Development Challenges in Haiti

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Medium-Term Economic and Social Trends

Haiti has a young population with a high *demographic dividend*. The country has an active and mobile work force that is seeking opportunities wherever they may be, thus leading to intense migration from rural to urban areas and to other countries, primarily the United States and Canada, as well as the Dominican Republic. Ten million Haitians live in their country, and the Haitian diaspora is estimated at three million.

The economy has alternated good and bad years in an overall downwards trend. Growth rates during the last ten years, at nearly 2% per year on average, were higher than in the previous two decades (1% annual growth, and 0% annual growth, respectively) but nevertheless per capita GDP today is more than 30% lower than in 1980. Inflation, in turn, has decreased in the last ten years, at 8% on average annually, although the last two years are reminiscent of the previous two decades, with inflation rates at 14%.

Haitian social statistics paint a dire picture. Poverty affected 59% of the population when last measured (in 2012). Rural poverty is much more acute, reaching 75% and in stark contrast with 29% in the metropolitan area. Extreme poverty (income of less than $1.2 per day) reached 24%. Inequality is rampant, and the Gini coefficient is among the highest in the region at 0.61. Literacy is lower than elsewhere in the region, at 75%, and although it is good news that younger cohorts have higher literacy rates—above 90%—quality of education remains a major concern. Similarly, access to safe water and sanitation and to health services is limited, which translates into mortality indicators that are usually four times the region's average (as is the case with mortality rates of children under 5 years, and maternal mortality).

Medium-Term Economic and Social Outlook

Haiti's annual economic growth is currently anticipated to be 3% for the five-year period 2018-2022, according to the IMF. High growth is needed to reduce poverty levels and to increase quality of life in a sustainable manner. Compared to historic data, however, 3% growth over five years may seem optimistic, as it has taken place only after profound crises (the embargo in the early 1990s and the earthquake in 2010). Nonetheless, considering Haiti's catch-up potential, higher growth can occur if it is undertaken on an appropriate basis (see the Development Challenges section below).

Inflation and general macroeconomic tensions can cause a rapid deterioration in both economic outcomes and social indicators. Inflation of 9% is expected in 2018, declining to 5% in 2019-2022. Overcoming macroeconomic instability will remain an important task, and Haiti faces significant risks in that regard.

Risk Factors

Short-term macro stability is subject to many risk factors, the most important being i) hikes in the prices of Haiti's food and fuel imports, ii) a slowdown in U.S. economy, iii) the occurrence of natural disasters,

and iv) external financing shocks.[1] In broad terms, the type of effect derived from the first three of those risks is evident, despite some uncertainty about their size.[2] Financial shocks, however, deserve additional scrutiny. They can place tremendous pressure on the country, particularly since advanced strategies of multiyear budget planning, systemic risk insurance, hedging and large financial buffers are unavailable, and because options for conducting monetary policy are limited. In such a scenario, fiscal policy becomes procyclical, contributing to increased vulnerability to shocks. Recent shocks include the reduction of Petrocaribe loans, which suddenly decreased access to flexible public financing from 4% of GDP to less than 1%. But positive shocks like external cancellation may have had other, more subtle consequences. On the one hand, there are obvious and almost immediate positive effects on public finances. As a result of debt relief efforts including the initiative for Heavily Indebted Poor Countries (HIPC), the Multilateral Debt Relief Initiative (MDRI), and relief efforts following the 2010 earthquake, Haiti had most of its external debt cancelled, amounting to 50% of its GDP from the mid-2000s. Total external debt stocks reached a local minimum of 8.7% of GDP in 2011, from a local maximum of nearly 44% of GDP in 2013. On the other hand, there is a negative effect related to moral hazard. Between 2010 and 2015 external borrowing proceeded at a rapid pace, fueled by soft lending from Venezuela, and by 2017 it reached record-high nominal levels (USD 2.2 billion), raising concerns about the country's future ability to honor the debt.

Development Challenges

Existing methodological options to identify drivers of growth are not accurate.[3] The economic trajectory of countries that developed suggests that improved access to quality education and improved health are required for productivity growth, and this might be Haiti's best bet in terms of public policy.[4] Another useful tool, though perhaps with less of a causal implication, is a model that compares the actual state of a given country to a large set of others, including peers in terms of GDP per capita, that can point to gaps in key sectors of the economy (bearing in mind that this comparison relies on scarce data and hence only low power analysis can be derived from it[5]). Applying this methodology to Haiti uncovers gaps in infrastructure and a wide array of institutional elements that affect transactions and efficiency in the private and public sectors (Figure 1). While narrowly defined health and education sectors are in line with peers, this result is derived from only a small number of indicators (such as infant mortality and literacy, respectively) and does not include other information that is important in assessing effective access and quality. Government and institutional capacity are lacking in the country, as indicated by large gaps.

Measurements of Haiti's institutional capacity can be found in international rankings. For example, it ranks 11th of 178 countries on the Fragile States Index (where number 1 is the most fragile state), and it

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[1] This paragraph focuses on the more traditional external set of shocks as risks, the occurrence of negative outcomes in any given variable that could affect the economy, hence regarding structural and institutional as well as political elements as the main factors behind vulnerabilities, i.e., contextual or other elements that are responsible for generating large surface of attack and higher losses in the event of negative outcomes

[2] See IDB (2017) for an estimate of the annual costs of natural disasters.

[3] The following quote from Robert J. Barro expresses the point: "My view is that pinpointing precisely which X variables matter for growth is impossible. However, what is feasible is interpreting the results in terms of broad influences that matter for growth; for example, quality of institutions, openness to markets and so on" (Barro, 2015).

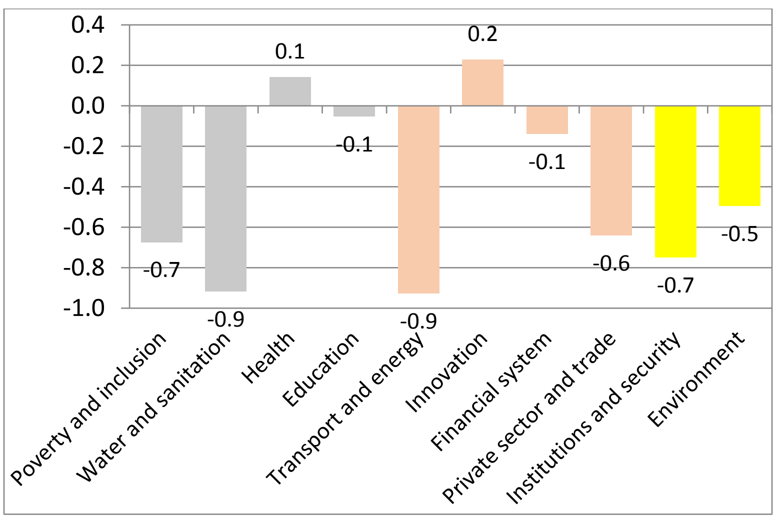
[4] This is the main result of the methodology developed at the IDB by a group led by Alejandro Izquierdo. Although they empirically assess growth determinants for countries in LAC, the closest LAC neighbor country has four times Haiti's GDP per capita, and thus Haiti cannot join any cluster. As such, it becomes its own cluster, separated from the nearest cluster by much more than what separates any other two clusters.

[5] In general, this is meant to indicate that a true effect may pass unnoticed, and false effects may be detected and overstated.

also ranks low in the World Bank Governance indicators. Institutional advancement and GDP are usually highly correlated, with causality running both ways, which means that making durable advancement in institutional stability and government capacity is a long-term process. Political instability has certainly played a role in the country's lack of solid institutions, and it may have particularly affected democratic institutions. The political system lacks transparency and stable rules, and the independence of the powers of the state is not strong. In cases of extreme dysfunction, the parliament has been dissolved by both de facto and democratically elected presidents. Moreover, at a more fundamental level, economic elites, politicians and the public in general have created a situation in which the resulting social contract is not conducive to economic stability and growth.[6]

Growth diagnostics exercises focus on the elements that are deleterious to growth and that can spur growth when they are mitigated. In one interpretation, the analysis applies to the private sector and other economic actors for whom growth patterns can be represented by a typical growth equation and aims at identifying active binding growth constraints. In the case of Haiti, infrastructure and institutional failures as well as weak basic public services contribute to weak returns on investment projects, and to challenges regarding appropriation of those returns by the private sector. Good projects with acceptable expected returns may in turn not be feasible due to lack of financing. In this regard, and despite no evident shortage of savings (interest rates in comparable segments of the credit market are not dissimilar to those in other more advanced economies, and aggregate investment is high at 25% or more annually), the banking sector seems to have denied access to credit to its riskier customers. In an uncertain environment, the financial system may have contributed to improving system-wide financial security by taking a rather cautious approach to lending, although potentially at the cost of short-term credit-driven growth.

Figure 1. Haiti's Gap Analysis



Notes: The bars represent a gap in one sector of the economy and are measured in standard deviations. The gap represents the distance between actual and predicted performance. The latter is obtained as the output of a regression equation (of which the main parameters had been estimated with a large cross-section of countries) using Haiti's GDP per capita as an input.

[6] See, for example, Naidu, Robinson, and Young (2016).

Conclusion

There is hope for a positive evolution of Haiti's economy. Haiti is still likely to experience *recovery growth* in response to the shocks of previous years, and it has a flexible and geographically well-located economy. For example, the manufacturing and export industry is growing again, though from very low levels after the embargo of the 1990s and the crisis-prone 2000s. Structural change in that direction may positively affect the efficiency of the economy, in the sense that it produces more value added with the same resources and uses its comparative advantage effectively. Haiti's agriculture, a key sector for growth but also for income equality, is also capable of trending upwards, in part because it is starting from a very weak base and could hence increase production and productivity at a higher pace (as has been seen elsewhere in the region).

References

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