



Country Economic Review and Prospects

October 2002

Wilson Laleau

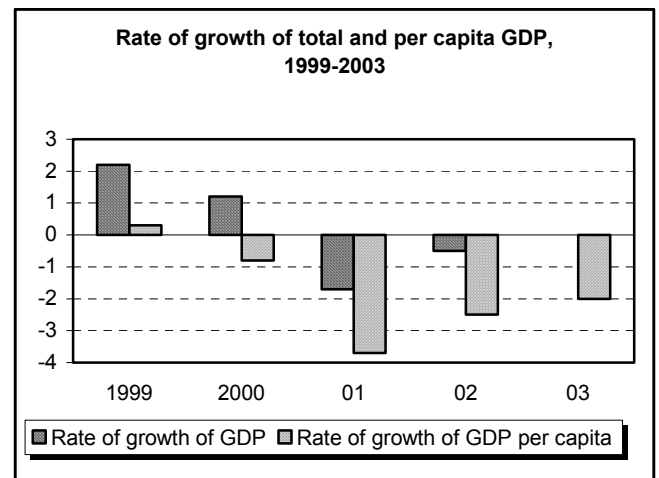
Executive summary

Over the last two years, the economic performance of Haiti has been particularly poor. In 2001 real GDP declined by 1.7 percent, and it is expected to fall further this year (by about 0.5 percent). The current account deficit would have been in the region of 20 percent of GDP, if it had not been for workers' remittances, which are in the neighborhood of 15 percent of GDP, indicating massive and growing emigration. In 2001 the overall central government deficit rose as a ratio to GDP, as fiscal revenue declined to a historically low level of around 7.5 percent, recovering only slightly in 2002. The scarcity of foreign financing has caused international reserves to drop steadily over the last few years, and they are now account for less than one month of imports. However, prospects for a resolution of the political crisis introduce an element of hope. The government has made commitments to organize elections by the second quarter of 2003, and resolutions of the Organization of American States (OAS) have allowed international financial institutions to prepare for the normalization of economic cooperation with Haiti. The budget for Fiscal Year 2002 was voted only in June 2002. This is a positive development, as this is the first one in the last five years – even if it arrives too late to have any impact on economic results this year. On the negative side, the crisis that has erupted in the credit cooperatives is casting a shadow over the financial system. The fiscal costs of resolving the problem are likely to be high, and the resource constraints on the Government of Haiti will become tighter.

Recent Economic Developments

During 2002, the economic crisis that has gripped Haiti since 1997 continued unabated, with a decrease of real GDP estimated of around 0.5 percent, following the 1.7 percent decline of the year before. Real GDP per capita has fallen by almost 7 per cent over the last three years (see figure1).

Figure 1



In spite of a sharp decline in interest rates, credit to the private sector remained sluggish and private investment fell. Furthermore, the public sector's total expenditure as a share of the GDP has fallen, and so have all of its components – especially capital expenditure. The latter, which is a good catalyst for private investment in Haiti, fell by more than 4 percentage points in Fiscal Year (FY) 2002 (October 1, 2001 to September 30, 2002) relative to FY 2001. Interest payments on the internal debt have been skipped, and arrears on external debt continue to accumulate. Aggregate demand and all its components fell for the second

year in a row.

Haiti has faced a poor external environment, including the drop in the international coffee prices, the oil prices increase last year, the September 11 attacks, and the slow recovery of the economy of the United States (Haiti's main trading partner, particularly with regard to the export assembly sector). Employment in the assembly sector decreased by 26.4 percent in 2001 (from 18,502 workers in 2000 to 13,613 in 2001). That places the sector very far away from its 1991 employment figure (33,607).

In 2001, the current account balance registered a deficit of 4.8 percent of the GDP. While the trade deficit was almost 20 per cent of GDP, workers' remittances continued to rise and now account for 15 per cent of GDP, indicating heavy and accelerating emigration of Haitians both to the United States and the Dominican Republic. Imports of goods and services declined (by 3.2 percent), after a 7.9 percent increase in 2000. During 2002, on the basis of available data, this trend seems to be continuing, as aggregate demand is shrinking. As a result, the current account deficit may fall slightly, even in the face of declining export earnings.

In spite of a 2.3 percent increase in assembly sector exports in 2001, total exports also declined by around 3 percent. This is explained mainly by the poor performance of agriculture exports. The exports of assembly products are set to decline in 2002, in view of the stalling recovery of the United States (the destination of 90 percent of such exports). Over the longer term, Haiti has been losing competitiveness in these products. Since 1997, this sector has been experiencing job losses, plant closures and the bankruptcy of some firms, mainly because of United States buyer outsourcing to producers from other countries, including Mexico, Central America, Dominican Republic, and Asia.

Economic Policies

In 2002, international reserve losses have prevented a real depreciation of the gourde. All in all, the real exchange rate appreciated somewhat between September 2001 and September 2002, because of expansionary fiscal and monetary policies. In order to cope with the fall in reserves that it has endured for some time, the Central Bank raised reserve requirements on dollar deposits from 21 to 31 percent (which is the same as in gourde deposits). This resulted in a sharp contraction in credit to the private sector.

The chronic recession and poor administration of both tax collection and public expenditure make it very difficult to balance the budget. The total expenditure of the central government as a share of the GDP increased from 9.3 percent in FY 2001 to 11 percent in FY 2002. The central government's deficit amounted to about 3 percent of the GDP in FY 2002, and was financed mainly by Central Bank advances and the accumulation of arrears. The wage bill as a share of GDP decreased from 4.4 percent in FY 2001 to 3.9 percent in FY 2002, but there was a very strong increase (46.7 percent) in the operations of the central government (purchase of goods and services) and in unrecorded expenditures.

In the other hand, fiscal revenue is rising in FY 2002 relative to a year earlier. In spite of its recognized weaknesses, tax collection improved, and revenues rose from 7.5 percent to 8 percent. However, increasing world oil prices in recent months have reduced fiscal revenues, as prices at the pump remain constant.

Monetary policy, geared mostly to financing the fiscal deficit, has been expansionary over the year. Domestic credit as a share of the GDP rose by 6.5 percentage points in 2002, after an 18.1 percent increase in 2000. In order to mop up the excess liquidity that the deficit is producing, the Banque de la République d'Haïti (BRH) has had to conduct permanent sterilization activities by

selling its own paper to the banks and the public. Another consequence of the deficit has been a fall in net international reserves from US\$116 million in September 2001 to US\$52 millions in August 2002 (less than one month of imports). Beginning in April 2002, the BRH started buying dollars in the open market in order to reduce the speed of reserves losses.

In that context, the dollarization of the economy continued to rise. The ratio of dollar deposits to total deposits of the banking system increased from 41 percent at the end of 2001 to almost 46 percent in September 2002. As in other countries, dollarization is increasing faster for time deposits than for demand deposits. This process has been fed by fears that the real exchange rate would depreciate.

On the positive side, the prudential norms of the banking sector are improving. The proportion on non-performing loans declined from 9.2 percent in September 2001 to 8.9 percent in March 2002. The recent reductions in interest rates and the requirement of tougher guarantees by banks before making loans explain this improvement.

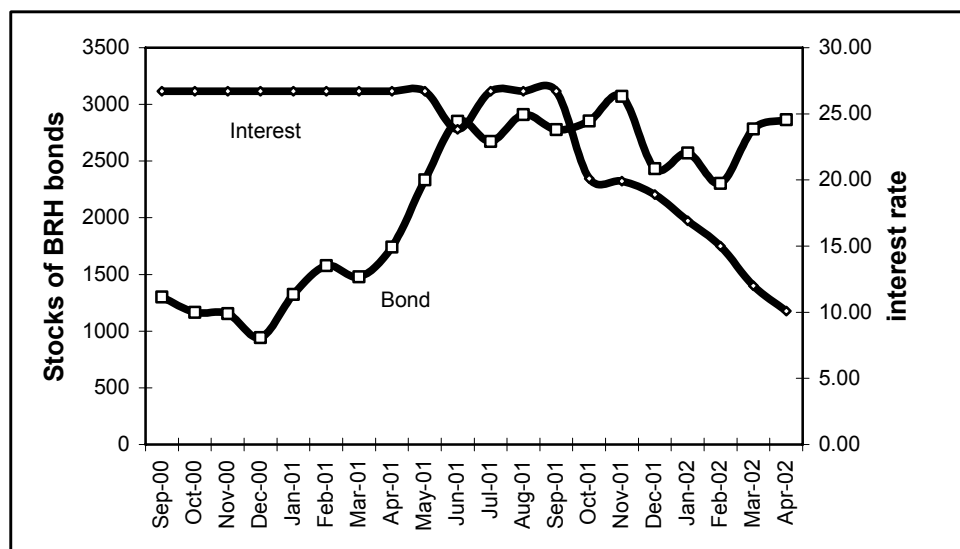
Another important issue has been the rapid and unregulated expansion of saving and credit cooperatives. Indeed, over the last few years, these institutions have increased their importance by remunerating time deposits at monthly rates of

12 to 13 percent. By March 2002, as some of them unilaterally suspended payment of interest, several of these institutions collapsed. Although there is no information on total deposits in the cooperatives, the net social loss must be very high, as many individuals invested their accumulated savings and even sold real assets to take advantage of the interest rates on offer. In July 2002, Parliament passed a law creating a supervisory institution under the authority of the Central Bank. In the meantime, the government announced it would be compensating depositors for their losses. However, how this will be done and who will pay for it are not yet clear.

In order to reduce real interest rates and relax financial pressures on commercial bank portfolios, in April 2002 the Central Bank reduced its 91-day interest rate from 27 percent in September 2001 to 10 percent. In spite of this fall in yields, the stock of BRH bonds outstanding rose by 11 percent over the year (see figure 2). This reflects partly a risk-averse attitude of commercial banks, but also the sterilization activities of the BRH. Interest rates on time deposits have fallen from 14 percent in September 2001 to 8 percent in August 2002, and interest rates on loans from 30 percent to around 26 percent over the same period. Real interest rates on time deposits in gourdes became negative and the interest rate differential between deposits in gourdes and in dollars fell.

Figure 2

Short term interest rates and BRH bond stocks



The process of modernization of public enterprises has been discontinued for some time. The poor performance of public enterprises, which benefit from quasi-monopoly positions (electricity, telecommunications, postal services, airport and port management, some banking services), impose large costs on other economic activities. Only two of the nine modernization projects have been completed in the last four years. No progress was made on this respect in 2001 or 2002. Plans to privatize the operations of ports, airports, and water and sanitation are on hold. It must be noted, however, that the country has unilaterally implemented some economic reforms that make it one of the most open economies in the Latin American and Caribbean region.

In July 2002 Haiti ratified the Treaty of Chaguaramas and became the fifteenth member of the Caribbean Common Market (CARICOM). However, it has been exempted from the full application of the 1992 common external tariff for a renewable five-year period. Its tariffs are already very low (with a maximum of 15 percent), compared to its CARICOM partners,

which have a tariff ceiling of 35 percent for non-agricultural products and of 40 percent for agricultural products. For convergence to be achieved, efforts need to be made on the Haitian fiscal system, which, contrary to that of the CARICOM, relies heavily on indirect taxes.

As a Least Developed Country (LDC), Haiti is seeking to become a member of the United States Africa Growth and Opportunity Act (AGOA), signed in August 2002 by President Bush in favor of 35 Sub-Saharan African LDCs countries. This treaty, which grants preferential access to these countries' exports to the United States, is even more favorable than the Caribbean Basin Preferential Treatment Agreement (CBPTA). However, Haiti has had difficulty in filling its quotas under the CBPTA, and efforts must be made to accomplish this goal.

Outlook

The economic and financial situation of Haiti is worrisome. The possibility of financial and technical support from international institutions

opened up by the OAS resolution delinking economic assistance from the political situation is a hopeful beginning. However, there are still several steps that must be taken by the country to normalize its relations with the international community.

In the first place, the country must achieve a much greater degree of macroeconomic stability. Haiti and the IMF did not sign a Staff Monitored Program (SMP) for the FY 2002. Recently a mission from the IMF met with the economic authorities, and negotiations are in process on an SMP for FY 2003. It is very important for the government to reach an accord with the IMF. Such an agreement would signal the government's commitment to macroeconomic stability and would unlock sizeable volumes of external assistance.

Second, even with delinking, the political impasse is continuing to exert a negative effect on the economy. Investment will not rebound without a

final political settlement. And the multilateral institutions cannot disburse without the agreement of Parliament. As of this writing, the legislative period was due to end in January 2003, and a date for new elections has not yet been set.

Third, the administrative apparatus of the state is very weak, and this clearly affects economic performance. Haiti does not have yet a budget making process. The budget for FY 2002, the first one since the mid 1990s, was only recently approved. In spite of advances, the current crisis of the credit cooperatives has revealed serious deficiencies in the regulatory framework for financial institutions. Haiti has been unable to solve fundamental problems, such as very low levels of education, deficient infrastructure, and a decline in electric power production. The most optimistic forecasts for the economy are no growth for 2003. If oil prices were to rise owing to a war with Iraq, the outcome could be far worse.