EBS/86/257
Supplement 1

CONFIDENTIAL

December 22, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Haiti - Structural Adjustment Arrangement

Attached for the records of the Executive Directors is the text of the structural adjustment arrangement for Haiti agreed at Executive Board Meeting 86/201, December 17, 1986.

Att: (1)

Haiti-Structural Adjustment Facility: Three-Year and First Annual Arrangements

Attached hereto is a letter with an annexed policy framework paper and a letter with an annexed memorandum of economic policies dated November 21, 1986 from the Minister of Economy and Finance of Haiti, requesting from the Fund a three-year structural adjustment arrangement and the first annual arrangement thereunder, and setting forth:

(i) the objectives and policies of the program to be supported by the three-year arrangement, and

(ii) the objectives and policies of the program to be supported by the first annual arrangement.

To support these objectives and policies, the International Monetary Fund grants the requested arrangements in accordance with the following provisions and subject to the regulations for the administration of the structural adjustment facility:

1. For a period of three years from December 17, 1986 Haiti will have the right to obtain three successive loans from the Fund under the structural adjustment facility in a total amount equivalent to SDR 20.727 million.

2. The first loan, in an amount equivalent to SDR 8.82 million, is available for disbursement at the request of Haiti.

3. The second and third loans will be available upon approval by the Fund of the corresponding annual arrangements and will be disbursed at the request of Haiti. The amount of the second loan will be equivalent to SDR 5.9535 million, and the amount of the third loan will be equivalent to SDR 5.9535 million.

4. Before approving the second annual arrangement, the Fund will appraise the progress of Haiti in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, taking into account primarily the following:

(a) the indicators described in paragraphs 16, 23, and 25, and Tables 1 through 4 of the Memorandum of Economic and Financial Policy, October 1986-September 1989 (Attachment II, Annex),

(b) the indicators described in Table 9 of EBS/86/257 (11/21/86),

(c) imposition or intensification of restrictions on payments and transfers for current international transactions,

(d) introduction of multiple currency practices,

(e) conclusion of bilateral payments agreements which are inconsistent with Article VIII,

(f) imposition or intensification of import restrictions for balance of payments reasons.

5. In accordance with paragraph 8 of the attached letter transmitting the memorandum of economic policies, Haiti will provide the Fund with such information as the Fund requests in connection with the progress of Haiti in implementing the policies and reaching the objectives supported by the first annual arrangement.

6. In accordance with paragraph 9 of the attached letter transmitting the memorandum of economic policies, Haiti will consult with the Managing Director on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests such consultation because he considers that consultation on the program is desirable. These consultations may include correspondence and visits of officials of the Fund to Haiti or of representatives of Haiti to the Fund.

Haiti

Port-au-Prince, November 21, 1986

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosière:

On behalf of the Government of Haiti, we are transmitting herewith the annexed Policy Framework Paper which sets out the Government's principal macroeconomic objectives for the next three years, and the policies of adjustment and structural reform that will be put in place to achieve those objectives. In support of these structural policies and adjustment efforts, the Government of Haiti has requested a structural adjustment arrangement from the Fund under the Structural Adjustment Facility, as well as an Economic Recovery Credit from the International Development Association.

Sincerely,

Onill Millet
Governor
Bank of the Republic of Haiti

Leslie Delatour
Minister of Economy
and Finance

HAITI

Policy Framework Paper, 1986/87 to 1988/89 1/

1. The provisional Government which came to power in February 1986 has scheduled elections for November 1987, with the then elected Government taking office in February 1988. The present Government intends to reform public finances and economic policies to hand over a viable, growing economy to its elected successor and to establish conditions from which, in the Government's view, retrogression to the inappropriate policies of the past would be difficult.

I. Structure and Problems of the Economy

2. Haiti is a small, low income, densely populated, predominantly rural, and open economy. Its 5.3 million people occupy 28,000 square kilometers, the western end of the island of Hispaniola. Life expectancy at birth is only 53 years, the infant mortality rate is about 120 per 1,000 live births, over 25 percent of children suffer from second or third degree malnutrition, and about 65 percent of adult Haitians are illiterate. Economic and social conditions improved in the 1970s, but the economy has stagnated since 1980, unemployment has increased, and per capita income has fallen; per capita income is still less than US$400, and half the labor force is unemployed or underemployed.

3. The low level of per capita income itself contributes one of the main structural problems confronting the economy: gross national savings are very low, averaging only about 5 percent of GDP since 1980. This deficiency of savings, which is particularly marked in agriculture, leaves the economy reliant on external savings in the form of concessional aid to attain levels of investment consistent with sustained growth.

4. Three quarters of the population live in the rural areas, and ultimately depend on agriculture. Per capita agricultural production has fallen steadily as population pressure has intensified. Only about 20 percent of the rugged, mountainous terrain is considered cultivable; nonetheless, about 30 percent is actually cultivated. The average farm size is below 1.1 hectares. This shortage of land, coupled with the demand for wood and charcoal for energy, has generated a vicious circle of deforestation and soil erosion that has further intensified the shortage. Declining rural incomes have generated substantial rural-urban and international migration. The total population is growing at 1.8 percent per annum, net of emigration of 0.5 percent, while the urban population is expanding by 4 percent per annum.

1/ Haiti's fiscal year runs from October to September.

5. Public policies in agriculture have exacerbated the scarcity of land. A million people on the hillsides depend on coffee, the major cash crop, which is subject to an export tax. This tax has been reduced from 26 percent in the early 1980s to its current level of about 22 percent but still represents half the price received by the producers. Producer prices for foodstuffs have been increased to well above world prices by import restrictions. Thus, the cultivation of maize on the hillsides instead of coffee has been fostered and soil erosion worsened. Cotton production was also discouraged by a producer price below the import parity price. Public agricultural investment and credit programs have been targeted more to social relief than to stimulating either growth in productivity, output, and employment or effective soil conservation.

6. In recent decades, output and employment have shifted toward urban activity, largely as a result of a scarcity of cultivable land and the establishment in the 1970s of a labor-intensive assembly industry. Agriculture now accounts for only one third of GDP compared with one half in the early 1950s. The economy has become much more open; the total value of exports and imports of goods and services has risen to 50 percent of GDP.

7. Despite the expansion of the manufacturing sector for export, the external payments position is weak; the export base remains narrow, leaving Haiti vulnerable to exogenous shocks. The assembly industry produces a very limited range of products--electronics, clothing, and sporting goods--yet accounts for over 50 percent of all exports; external factors, such as the 1980-83 world recession, the shakeout in the North American computer industry, and industrial countries' trade barriers to its textile exports, have contributed to the recent slowdown in this sector. Coffee, which accounts for about 25 percent of exports, is particularly vulnerable to climatic adversity, especially hurricanes. Tourism has virtually ceased as a result of publicity concerning the AIDS disease and, more recently, civil unrest immediately before and after the ousting of the Duvalier Government. The only bauxite mine closed in 1982 as deposits were exhausted.

8. In the second half of the 1970s economic growth, averaging 4 1/2 percent per annum, allowed for some improvement in real per capita income. The Government pursued prudent financial policies and foreign development assistance was substantial. The economy was virtually on a dollar standard, with the gourde remaining at a fixed parity of five to the U.S. dollar, and prices were relatively stable. These conditions helped engender private sector confidence and thereby promoted the continued rapid expansion of the assembly industry, established without protection. Although it has enjoyed tax holidays and other investment incentives, the industry's primary advantage has been the freely determined structure of wages in Haiti. Until recently it was the fastest growing assembly industry in the Caribbean Basin; over 50,000 jobs hadbeen created by 1980. In contrast, the private industrial sector producing for the domestic market, which grew quickly in the early 1970s

behind high walls of both formal and informal protection, quickly saturated this market and has stagnated for almost ten years. There is little scope for these domestic industries to expand into export markets without major restructuring.

9. From 1980 to 1985 the public sector expanded its influence in the economy through higher rates of taxation and even higher levels of public expenditure. The control and allocation of public expenditure was seriously deficient. Extrabudgetary expenditures rose disturbingly. New and inefficient public industrial enterprises were formed. Transfers from the Treasury to the investment budget were partly diverted to meet salary payments in ministries without development functions, reducing the availability of counterpart funds for aid-financed projects. Public savings dropped to less than 1 percent of GDP on average and recourse to nonconcessional financing, mostly central bank credit, increased to more than 3 percent of GDP on average. This in turn exerted heavy pressure on the balance of payments; official net reserves declined at an annual average rate of US$22 million. By 1985/86, gross reserves had fallen to less than three weeks' import coverage. Payments arrears emerged and a parallel foreign exchange market developed, with the gourde selling at a discount which at times exceeded 20 percent.

10. The confidence of both the private sector and the international donor community was eroded. The growth of the footloose assembly industries slowed and has stagnated since 1983. Employment in this sector peaked at about 60,000 jobs but is estimated to have declined by around 10 percent in 1985/86, mainly in response to political uncertainty and recent civil unrest. Donors expressed concern over inappropriate public investments, the lack of overall public investment priorities, and poor policies in agriculture and industry. In the absence of a major overhaul of public investment, foreign aid to the public sector declined from 1983 to 1985.

11. The Government's increased revenue demands on the domestic economy in the 1980s were reflected in aggressive pricing policies in public industrial enterprises that enjoyed trade monopolies. Together with the intensification of import restrictions and private production and importing monopolies, this inflated prices for basic consumer goods to well above world levels. An outright ban on importation of specific consumption articles was first introduced in 1981 and then replaced by an administered system of import licensing after 1982. Both trade restrictions and pricing policies created price distortions with neighboring countries, and encouraged contraband in imported consumer goods.

II. Medium-Term Economic Objectives

12. Haiti's development problems are severe and cannot, of course, be resolved in the short life of this government or, indeed, by 1988/89, the period covered by this paper. The reform program that has been developed by the authorities, to cover their period in office through February 1988 and beyond, seeks to promote economic expansion through

export-led growth and improved agricultural performance. These objectives will be fostered both directly by the removal of impediments to efficient resource allocation, and indirectly by the impetus to higher capital inflows that such policies should generate.

13. Central to this strategy is a rebuilding of the confidence of both private investors and the donor agencies. During 1985/86 significant reductions in financial imbalances were achieved, setting the stage for structural adjustment with the support of increased inflows of concessional aid.

14. The medium-term macroeconomic objectives of the program are: (a) to generate a real GDP growth rate of at least 4 1/2 percent a year, mainly through improved assembly sector performance and an anticipated upturn in coffee production; (b) to reduce Haiti's inflation rate to the level of its major trading partners currently estimated at some 4 percent; and (c) to achieve an overall balance of payments surplus equivalent to almost 1 1/2 percent of GDP in 1986/87 and close to 1 percent of GDP in each of the following two years, so as to permit the strengthening of official net international reserves and some replenishment of the central bank's gross foreign assets.

15. Taking into account the expected flow of official grants and concessional loans and the overall reserve objectives, the current account deficit would widen from 5 percent of GDP in 1985/86 to an average 7 percent in the three years of the program. Expectations are that the light assembly sector will recover after three years of stagnation, the volume of its exports growing by some 4 1/2 percent in 1986/87 and 6 1/2 percent thereafter. Coffee production is characterized by a cycle; after two years of low production, a sharp increase is anticipated in 1986/87, with export volume estimated to expand by about one sixth to return to its average level over the last five years, and to remain around this level in 1987/88 and 1988/89. This would yield average growth in aggregate export volume of over 5 percent per year, with export value rising by almost 8 percent on average. Import value would rise by some 23 percent in 1986/87 from the very depressed level of 1985/86, and continue to rise at a less rapid pace in 1987/88 and 1988/89, reflecting the sustained recovery of the economy.

III. Instruments and Timing

16. Since coming to power in February 1986, the Government has taken important steps to eliminate financial imbalances and price distortions. Haiti's financial position improved substantially in fiscal year 1985/86. The public sector made net repayments to the domestic banking system and reduced its foreign commercial debt. The overall balance of payments recorded a US$28 million surplus, compared with a US$23 million deficit in the preceding fiscal year. Prices dropped by 4 percent from February to July 1986, and the discount on the gourde declined to 5-7 percent. However, manufacturing activity and exports were affected by recent political events, and the economy is still in recession.

1. Overall fiscal policy

17. The Government will exercise fiscal restraint while improving resource allocation. The overall public sector deficit (before grants) will be held to about 7 percent of GDP each year of the adjustment period, well below the average level of recent years. This deficit will be more than offset by foreign grants and concessional loans, enabling the Government (and the nonfinancial public sector as a whole) to reduce its indebtedness to the domestic banking system and foreign commercial creditors. If the donors' response to the Government's program exceeds present expectations, the Fund's management will be consulted on the terms and use of these resources. Conversely, if concessional financing falls short of present expectations, the deficit objective will be reduced so that the level of nonconcessional debt can still be reduced.

18. The Government has begun and will continue to implement tax reforms. The aim is to improve tax and customs collection; the Government firmly believes that by broadening the tax base and lowering rates of taxation the current high levels of evasion can be reduced. By the end of calendar 1986 the income tax system will be simplified with fewer tax brackets, fewer exemptions, lower marginal rates, and a greater degree of consistency between the treatment of individuals and corporations. Also during 1986/87 administrative procedures will be improved, in particular by facilitating cross checks between income, sales, and trade taxes. The value-added tax will be more stringently enforced in order to reverse the recent slowdown in collections. Numerous low yield specific taxes have been and will be eliminated. Other taxes earmarked for special projects have been eliminated or reduced. The customs valuation procedure will be improved and enforcement will be strict. The replacement of quotas with tariffs, discussed below, will yield additional revenues. Export taxes will be phased out.

19. Control over treasury expenditure will be reinforced, waste eliminated, limits placed on total authorizations enforced, and expenditures reallocated to favor development objectives. The Government will concentrate recurrent expenditure on priority development purposes such as agricultural services, irrigation maintenance, road maintenance, health, and education in order to ensure that existing investments yield the highest returns. During 1985/86 wasteful expenditures equal to 3 percent of GDP at an annual rate were eliminated, with part of this saving (1.0 percent of GDP) reallocated to priority areas such as health, education, justice, and the armed forces.

20. The Government will limit the public sector wage bill and provide adequate nonwage recurrent funds to development-oriented ministries. The 1986/87 budget sets a limit of G 676 million on the government payroll. The increase over the 1985/86 reported wage payments is about 20 percent, which reflects both the inclusion of wage components of expenditures previously budgeted under "Special Obligations" and the full year effect of the reallocations to the ministries of health, education, and agriculture referred to above. Public employment will

not be expanded. As far as possible, spending on the nondevelopment apparatus of the state will be contained, except as necessary for the maintenance of law and order, the administration of justice, and the establishment of democratic procedures. Public education and health spending will continue to increase through 1988/89, although major steps will first be taken in 1986/87 to eliminate inefficiencies and low priority components within existing expenditure, including wage payments to nonexistent personnel that are particularly prevalent in the Ministries of National Education and Public Health and Population. The Government will in 1986/87 review the staffing levels of all ministries, agencies, and offices.

21. The budgeting of public current and investment expenditure and the coordination of external aid will be improved. A start will be made in 1986/87 to improve accounting in the public sector following audits of various ministries and public enterprises. The Cour Superieure des Comptes will be reformed during 1986/87 to take on an effective role in auditing ministerial spending.

2. Public enterprises

22. To stem financial and economic losses, two major public industrial enterprises, the Darbonne sugar mill and the ENAOL vegetable oil plant, were closed in 1985/86 and the cement factory, flour mill and the second public sugar mill will be restructured in 1986/87 and 1987/88. Precise measures will depend on the results of detailed audits that should be completed by early 1986/87. Ciment d'Haiti will have to reduce its costs through competition with imported cement. In addition, the Government intends to remove the privileged status of those of the three public industrial enterprises which may remain open so that they compete with private local and foreign producers; this will be achieved through import liberalization and the denial of access to budget subsidy. Vegetable oil imports were liberalized in 1985/86.

23. The Ministry of Finance will in 1986/87 establish a unit to exercise financial control over public enterprises. The Government will subject all public enterprises, both in the productive sectors and public utilities, to regular audit. Electricite d'Haiti will continue to use marginal cost pricing and the Government will eliminate public sector arrears to it by the end of 1987/88. The Government will not establish any new public or mixed industrial or agroindustrial enterprises.

3. Public investment

24. The public investment program will continue to be supported by external donors, largely financed with concessional aid and enhanced with technical assistance. The Government will concentrate on completing high priority projects already under execution and will not finance any projects with nonconcessional external borrowing. Moreover, the Government will ensure that concessional aid finances projects that are

within its absorptive capacity, and that principally support agricultural production, exports, and the improvement of human capital. In addition, the Government is preparing a series of quickly-disbursing small projects that could help external aid donors concentrate on employment generation in the short term. The World Bank has assessed the public sector investment program for 1986/87. It represents a considerable improvement on the past with the elimination of many small and unproductive projects. With one exception (an international airport proposed for Cap Haitien that would represent about 2 percent of total public investment) the program is appropriate, satisfying the above mentioned criteria. The Government and the World Bank intend to hold a formal meeting of the Haiti subgroup of the Caribbean Group for Cooperation in Economic Development in late 1986 and on other occasions during 1987/88 and 1988/89. The Government intends that these should be used to improve the quality of donor-financed projects.

25. The investment program will be reviewed annually in consultation with the World Bank in order to ensure that it contains only priority projects for which the Government has adequate counterpart funds. The Government cannot begin major new projects in its short lifetime and is therefore concentrating principally on policy reform. The program will not, as in the past, include "projects" without investment content that do no more than support public employment, and the Government will also attempt to improve coordination with nongovernmental organizations, extending to other sectors the relative success in the health field.

26. Making appropriate changes to the public investment program will, of course, take time. The priority for physical infrastructure will be to support the expansion of productive sectors, especially for export. For agriculture, this will mean a concentration on irrigation, especially rehabilitation and maintenance, and on feeder roads. For industry, it will mean a concentration on the provision, operation, and maintenance of adequate power, water, telecommunications, and transport facilities to exporters.

27. Major investments in human capital are particularly necessary. The bulk of education and health services are now provided by the private sector. The Government will continue to improve cooperation with the private sector to expand and improve both public and private services, concentrating on the relatively underserved rural areas. Especially important in the light of population pressure will be family planning. Health personnel will be reassigned from Port-au-Prince to rural facilities. The reform of basic education will continue and schemes will be devised to hold teachers in the public school system and to encourage them to teach in rural areas.

4. Monetary and credit policies

28. The Government's fiscal policy will lead to a reduction in public debt to the domestic banking system. To counteract the monetary consequences of previous central bank financing of fiscal deficits, commercial bank reserve requirements were raised in 1985/86 to sterilize the

overhang of excess domestic liquidity that had placed pressure on the balance of payments and the parallel exchange rate. An active monetary policy, including flexible use of reserve ratios, will continue.

29. In addition to limiting monetary expansion, the Government intends to improve the allocation of credit and the functioning of the domestic monetary system. Control over interest rates has been relaxed; the ranges for permissible deposits and loan rates at the commercial banks were widened in July 1986. Rates are already positive in real terms and competitive with money instruments abroad. The Banque Nationale de Credit, which is government-owned, will continue a cautious lending policy in terms of both the magnitude of credit extended to the private sector and the quality of its loan portfolio.

30. The agricultural sector's access to credit, which is limited inter alia by the concentration of commercial bank branches in and around Port-au-Prince, will be enhanced during 1986/87 by the establishment, with the assistance of international agencies, of a new agricultural development bank, the closure of the existing Bureau de Credit Agricole and Banque Nationale de Developpement Agricole et Industriel, and the merging of their performing portfolios with the new bank.

5. Competition policy

31. To improve the allocation of resources, and also welfare by lowering consumer prices, the Government is exposing public and private monopolies to competition from imports and is breaking up import monopolies. As noted, ENAOL has been closed and the vegetable oil market liberalized. During 1985/86 the list of products subject to import quotas was reduced from 111 to 35 and many specific tariffs, including those on goods previously subject to import quotas, were replaced with ad valorem tariffs averaging 20 percent and never exceeding 40 percent. Ad valorem tariffs were also reduced. Import liberalization will continue in 1986/87. During 1986/87, the vast majority of the remaining 35 import quotas and prohibitions will have been replaced with tariffs. Licensing will remain in effect for only about six products. In addition, a major tariff reform will be implemented, replacing all specific tariffs by ad valorem ones, and lowering all tariffs so that the new ones average about 20 percent, with only a few items subject to a tariff rate of more than 40 percent.

6. External policies

32. The Government considers it of paramount importance to maintain the fixed parity of 5 gourdes to the U.S. dollar. In the transition to new democratic institutions the Government judges that the preservation of the current fixed exchange rate provides a firm anchor for fiscal and monetary policy in the immediate future. Moreover, in the 1970s this fixed exchange rate regime, together with the pursuit of prudent fiscal and credit policies, created a climate of confidence which led to the establishment of the assembly industry. For several years beginning in

1979, the link with the U.S. dollar led the gourde to appreciate in real effective terms against the currencies of Haiti's main trading partners. This had little effect on Haiti's export performance because the domestic wage structure remained largely market-determined and highly competitive; indeed in real terms, the minimum wage rate has fallen by one quarter in the last five years. Moreover, the recent depreciation of the dollar against other major currencies has brought about a decline in the real effective value of the gourde of over 10 percent during the last 12 months, offsetting to an important extent the earlier rise. However, the Government recognizes that its commitment to trade liberalization while maintaining a stable exchange rate implies the maintenance of demand management policies to avoid excessive growth in imports.

33. The Government aims to achieve an overall surplus in the balance of payments which will allow official gross reserves to be reconstituted. Existing arrears will be settled during 1986/87, in part through refinancing. Some widening of the current account deficit of the balance of payments will occur through 1988/89 with increased concessional development assistance.

34. Economic growth requires a resumption of agricultural and industrial export growth. The Government will in 1986/87 attempt to negotiate the reduction of foreign barriers to Haitian exports, notably the United States textile quota. Starting in 1986/87, the Government will progressively remove all export taxes.

7. Production policies

35. Within agriculture, the incentive to produce coffee rather than grains should be increased as a result of the reduction in the coffee export tax to 10 percent in 1986/87 and its elimination thereafter, and the replacement of quantitative restrictions on grain imports with tariffs and/or a system of import threshold prices. This should discourage the production of grains on marginal hillside land and encourage their replacement with coffee and other trees, which would reduce soil erosion. Looking toward the longer term, initial steps will be taken to emphasize irrigation rehabilitation, operation and maintenance, and toward collecting more appropriate irrigation charges. Agricultural credit will be focused more on supporting investment and production; as noted, existing credit agencies will be replaced during 1986/87 by a new agricultural development bank. Subsidies on fertilizers within rural development projects will be removed in 1986/87 in order not to discourage private distribution channels. Not later than 1987/88 a start will be made on raising rents on State lands and possibly also on taxing large landholdings. During 1986/87-1988/89, efforts will be made to focus rural development projects more explicitly on production, to concentrate more on anti-erosion measures including forestry, to strengthen the extension service, and to improve the Ministry of Agriculture's operations including decentralization from Port-au-Prince.

36. Within industry, trade liberalization in 1986/87 should stimulate more efficient production and will be accompanied by appropriate technical assistance and credit to private firms beginning to restructure, especially toward exporting. New investment will be encouraged by continuing the incentives contained in the 1985 Investment Code but its interpretation will henceforth be the same for all investors. The establishment of a private Free Zone in Port-au-Prince and new private industrial parks will be encouraged. As noted, the public industrial enterprises are being restructured to improve efficiency. Administrative procedures--including some permit procedures under the Investment Code--that hamper investment, exports, and export-related services will be reviewed and appropriate reforms initiated during 1986/87. In the labor market, the industrial export sector should continue to benefit from the free determination of wages.

8. Social impact

37. Some 80 percent of Haitians live in absolute poverty and should benefit from reduced prices, the elimination of the coffee export tax, the restoration of confidence and thus the expansion of growth and employment, and increased public spending on health and education. Adverse social consequences of the closure of public enterprises have been mitigated by generous severance pay; industrial firms affected by the trade liberalization will be provided technical assistance to help them restructure toward more efficient production.

IV. Investment, Savings, and External Financing

38. In recent years, highly concessional loans and grants have accounted for about 30 percent of total public sector resources, 65 percent of public sector investment, and 35-40 percent of import payments. However, external assistance declined as financial imbalances emerged and deficiencies in investment planning intensified. With official capital inflows diminishing, the external current account deficit narrowed as imports declined to levels that were incompatible with sustained growth. In fiscal year 1985/86, gross domestic investment reached a low of 12 percent of GDP, almost 4 percent of GDP below the average of the early 1980s. This decline was concentrated in public sector investment which fell from over two thirds of total investment in the early 1980s to less than one half in 1985/86.

39. During the three years to 1988/89 gross domestic investment is projected to recover strongly, rising by almost 5 percent of GDP. Public sector investment is projected to rise by 3 percent of GDP over the three-year period, but will not attain the levels reached in the early 1980s, when it was bloated by large scale, ill advised industrial projects in part financed by recourse to commercial external borrowing and the depletion of official reserves. Private investment is projected to rise modestly; it would reach 8 percent of GDP by the end of the three-year period, and thus surpass the levels attained in the early 1980s.

40. The recovery of private and public investment will, in part, be financed through a recovery in the domestic savings of both sectors. Public sector savings are projected to recover to close to 2 1/2 percent of GDP; together with higher private savings, this will yield total domestic savings of 8 percent of GDP, well in excess of the low levels of the early 1980s. Nevertheless, reflecting the low level of per capita incomes, domestic savings will not be adequate to finance the higher level of investment; indeed, the reliance on external savings will inevitably increase as investment recovers from its current depressed level. Thus, the sharp rise in investment is expected to be accompanied by a widening of the current account deficit (excluding official transfers) from US$102 million in 1985/86 to US$158 million in 1986/87. The highly concessional nature of the foreign aid (mostly grants and high grant element loans) that would finance this deficit should ensure that the external debt service will remain both small and manageable, enabling Haiti to maintain orderly relations with its foreign creditors. In 1986/87, debt service payments are expected to peak at 17 1/2 percent of exports of goods and services as external arrears are settled; thereafter debt service payments will fall sharply to just 10 percent of exports of goods and services in 1988/89.

41. Both multilateral and bilateral donors will substantially increase foreign aid disbursements in 1986/87. The World Bank's Loan Committee has authorized the Bank staff to appraise a proposed Economic Recovery Credit of at least US$30 million, to be disbursed over 1986/87 and 1987/88. This may be accompanied by a technical assistance credit of about US$3 million to fund inter alia the monitoring and improvement of the public investment program. In addition, a proposed US$20 million transport project credit, which has already been appraised, should be negotiated with the Haitian authorities in November 1986. Consequently, disbursements from IDA are expected to double to about US$40 million in 1986/87 and remain around that level the following year.

42. Grants and loans from the principal donor, the United States, which rose by US$35 million in 1985/86 are expected to increase by a further US$25 million in 1986/87 to some US$109 million. Together with the prospective initial loan disbursement under the Structural Adjustment Facility and substantial increases in grants and loans from other sources, this yields a projected increase in net capital inflows of US$60 million to a level of US$190 million in 1986/87. These inflows would more than cover the projected widening of the current account deficit from 5 percent of GDP in 1985/86 to over 6 1/2 percent in 1986/87, while allowing for an improvement in official net international reserves of some US$32 million (1 1/2 percent of GDP) in 1986/87. To facilitate attainment of the growth objective of the program and the aim of further replenishing the country's international reserves, capital inflows in 1987/88 and 1988/89 would have to remain at levels similar to that projected for 1985/86. There are indications that this aid would be forthcoming provided the Government perseveres in its effort to adjust and restructure the economy. Formal meetings of the Haiti subgroup of the Caribbean Group for Cooperation in Economic Development,

chaired by the World Bank will, as noted, be convened periodically to facilitate both the continuation of higher levels of assistance and the improved coordination required to ensure that it is used efficiently.

Haiti: Key Indicators

(Ratios and growth rates in percent)

	Fiscal Year Ended September 30							
					Est.	Projected		
	1982	1983	1984	1985	1986	1987	1988	1989
GDP real growth rate	-3.4	0.8	0.3	1.1	-1.4	4.5	5.0	4.5
GDY real growth rate	-5.4	2.0	-0.2	1.3	-0.7	4.3	4.6	4.2
GDY/capita growth rate 1/	-7.2	0.2	-1.9	-0.5	-1.6	2.5	2.8	2.3
Consumption/capita growth rate	-11.4	0.4	-3.9	0.8	-0.2	2.1	2.0	1.6
Consumer prices (average)	9.0	8.8	8.0	8.4	8.5	4.0	4.0	4.0
Debt service (in US$)	26.6	30.6	42.1	36.3	46.2	56.0	44.7	35.9
Debt Service/XGS 2/	8.9	10.5	13.1	11.3	15.3	17.6	13.0	9.9
Debt Service/GDP	1.8	1.9	2.3	1.9	2.2	2.4	1.8	1.3
Gross investment/GDP	16.6	16.3	15.9	14.6	12.1	14.6	16.3	17.0
Domestic savings/GDP	6.4	5.9	6.8	6.1	5.7	6.2	7.3	8.2
National savings/GDP	5.3	4.4	5.7	5.4	5.0	5.6	6.8	7.8
Marginal national savings ratio 3/	18.90	-0.45	0.17	--	-0.02	0.12	0.19	0.19
Public investment/GDP	9.8	10.5	11.2	8.5	6.1	8.0	9.1	9.1
Public savings/GDP	0.6	1.2	0.6	1.0	1.0	1.2	1.9	2.3
Private investment/GDP	6.8	5.9	4.7	6.1	6.0	6.6	7.2	7.9
Private savings/GDP	4.6	3.2	5.1	4.3	4.0	4.4	4.9	5.5
Ratio of public/private investment	1.45	1.76	2.38	1.39	0.97	1.21	1.26	1.15
Government revenue/GDP	11.1	11.3	11.1	12.4	11.5	10.2	10.9	11.5
Government expenditure/GDP	20.4	18.7	19.9	19.2	16.4	16.4	17.1	17.5
Government deficit (-)/GDP 4/	-9.3	-7.4	-8.8	-6.9	-4.9	-6.2	-6.2	-6.0
Overall public sector deficit (-)/GDP 4/	-9.2	-9.2	-10.6	-7.5	-5.1	-6.8	-7.2	-6.8
Export growth rate 5/	27.0	5.8	11.5	-6.4	-6.7	4.9	5.7	6.5
Exports/GDP 5/	13.2	12.0	12.6	11.2	9.9	9.8	9.6	9.6
Import growth rate 5/	-17.3	7.7	1.2	-8.7	-10.7	19.3	11.0	3.8
Imports/GDP 5/	21.4	20.5	19.4	17.3	13.7	15.5	16.3	16.2
Current account balance (in US$)	-119.2	-151.7	-139.0	-130.8	-102.2	-158.5	-184.0	-192.5
Current account balance/GDP	-8.0	-9.3	-7.7	-6.8	-4.8	-6.8	-7.2	-7.0

Sources: Ministry of Finance and Economic Affairs; Bank of the Republic of Haiti; and Fund and World Bank staff estimates.

1/ Growth rate of gross domestic product per capita, adjusted for terms of trade changes.
2/ Debt service as a percentage of exports of goods and services.
3/ Change in gross national savings as a ratio to change in gross national product.
4/ Before grants.
5/ Merchandise exports and imports; growth rates refer to volumes.

ATTACHMENT I

ANNEX

POLICY CHANGE AND TIMING MATRIX
1986/87 - 1988/89

Policy Area	Objectives and Targets	Strategies and Measures	Timing of Measures 1/ 1986/87	1987/88	1988/89
1. Fiscal Policy	Reduction in nonconcessional debt of the public sector.	- Improved revenue collection, tax reform, and improved control of expenditure and public enterprises.	X	X	X
(a) Revenue	Improved revenue collection.	- Improve operations of tax and customs authorities.	X	X	X
		- Improve customs valuation.	X	X	
		- Reinforce value added tax collection.	X		
		- Eliminate petty specific taxes.	X		
		- Introduce new income tax law.	X		
		- Establish variable petroleum import tax.	X		
(b) Expenditure	Maintain tight limits on Treasury expenditure and reallocate toward development.	- No extrabudgetary spending.	X	X	X
		- Reinforce control of expenditure.	X		
		- Audit Ministry of Finance.	X		
		- Improve public sector accounting.	X	X	X
		- Limit public sector wage bill.	X	X	X
		- Review public sector staffing.	X	X	
		- Reallocate current expenditure toward health, education, agriculture and road maintenance, especially for non-wage recurrent spending.	X	X	X
2. Public Enterprises	Eliminate real resource losses and improve efficiency.	- End transfers from budget.	X		
		- Remove privileged status.	X	X	
		- Audit all enterprises.	X		
		- Reduce costs at Ciment d'Haiti and liberalize cement market.	X	X	X
		- Restructure Minoterie (flour), Citadelle sugar mill and Ciment d'Haiti, and remove privileged status.	X	X	X

ATTACHMENT I

ANNEX

POLICY CHANGE AND TIMING MATRIX (Continued)
1986/87 -1988/89

Policy Area	Objectives and Targets	Strategies and Measures	Timing of Measures 1986/87	1987/88	1988/89
(a) Banks and Credit Agencies	Improve credit for agriculture.	- Close Bureau de Credit Agricole and Banque Nationale de Developpement Agricole et Industriel.	X		
		- Establish new agricultural development bank.	X		
(b) Public Utilities		- Limit employment increases.	X	X	X
		- Reduce and then eliminate public sector arrears to Electricite d'Haiti.	X	X	X
		- Continue marginal cost pricing at Electricite d'Haiti.	X	X	X
3. Public Investment	Greater emphasis on priority needs of productive sectors and on human capital.	- Complete ongoing high priority projects.	X	X	
		- Eliminate projects without investment content.	X		
		- Prepare series of small employment-generating productive projects to attract new external donors.	X		
		- Review investment program annually to ensure adequate counterpart funding.	X	X	X
		- Improve coordination with nongovernment organizations in health, education and agriculture.	X	X	X
		- Improve external aid coordination.	X	X	X
		- Convene meeting of the Haiti subgroup of the Caribbean Group for Cooperation in Economic Development.	X	?	?
4. Monetary and Credit Policies	No recourse by the public sector to credit from the domestic banking system.	- Fiscal policy.	X	X	X
	Active monetary policy.	- Use reserve ratios flexibly.	X	X	X
	Improve allocation of credit.	- Liberalize interest rates.	X	X	
5. Competition Policy	Improve allocation of resources.	- Eliminate most quotas.	X		
		- Reduce tariffs to levels averaging about 20% and only a few exceeding 40%.	X		

ATTACHMENT I

ANNEX

POLICY CHANGE AND TIMING MATRIX (Concluded)
1986/87 - 1988/89

Policy Area	Objectives and Targets	Strategies and Measures	Timing of Measures 1986/87	1987/88	1988/89
6. External Policies	Maintain overall balance of payments surplus.	- Refinance existing arrears.	X		
	Improve access to export markets.	- Promote exports.	X	X	X
		- Renegotiate U.S. textile quota.			
7. Agricultural Policy	Improve producer incentives, especially for exports.	- Progressive elimination of coffee export tax.	X	X	
		- Elimination of other minor export taxes.	X		
		- Replace grain import quotas with tariffs and/or import threshold prices.	X	X	
		- Raise rentals on State lands.		X	
		- Tax large land holdings.			X
	Improve public services and credit to private farmers.	- Improve operations of Ministry of Agriculture and decentralize staff.	X	X	X
		- Provide adequate non-wage recurrent funds to Ministry of Agriculture	X	X	X
		- Strengthen extension service.	X	X	X
		- Emphasize irrigation rehabilitation, operation and maintenance over new construction.	X	X	
		- Establish new agricultural development bank.	X		
	Improve rural development projects.	- Remove subsidies on fertilizer supplied under some projects.	X		
		- Focus more on production.		X	X
8. Industrial Policy	Assist firms restructure toward exporting and efficient production.	- Provide technical assistance and credit.	X	X	X
	Promote private investment and exports.	- Apply consistently the 1985 Investment Code.	X	X	X
		- Improve administrative procedures, including customs handling.	X	X	X
		- Encourage private Free Zone and private industrial parks.		X	X
9. Social Sectors	Improve human capital.	- Improve internal efficiency of public health and education ministries and their cooperation with the private sector and nongovernment organizations.	X	X	X
		- Emphasize family planning.	X	X	X
		- Reassign health personnel away from Port-au-Prince.	X	X	X
		- Continue reform of basic education.	X	X	X

1/ By Haitian fiscal year which runs from October-September.

Haiti

Port-au-Prince, November 21, 1986

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosière:

1. Since coming to power on February 7, 1986, the National Council of Government has taken a series of far-reaching policy actions aimed at reforming public finances and economic policies in order to hand over its elected successor a viable, growing economy. Elections have been scheduled for November 1987, with the elected Government taking office in February 1988.

2. The measures that have been put into effect include: (a) a reduction in total government expenditure with increased allocations for the agricultural sector, education, public health, and the maintenance of law and order; (b) income tax and customs tariff reform to simplify the tax system and make it more equitable, more income elastic and easier to administer; (c) the shutting down of two money-losing highly protected public enterprises in the sugar and vegetable oil sector to serve strong notice of our intentions to improve the efficiency of resource use in the public sector; (d) a first round of trade liberalization also designed to encourage competitive practices in the economy; (e) a sharp reduction in the coffee export tax and the elimination of all taxes on other export commodities to encourage production and exports; and (f) a substantial relaxation of controls on interest rates on deposits and loans to encourage savings formation and to improve resource allocation.

3. These measures have already contributed to a significant improvement in the financial situation. The overall public sector deficit was sharply reduced and, for the first time in many years, net repayments were made to the domestic banking system and external commercial creditors. The overall balance of payments registered a US$28 million surplus, following deficits in each of the preceding six years. The 12-month rate of inflation declined to less than 1 percent in September 1986, from 18 percent last December; and in the parallel exchange market the discount for the gourde is now hovering in the 5-7 percent range, after having exceeded 20 percent earlier in the year.

4. This auspicious start notwithstanding, the structural and development problems confronting Haiti are severe, and there can be little doubt that they can be resolved only through time. The Government is determined to persevere in the implementation of adjustment and structural reforms with the aim of strengthening the balance of payments to set the basis for resumption of sustained growth and employment creation in the economy, as outlined in the annexed Memorandum of Economic and Financial Policies (October 1986-September 1989), and in the Medium-Term Policy Framework Paper which has been transmitted to you.

5. The Policy Framework Paper was prepared in close collaboration with the staffs of the Fund and the World Bank. The Government of Haiti will remain in close contact with the staffs of both institutions on developments and progress in implementing the policies outlined therein. The Policy Framework Paper will be updated annually as the program is implemented.

6. For 1986/87, the Government intends to build on the progress made last year in reducing external and internal imbalances by adopting a program which calls for tight fiscal and credit policies to maintain financial stability. Equally importantly, the program includes specific actions to streamline the public enterprise sector, rationalize public investment, reform the tax system, liberalize the trade system, and encourage agricultural production. These objectives and policies are set forth in the attached Memorandum of Economic Policies, 1986/87 and are consistent with the thrust of the strategy in the Policy Framework Paper. In support of these objectives and policies, Haiti hereby requests from the Fund a three-year structural adjustment arrangement in the amount that will be available to Haiti under the Fund's Structural Adjustment Facility, and the first annual arrangement thereunder.

7. In support of our efforts of adjustment and structural reform, we also have requested an Economic Recovery Credit from the International Development Association. This credit has already been appraised and the expectation is that it will be considered by the IDA Board of Directors in the first quarter of 1987.

8. Haiti will provide the Fund with such information as the Fund requests in connection with the progress made by Haiti in implementing the policies and achieving the objectives of the program.

9. The Government believes that the policies and measures set forth in the attached memorandum are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. Haiti will consult with the Fund in the adoption of

any measures that may be considered appropriate, at the initiative of the Government of Haiti, or whenever the Managing Director requests such consultation.

Sincerely,

Onill Millet
Governor
Bank of the Republic of Haiti

Leslie Delatour
Minister of Economy
and Finance

November 21, 1986

HAITI

Memorandum of Economic and Financial Policy

October 1986 - September 1989

I. Introduction

1. The Haitian economy performed relatively well during the 1970s as the Government kept spending under tight control, made little use of central bank credit, and limited its external borrowing on commercial terms. The overall balance of payments was generally in equilibrium or registered small surpluses, and economic growth averaged some 4 1/2 percent a year with little inflation.

2. Beginning in the early 1980s the direction of economic policies changed substantially. Fiscal discipline weakened and the public sector expanded the scope of its operations to the detriment of the efficient functioning of the economy. Public expenditure rose strongly, including substantial spending outside the budget. The Government created new and unprofitable industrial enterprises that produced sugar and vegetable oil, and purchased a controlling interest in an existing, loss-making cement plant. Public sector receipts were bolstered by increased taxation and substantial hikes in prices and tariffs of the public enterprises, exploiting their positions as protected monopoly suppliers to the domestic market. The increment in receipts, however, was overwhelmed by rising public expenditures.

3. The overall public sector deficit before grants averaged more than 10 percent of GDP a year from 1980 to 1985 (6 1/2 percent of GDP after grants), and nonconcessional financing of the public sector, largely in the form of central bank credit, averaged 3 percent of GDP. As a consequence, the balance of payments deteriorated; official net international reserves declined by about US$22 million a year and arrears accumulated. A parallel foreign exchange market emerged with the gourde trading at a discount which at times exceeded 20 percent. Inflation was, on average, double that of trading partners, mostly reflecting an intensification of trade restrictions introduced to stem the loss of international reserves, and the economy stagnated. Expansion of the hitherto dynamic assembly sector came to a halt; external factors were unfavorable, but a loss of private sector confidence exacerbated the slowdown. Similarly, external concessional financing declined as confidence in the Government's ability to use aid efficiently was eroded.

4. In fiscal year 1985/86 there has been a significant improvement in the public sector's financial position. This began with the approval of a budget that called for a reduction in the overall public sector deficit (after grants) from 4 percent of GDP in 1984/85 to 1.7 percent of GDP; within this total, central bank financing was to be limited to 0.4 percent of GDP, compared with 2.2 percent in 1984/85 and 3.5 percent

in 1983/84. When the present Government came to power in February 1986, the deficit and financing plan were broadly on track. The composition of expenditure, however, was noticeably different from that provided for in the budget as sound budgetary procedures were being ignored.

5. One of the first actions of the present Government was to cancel those budgeted expenditures, equivalent to some 3 percent of GDP, which were no longer considered necessary. Part of this saving was reallocated toward the areas of health, education, agriculture, and internal security. More than half of the total was used to effect reductions in the high prices charged by public enterprises for some basic commodities, including flour, sugar, and cooking oil, and to eliminate certain taxes previously earmarked for special projects. The very high rates of taxation on petroleum products also were reduced somewhat.

6. In sharp contrast to the previous six years, in 1985/86 the public sector was able to make net repayments on its external commercial debt and reduce the stock of debt to the domestic banking system. The overall public sector deficit (after grants) in 1985/86 is estimated at 1 percent of GDP; the deficit before grants was 5.2 percent of GDP, compared with 7 1/2 percent in 1984/85.

7. The reduction of the public sector deficit has been accompanied by a marked improvement in the external accounts. The external current account deficit narrowed by 2 percentage points of GDP to 4.8 percent of GDP in 1985/86 and, after six years of deficits, the overall balance of payments registered a surplus estimated at US$28 million. In response to the significant reductions in both domestic and external imbalances, the discount on the gourde in the parallel market has fallen back sharply since July 1986 to about 5-7 percent. Also, inflationary pressures have eased; the 12-month rate of increase in consumer prices came down from 18 percent in December 1985 to 1 percent in September 1986.

8. In addition to the measures just cited and their results in terms of a better macroeconomic performance, actions have been taken to improve resource allocation. The two public industrial enterprises that were launched in the early 1980s--the Darbonne sugar mill and the ENAOL vegetable oil factory--have been closed. Consumers have benefited from the reduction of prices charged by state enterprises and by the liberalization of vegetable oil imports. The private sector has been opened to similar competitive forces by a first round of trade liberalization. In July 1986, the Government reduced the number of import items subject to quotas from 111 to 35 and many specific tariffs, including those on goods previously subject to import quotas, were replaced by ad valorem tariffs averaging 20 percent and in no case exceeding 40 percent. Also, ad valorem tariffs were reduced. Interest rate controls are being applied more flexibly. The permissible bands within which commercial banks can freely set rates have been widened considerably. The upper limit on lending rates has been raised to 20 percent, and the prevailing rates on deposits are competitive with money instruments abroad.

II. Medium-Term Policies

9. The Government seeks to follow its success in stabilizing the economy by adopting over the three-year period beginning October 1, 1986 structural adjustments necessary to increase efficiency and achieve a higher and sustainable rate of economic growth. There can be little doubt that the deep-seated nature of the problems that the Haitian economy confronts can be overcome only in the medium to longer run. It is the Government's belief, however, that the right circumstances now exist to tackle these problems head on, and that the current opportunity to push through reforms should not be missed.

10. The Government's reform program aims to promote economic expansion through improved agricultural performance and export-led growth. Central to this strategy is the maintenance of recently achieved financial stability, which is seen as a prerequisite to the restoration of confidence among private investors and the donor community alike. The authorities are keenly aware that their program of structural change will inevitably entail transition costs as resources are shifted from uneconomic activities to more productive endeavors. Indeed there is a risk that some unintended effects on overall economic activity might be felt in the absence of strong external support. Therefore, the technical and financial assistance being pledged to Haiti by international agencies and bilateral donors is considered essential to improve the growth prospects in the near-term while the structural adjustments and resulting longer-run supply responses begin to take hold.

11. Wide-ranging policy reforms have been enacted and the momentum of reform will be maintained during the next three years. Described in detail in the Policy Framework Paper, the essential elements of the program are:

a. Trade liberalization

A comprehensive revision of the tariff structure will be implemented with sweeping reductions in the levels of protection. All but a few of existing quantitative restrictions will be eliminated and replaced by tariffs. The Government believes that this policy will expose private and public monopoly importers and producers to greater competition and encourage a shift of resources towards production for export, particularly into the unprotected assembly sector. Growth of this sector will continue to benefit from Haiti's competitive cost structure.

b. Agricultural policies

The Government will phase out the coffee export tax, reducing it from 22 percent in 1985/86 to 10 percent in 1986/87 before it is removed altogether. Coffee production should also be encouraged by replacing the quantitative restrictions on grain imports by tariffs or by a system of threshold prices, thereby reducing the relative price of locally grown maize which competes with coffee for scarce land. All other export taxes will be eliminated. The agricultural credit market will be restructured by the closure of the two existing credit agencies--the Bureau of Credit Agricole and the Banque Nationale de Developpement Agricole et Industriel--and the creation, with the assistance of international agencies, of a new agricultural credit bank. Within the public investment program, rural development projects will concentrate on irrigation and feeder roads.

c. Reform of the public enterprises

The operations of the public enterprises will continue to be rationalized; the enterprises will be subjected to greater financial control, including regular audits and limits will be placed on employment by the public utilities. Cement d'Haiti will cease the inefficient production of clinker and import it instead. The flour mill will be restructured; its entire management team was replaced on October 10, 1986, following an exhaustive external audit of the enterprise.

d. Reform of public expenditure allocation and control

The Government has already acted to eliminate wasteful expenditures. Current expenditure has been reallocated towards health, education, agriculture; limits will be placed on the public sector wage bill. There will be no extrabudgetary spending. Public sector accounting will be improved, inter alia, by establishing procedures for the monthly reconcilliation of the accounts of the Ministry of Finance and the central bank. The public investment program will be supported mainly by external donors. It will be reviewed annually in consultation with the World Bank.

e. Tax reform

The Government has already commenced work on a major tax reform aimed at simplifying the tax system and increasing its elesticity. As noted, import quotas have for the most part been replaced by tariffs and this process will continue until all but a few products are free of quantitative restrictions. The income tax system has been simplified with fewer tax brackets, fewer exemptions, lower marginal rates and a greater degree of consistency between the treatment of individuals and corporations. The government firmly believes that by broadening the tax base and lowering rates of taxation, the present high levels of evasion can be reduced. Administrative procedures will be improved, in particular by facilitating cross checks between returns for income, sales and trade taxes.

f. Fiscal policies

The centerpiece of the Government's macroeconomic program is the maintenance of a tight fiscal policy; the government recognizes that without fiscal discipline, structural reforms will be ineffectual. The overall deficit, after grants, is expected to increase in 1986/87 to

1.8 percent of GDP from the low of some 1.0 percent of GDP in 1985/86 and to remain close to this level in the following two years as higher levels of concessional finance are sustained. Assuming a favorable response of donors to the Government's reform program, the Government will limit the overall public sector deficit, before grants, to about 7 percent of GDP throughout the three year period, compared with a low of 5 percent of GDP reached in 1985/86. The anticipated increase in foreign concessional loans and grants will then more than finance this deficit, enabling the Government and the nonfinancial public sector as a whole to effect a net reduction in its outstanding stock of nonconcessional debt, both external and to the domestic banking system. However, if the level of external financial assistance surpasses expectations, the Government will consult with management of the Fund on the terms and uses of the additional resources. Conversely, should the level of concessional financing fall short of expectations, the deficit objective will be revised downwards so that the targeted reduction in nonconcessional debt is attained.

g. Monetary and credit policies

The Government's fiscal stance will set a sound basis for monetary and credit policy by facilitating a reduction in the stock of central bank credit to the public sector. This will help the authorities in limiting monetary expansion so as to achieve the government's objective of containing Haiti's inflation rate at the level of its major trading partners, thereby ensuring maintenance of the existing fixed parity of the gourde in terms of the U.S. dollar. Moreover, the reduction in the public sector's debt to the domestic banking system should allow an expansion in credit to the private sector without either jeopardizing the government's inflation objective or placing pressure on the balance of payments.

12. The Government intends to improve the allocation of credit and the functioning of the domestic money and credit markets. Controls over the commercial banks maximum and minimum deposit and loan rates will be relaxed; as already noted, the permissible ranges were widened in July 1986. The government owned Banque Nationale de Credit will be subject to a ceiling on its total credit expansion and will strive to improve the quality of its loan portfolio.

13. The Government believes that full implementation of the policies described above will restore confidence and allow for real GDP growth of at least 4 1/2 percent per annum over the next three years. While private and public sector savings are expected to recover, external resources in the form of concessional foreign aid will be needed to finance the higher level of investment required for growth. It is expected that the rise in investment will be accompanied by a widening of the current account deficit to an average of almost 7 percent of GDP. However, just as the wider public sector deficit will be more than covered by concessional financing, so the current account deficit will be more than financed on concessional terms. Thus overall balance of

payments surpluses equivalent to almost 1 1/2 percent of GDP in 1986/87 and close to 1 percent of GDP in each of the following two years are programmed. This would result in a strengthening of the official net international reserve position while external obligations are discharged in a timely manner. Given the highly concessional nature of external financing, the debt service burden would remain low.

III. The Program for Fiscal Year 1986/87

14. The Government's policies for fiscal year 1986/87 are designed to both consolidate the recently achieved financial stability and continue the momentum of structural reforms to improve resource allocation and the economy's growth potential over the medium term. The core of the program is thus the maintenance of a sound fiscal policy. This should enable the Government to hold down the inflation rate and achieve a programmed surplus in the overall balance of payments, while a recovery in exports and investment bring a resumption in economic growth. At the same time the process of structural reform will continue, the main elements being an overhaul of the tax system, further trade liberalization, and public enterprise reform.

Fiscal policies

15. It is the Government's belief that the newly enacted income tax law, the replacement of quota restrictions by tariffs, and the lower and more uniform rates of the revised customs tariff, will result in a tax system that is more equitable, easier to administer, and more responsive to movements in income. With the benefit of the broadening of the tax base, supported by a strengthening of tax administration procedures, it is possible for revenue in 1986/87 to surpass last year's receipts, despite revenue losses arising from the reduction of the coffee export tax. However, recognizing the difficulty of estimating revenues in the wake of such wide-ranging tax reforms, the authorities set total budget expenditures on the basis of a very conservative revenue estimate so as to avoid the need to resort to budget cuts during the year to attain the programmed fiscal outcome. If revenue collections were consistently to exceed budgetary projections, the program allows for supplementary appropriations to be passed, up to the amount of the difference between actual and projected receipts.

16. In line with the budget strategy just described, revenue has been projected at G 1,190 million, compared with actual collections of G 1,231 million in 1985/86. A similarly cautious approach has been followed in making budgetary provisions for outlays financed with external cash grants. Although expectations are that these grants may be as high as G 180 million, for programming purposes grant disbursements have been set at G 140 million. The budget places a limit on total treasury expenditures of G 1,290 million, below last year's total outlays of G 1,327 million. Therefore, the treasury would run a surplus of G 40 million, which would be used to reduce government debt to the

Central Bank. The public enterprises are expected to make net repayments to the domestic banking system and reduce somewhat their indebtedness to external commercial creditors in 1986/87. Under the definition that will be used for purposes of monitoring the implementation of the program, the stock of nonconcessional debt of the public sector will decline by G 60 million, compared with a reduction of G 48 million in 1985/86. The quarterly phasing of this reduction in nonconcessional debt is shown in Table 1. To ensure attainment of the programmed overall fiscal outcome, the evolution of treasury operations will be monitored against established quarterly targets for revenue and limits on expenditure as presented in Table 2.

17. The budget for 1986/87 includes a complete allocation of expenditures, abandoning the past practice of setting aside large sums for unspecified programs. Unallocated expenditures comprised almost one fifth of last year's budget; since July 1986, the savings derived from their elimination have been used to expand basic services and to provide for better maintenance of the existing capital stock. The budget for 1986/87 reflects this reorientation of spending priorities. Authorized spending levels for the ministries of Agriculture, Education, and Health have been raised by 27 percent, 64 percent, and 61 percent, respectively, and the share of these ministries in total recurrent expenditure (excluding debt service payments) has increased to 36 percent from some 22 percent in 1985/86. The budget also provides additional resources for the maintenance of law and order from funds previously assigned to the now disbanded militia.

18. The budget establishes a limit of G 676 million on remunerations to civil servants, compared with last year's reported wage and salary payments of G 561 million. This increase is largely related to reclassification of remunerations previously included in other budgetary categories or paid outside budgetary channels. The wage bill for 1986/87 also reflects pay increases awarded in July 1986 to public school teachers and health personnel. The Government will not give financial support to any of the state enterprises, and the budget contains no provisions for such support. The total elimination of government transfers to the state enterprise sector was made possible, in large part, by the closing of the Darbonne Sugar Mill which, in the last four years, had absorbed almost G 80 million in government transfers.

19. By eliminating subsidies and cancelling other wasteful expenditures, the Government was able to keep its current expenditures in 1985/86 some 3 1/2 percent in nominal terms below the 1984/85 level. By strengthening expenditure control procedures, maintaining a freeze on new public employment, and granting no new wage awards, current outlays are expected to be reduced by a further 3 1/2 percent in 1986/87 to a level no higher than G 1,190 million. To ensure that capital projects financed with external assistance do not suffer from costly interruptions due to lack of counterpart funds, the budget sets aside G 100 million as the local contribution to the investment program, double the

amount in 1985/86. In order to prevent expenditures in excess of appropriations, budgetary allocations for the operational expenses of the ministerial departments will be disbursed monthly. The pattern of investment spending is more irregular than that of the recurrent budget, often depending on progress made in the implementation of the various development projects; thus, transfers by the Treasury for the development budget will be released quarterly.

20. Total investment spending by the public sector is expected to rise to 8 percent of GDP, from last year's low of 6 percent. The World Bank has conducted an in-depth review of the public investment budget, finding it appropriate with the possible exception of a proposed airport to be built in Cap Haitien. The outlay involved, however, would amount to less than 2 percent of the total investment budget. In accordance with understandings reached with the World Bank, the project will be entirely financed from the operating profits of the National Airport Authority. The Bank's assessment of the overall investment budget is that it represents a substantial improvement from the past. Many small and unproductive projects have been eliminated as have projects which had little investment content. The Government will concentrate on the completion of ongoing projects, deferring decisions on new undertakings (except for the Cap Haitien Airport) to its elected succesor.

21. Reform of the public enterprises will continue. Actions have already been taken, including the closure of two money-loosing enterprises and the dismissal of the entire management team at the flour mill. Financial control from the center will be strengthened; regular audits will continue and there will be no transfers from the budget to public enterprises. Liberalization of the trade system will provide a general impetus for more efficient resource allocation in these enterprises. In the case of the cement plant, efficiency also will be improved by the installation of a new power plant and, upon completion of required port facilities, the use of imported rather than domestically produced clinker. For other enterprises the results of management audits will be used in deciding the detail of necessary rationalization measures.

Monetary and credit policies

22. The authorities will implement monetary and credit policies consistent with their objectives for inflation and real GDP growth in 1986/87. The monetary authorities (the Central Bank and the National Credit Bank) will observe (i) a ceiling on their net domestic assets (excluding the counterpart of valuation changes in net foreign assets) and (ii) a ceiling on credit extended to the private sector. On the basis of projected growth in the broadly defined money stock of 8.7 percent during 1986/87 and consistent with an improvement in the monetary authorities' net foreign asset position of US$32 million, the net domestic assets of the monetary authorities have been programmed to decline by 4.3 percent during fiscal year 1986/87. To bring the net

domestic assets within this limit, the Central Bank's net claims on the public sector will have to be reduced by 2 percent and external arrears fully eliminated.

23. Also, in recognition of the credit demand associated with a needed rebuilding of inventories as the pace of activity picks up, total commercial bank credit to the private sector is projected to increase by 14 percent during 1986/87. Within this total, credit extended by the National Credit Bank will rise by no more than 8 percent, as the Bank will strive to improve the quality of its loan portfolio. Also, the program allows for a reduction in commercial bank liquidity; no change is assumed in the Central Bank's liability position vis-a-vis the commercial banks, implying a reduction in commercial banks' effective reserves maintained at the Central Bank to 38 percent of their total deposits by September 1987, from the 42 percent estimated for September 1986. Quarterly ceilings for the monetary authorities net domestic assets and credit extended to the private sector are presented in Table 3. These ceilings have been set to take account of the usual credit expansion in the first quarter of the fiscal year as the coffee marketing season gets underway and consumer activity reaches a seasonal peak.

External policies and debt management

24. The Government considers it of paramount importance to maintain the fixed parity of 5 gourdes to the U.S. dollar and thereby provide a firm anchor for financial policy. Available indicators suggest that Haiti remains cost competitive in the important assembly sector; this competitive position has been strengthened by the depreciation of the U.S. dollar since September 1986 which has brought about a decline in the real effective value of the gourde.

25. The program calls for an overall surplus in the balance of payments of US$32 million in 1986/87 which will allow some reconstitution of net international reserves. To expedite the discharge of external obligations the Treasury has introduced procedures to ensure that debt service is properly budgeted and payments accurately recorded both at the authorization and payment stages, and by both the Treasury and the Central Bank. In its efforts to rebuild confidence, the Government attaches great importance to the prompt settlement of its external arrears, which stood at US$14.4 million at the end of September 1986. The Government expects that negotiations with a foreign grain supplier to reschedule payments arrears will be concluded before the end of March 1987; the remaining arrears will be settled through cash payments during the course of the current fiscal year. A schedule for the elimination of external arrears is presented in Table 4. Debt service payments are projected to rise by 2 percent of total export of goods and services to peak at 17 1/2 percent in 1986/87, before declining sharply in the following two years. By 1988/89, the debt service ratio is projected to be less than 10 percent. Although concessional debt--which has a high grant element, since it is mostly on terms comparable to those of IDA

credits--will rise in 1986/87 and beyond, Haiti's external nonconcessional debt and liabilities to the Fund will decline sharply, falling by US$27 million or 16 percent in 1986/87 and by similar percentages in the following two years. Neither the Government nor the monetary authorities will contract or guarantee any nonconcessional external credit within the 1-12 year maturity range (other than the refinancing of arrears referred to above). The stock of outstanding external public commercial debt will be reduced in accordance with the schedule presented in Table 4.

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The Government believes that the adjustment and growth-oriented policies set forth in this memorandum will succeed in removing obstacles that stand in the way of more rapid growth of output and employment. The Government would like to count on the support of the international community to carry out this program. Because of the uncertainties involved, the Government stands ready to subject these policies to continuous review and to adopt further measures as required to ensure attainment of the program's objectives and targets.

Table 1. Haiti: Net Financing of the Public Sector from Domestic and Nonconcessional External Sources 1/

(In millions of gourdes)

	Ceilings on Cumulative Net Financing 2/
October 1, 1986 to December 31, 1986	-25
October 1, 1986 to March 31, 1987	-34
October 1, 1986 to June 30, 1987	-65
October 1, 1986 to September 30, 1987	-60

1/ Defined as the sum of: (a) net credit from the domestic banking system to the public sector; (b) net foreign financing of the public sector contracted at nonconcessional terms; and (c) domestic borrowing by the public sector outside the banking system.

2/ A negative sign denotes net repayment of outstanding credits or an accumulation of deposits.

Table 2. Haiti: Summary Operations of the Treasury

(In millions of gourds)

	Targets for Cumulative Treasury Receipts 1/	Ceilings on Cumulative Treasury Outlays 2/
October 1, 1986 to December 31, 1986	350	330
October 1, 1986 to March 31, 1987	680	656
October 1, 1986 to June 30, 1987	1,020	970
October 1, 1986 to September 30, 1987	1,330	1,290

1/ Includes cash grants.
2/ The expenditure ceilings for the periods ending March 31, June 30, and September 30, 1987 may be increased by any cumulative excess in receipts from those targeted in the preceding quarter. Includes amortization payments.

Table 3. Haiti: Credit Ceilings

	Net Domestic Assets Cons. Balance Sheet of Central Bank (BRH) and National Credit Bank (BNC) 1/	Credit to Private Sector by National Credit Bank
	(In millions of gourdes)	
Position as of:		
September 30, 1986 (actual)	1,503	292
Limits on position as of:		
December 31, 1986	1,603	310
March 31, 1987	1,446	312
June 30, 1987	1,425	316
September 30, 1987	1,440	316

1/ Defined as the difference between (a) their liabilities to the private sector; and (b) their net international reserves.

Table 4. Haiti: External Debt Operations

(In millions of U.S. dollars)

	Total External Arrears	Public Sector Commercial Debt 1/
Stock outstanding as of:		
September 30, 1986 (actual)	14.4	100
Limits on maximum stock as of:		
December 31, 1986	13.0	99
March 31, 1977	2.6	98
June 30, 1987	1.2	97
September 30, 1987	--	96

1/ Includes short- and medium-term external commercial debt of the nonfinancial public sector, publicly-guaranteed commercial debt, and short-term foreign liabilities of the monetary authorities.