only to eliminate the arrears to the Fund, but also to improve the general environment within which the investment projects supported by the Bank would be implemented. The case of Haiti raised a question that would have to be addressed by the World Bank's Executive Directors, namely, whether there could be any delays in providing Bank assistance to Haiti if there should suddenly be a reversal in the efforts by the Fund and the Haitian authorities to reach an agreement on a program. It was clear that any additional credits extended by the Bank would be conditional upon an agreement between the authorities and the Fund, the clearance of the arrears to the Fund, and the putting in place of a solid economic program.

There was no single criterion that could easily be used in deciding whether or not one institution--the Fund or the World Bank--should proceed

to provide assistance to a member country while the country still had arrears to the other institution, the Acting Chairman commented. However, in the present case of Haiti, the institutions had reached a working relationship with the Government that they hoped would result in the continuation of the implementation of policies and, later in 1989, in the provision of financial support by the Fund for Haiti.

Mr. Piantini thanked Executive Directors for their comments.

The Acting Chairman made the following summing up:

Executive Directors were in broad agreement with the thrust of the appraisal of the staff report. Directors expressed considerable concern over the deterioration of economic conditions following the outbreak of civil unrest in mid-1987 and the subsequent curtailment of external assistance, as well as the more recent weakening of the public finances. Directors noted that output and imports had declined sharply, inflationary pressures had re-emerged, and the discount in the parallel exchange market had increased. They also observed that Haiti's official international reserves had fallen to critical levels, and were disturbed about the accumulation of overdue payments to the Fund.

Directors were disappointed that slippages in revenue collections and spending increases by the public enterprises during the first half of the current fiscal year had resulted in a weakening of the stance of fiscal policy. Therefore, Directors welcomed the recent commitment of the authorities to tighten fiscal policy during the last four months of the current fiscal year in an effort to reduce domestic price pressures and strengthen Haiti's external payments position. Directors encouraged the Haitian authorities to implement the intended measures without delay, including price increases for goods and services sold by the public enterprises and an improvement of control over the operations and efficiency of the public enterprises. In this context, the increase in gasoline prices and broadening of the VAT were seen as appropriate. Directors also emphasized that pursuit of wage restraint in the public sector was essential to avoid generalized demands for wage increases in the private sector. They welcomed the authorities' decision not to increase the surrender requirement for exports and urged them to improve the climate for foreign capital flows into Haiti.

Directors noted that firm implementation of the measures contemplated by the authorities should enable Haiti to meet all payments to the Fund falling due during June-September 1989 and would help lay the ground for an economic program for FY 1989/90 which could be supported by the use of Fund resources once arrears to the Fund have been cleared. Directors urged Haiti to make all efforts to settle overdues to the Fund. They stressed the importance of undertaking the policy measures needed to

assure a suitable economic program for the period of FY 1989/90, because a major improvement in Haiti's track record of policy implementation, as well as an improvement in the political climate, were generally seen as preconditions for a restoration of aid flows on which the economy is critically dependent.

Directors remarked that even with considerable improvement in financial performance, a significant increase in public investment and a resumption of the structural reform process interrupted in 1987 would be necessary to restore sustainable economic growth and improve the external position over the medium term. Directors also expressed the hope that, given the economic and social imbalances confronting Haiti and the country's poverty, circumstances would permit the acceleration of external assistance on concessional terms in the near future.

Several Directors welcomed the collaboration between the Bank and the Fund in an effort to encourage Haiti to clear its arrears and encouraged the two institutions to continue to work closely together to assist Haiti in achieving its economic policy reforms and clearing of arrears to the Fund.

It is proposed that the next Article IV consultation with Haiti be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Overdue Financial Obligations - Review of Decision on
Complaint Under Rule K-1

1. The Fund has reviewed Decision No. 9078-(89/16), adopted February 15, 1989, in light of the facts described in EBS/89/124 (6/21/89) pertaining to Haiti's overdue financial obligations to the Fund.

2. The Fund welcomes the payments made by Haiti and the intention of the authorities to give priority to the full settlement of the overdue financial obligations to the Fund. Nevertheless, the Fund regrets Haiti's continuing nonobservance of its financial obligations to the Fund in the General Department and notes the financial burden placed upon other members by the continuation of these arrears. The Fund urges Haiti to make full and prompt settlement of its overdue financial obligations to the Fund.

3. The Fund welcomes the commitment of the authorities to pursue measures designed to strengthen Haiti's external payments position and normalize its relations with the international financial community. The Fund stands ready to cooperate with

Haiti in support of these efforts, notably in completing the formulation and implementation of an appropriate adjustment program.

4. The Fund shall review further Decision No. 9078-(89/16) within a period of three months, taking into account any further developments.

Decision No. 9201-(89/82), adopted
June 26, 1989

Overdue Financial Obligations - Notice of Failure to Settle
Trust Fund Obligations

1. The Managing Director's notice of failure to settle Trust Fund obligations dated June 21, 1989 with respect to Haiti, in EBS/89/124, is noted. It shall be placed on the agenda of the Executive Board for the same date as the next review of Decision No. 9078-(89/16).

2. The Fund urges Haiti to become current in its financial obligations to the Fund promptly and to avoid thereby the need for the Fund to take remedial action.

3. Consideration of the Trust Fund notice particularly affects Haiti. The member shall be informed by rapid means of communication of this matter and of its right to present its views through an appropriately authorized representative.

Decision No. 9202-(89/82) TR, adopted
June 26, 1989

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/89/81 (6/23/89) and EBM/89/82 (6/26/89).

2. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/89/163 (6/22/89) is approved.

APPROVED: January 18, 1990

LEO VAN HOUTVEN
Secretary