DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

HAITI

STRENGTHENING PUBLIC RESOURCE MANAGEMENT

(HA-L1017)

GRANT PROPOSAL

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ABBREVIATIONS

AGD	General Customs Directorate
BRH	Central Bank of the Republic of Haiti
CESI	Committee on Environmental and Social Impact
CSCCA	Cour Supérieure des Comptes et du Contentieux Administratif
CST	Special Accounts of the Treasury
DEE	Office of Economic Studies
DGI	Internal Revenue Office
EGRO	Economic Governance Reform Operation
EPCA	Emergency Post-Conflict Assistance
FGDCT	Management and Development Funds of Territorial Collectivities
GOH	Government of Haiti
HIPC	Highly Indebted Poor Country Initiative
HRS	Human Resource Strategy
I-PRSP	Interim Poverty Reduction Strategy Document Paper
ICF	Interim Cooperation Framework
IDA	International Development Association
IGF	Inspection General des Finances
IMF	International Monetary Fund
MDRI	Multilateral Debt Relief Initiative
MEF	Ministry of Economy and Finance
MPCE	Ministry of Planning and External Cooperation
NGOS	Non-governmental Organizations
NIR	Net International Reserves
NPV	Net Present Value
OBL	Organic Budget Law
OHRM	Office of Human Resource Management
PBG	Policy-Based Grant
PIP	Programme d'Investissement Public
PMO	Prime Minister's Office
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Redaction Strategy Paper
TC	Technical Cooperation
TI	Transparency International
TOFE	State Financial Operations Table
ULCC	Anti-Corruption Unit
USAID	US Agency for International Development
WTO	World Trade Organization

PROJECT SUMMARY
HAITI
STRENGTHENING PUBLIC RESOURCE MANAGEMENT
(HA-L1017)

Grant Terms and Conditions				
Beneficiary: Republic of Haiti				
Executing Agency: Ministry of Economy and Finance				
Source	Amount	%		
IDB	12.5m	100%		
Local	0	0%		
Other/Co financing	0	0%		
Total	12.5m	100%	Currency:	US$

Project at a Glance

Project objective:
The proposed Program has been designed following the programmatic approach, with a sequence of two policy-based Grants (PBG). The general objective of this program is to contribute to improving the efficiency, effectiveness and transparency of the management of public resources in Haiti, thereby providing a strong fiscal basis for sustained growth. This first PBG operation will improve policies in six areas: (i) macroeconomic management, (ii) public expenditure management, (iii) human resource management, (iv) transparency, (v) internal revenue, and (vi) customs.

Special contractual clauses:
The disbursement of the single tranche is subject to compliancy of policy conditionalities according to the Chapter II and Annex I of this document.

Exceptions to Bank policies: none.

Project consistent with Country Strategy: Yes [X] No [ ]

Project qualifies for: SEQ[ ] PTI [ ] Sector [ ] Geographic[ ] Headcount [ ]

Procurement: N.A.

Verified by CESI on: September 29, 2006

I. INTRODUCTION AND COUNTRY CONTEXT

A. Program Rationale

1.1 The Proposed Programmatic Policy Based Grant (PBG) is a two-project fast-disbursing budget support grant, of which the first operation is for the amount of US$12,5 million. It is designed to support measures conducive to facilitating the Haitian Government's implementation of the Poverty Reduction and Growth Facility (PRGF) structural adjustment measures agreed with the IMF in the context of the Highly Indebted Poor Country Initiative (HIPC) Initiative and future debt relief.

1.2 This PBG is needed for three reasons: (i) to support the government in its implementation of the PRGF; (ii) to build on the good track record established by the Government in the area of economic governance thus far; and (iii) to help close the financing gap for the 2006/2007 fiscal year. A Programmatic PBG allows for greater flexibility in deciding on reform measures in an institutional setting that requires coordination among various institutions, and in measuring outcomes of the first interventions in order to target subsequent policy reforms more effectively. The program will focus on supporting measures that the government has been pursuing to make public financial management more efficient and transparent by defining immediate steps and a critical path for providing sustainability for the new management methodologies and the information policies affecting public expenditure.

1.3 **Implementing the PRGF**: this three-year program supported by the IMF under the Poverty Reduction and Growth Facility (PRGF) provides a macroeconomic framework that will be anchored by fiscal and monetary discipline, and structural reforms to increase revenues, improve financial management and governance, strengthen the financial system, and create conditions for private-sector led growth. Therefore, this PBG will contribute to create the fiscal space needed in this process through the support of measures that contribute to increase revenue collection; more efficient allocation of resources for poverty reduction; streamline Public Financial Management; and improving control and transparency.

1.4 **Building on a good track record**: the measures supported through this PBG are based on the Government's commitment to reforms in public management and the solid macroeconomic track record of the country. Haiti has had a satisfactory performance under two previous macroeconomic stabilization and structural reform programs supported by the International Monetary Fund through the Emergency Post-Conflict Assistance (EPCA I and EPCA II) from October 2004 to September 2006. Furthermore, a good track record of successful reforms in public sector management has included (i) approval of budgets before the start of fiscal year and their publication in the official journal; (ii) publication of information on budget execution on a monthly basis; (iii) limiting of discretionary spending through ministerial current accounts to below 10 percent of budgeted non-wage credits; and (iv) civil service employment verification based on attendance lists and elimination of ghost workers. In order to improve revenue collection, information is being

collected on all taxpayers in a computerized central taxpayer file; and a computerized data collection system is being installed in some provincial ports.

1.5 The initial PBG would be followed by a subsequent PBG operation on demonstrable progress on the reform agenda and improvements in sector performance. Given the long-standing and complex nature of the problems in the sector, Bank support should be sustained and comprehensive if the program is to achieve its long-term objectives. The sequencing of programmatic grants will have the added benefit of mitigating the risks of policy slippage, by maintaining a high-level dialogue with the Government and sustaining pressure for results in the sector.

1.6 The Program has been structured to complement and continue the reform efforts undertaken by the Bank's Fiscal Reform and Governance Program (1644/SF-HA), approved in July 2005, and the World Bank's Economic Governance Reform Operation I (EGRO I and II) consisting of an adjustment credit for US$36.5 million already approved, and an adjustment grant for US$24.5 million, to be approved soon. Besides, the program is designed to be effective within the context of what is considered politically and institutionally feasible in Haiti at this time, and seeks to firm up Government's ownership of the reforms that are being implemented. . The first Policy Based Grant will improve policies in six areas: (i) macroeconomic management, (ii) public financial management, (iii) human resource management, (iv) transparency, (v) internal revenue, and (vi) customs.

1.7 **Budget support and financing gap**: the Government's budget is heavily dependent on external assistance. Budget support from the IDB, World Bank, European Union (EU), France, and the USA plays a critical role in financing public capital and recurrent expenditures. In July 2004, donors pledged US$1.1 billion in aid for a two-year period. According to government estimates, some US$960 million has been disbursed so far, of which about 20 percent has been as budget support. At the July 25, 2006 conference, donors pledged new assistance of US$750 million (16 percent of GDP) for the next fiscal year, mostly in the form of project aid. This PBG, being a budget support program, is essential for the continued achievement of structural targets, since it helps avoid Central Bank financing of budgeted expenditures needed to provide adequate resources for investment and poverty reduction.

B. Socioeconomic Framework

1.8 Marked by political instability, economic mismanagement and exogenous shocks, Haiti has suffered negative economic growth over three decades in the last forty years. Even when economic growth has taken place, it has not been sustained. Haiti's pattern of socio-economic development has also been characterized by marked inequalities in access to productive assets and public services that have been the result of exclusionary policies and ineffective public institutions. Therefore, the poor have shared less of the gains from growth, if and when this has materialized. In turn, the inability of poor Haitians to exploit growth-promoting opportunities for investment in physical and human capital has created a vicious circle of weak economic growth and persistent poverty and inequality.

1.9 Haiti is the poorest country in the Americas with more than half of the population (54 percent) living with less than US$1-a-day and 78 percent living with less than US$2-a-day (2001 data). In addition, Haiti also has the most unequal income distribution in the region, with a Gini coefficient of 0.65 (World Bank 2003). The country ranked 153 of 177 in the 2005 United Nations (UN) Human Development Report, and life expectancy for Haitians has in fact decreased from 55 to 53 over the past five years.

1.10 In addition to the obstacles to asset creation related to the precariousness of jobs and the lack of access to health, nutrition and education services, the external risks related to the political and security situation, and the environmental risks due to the degraded state of the environment and the risk of natural disasters, in particular hurricanes, further exacerbate the effects on the population. The economic and social impact of the political turmoil and natural catastrophes in 2004, and the ongoing political unrest and violence have created a risk of the country not achieving the Millennium Development Goals (MDG). Although many Haitians have avoided falling into complete destitution in the face of many shocks (both domestic and exogenous) by using remittances for food consumption, education and health services[1], studies have shown that the most vulnerable groups typically do not have access to remittances.

1.11 However, in the last few years, there have been significant positive developments on several fronts in Haiti. The country has begun its transition away from political conflict and economic instability. The economy has been largely stabilized and significant advances were made toward creating conditions for sustainable economic growth and poverty reduction. On the political front, successful elections last year offer hope for national reconciliation and lasting political stability. The international community has been supporting Haiti by providing large economic and humanitarian assistance, and by helping to restore security through deployment of a U.N. stabilization force.

1.12 In April of 2004, the donor community joined forces with, the Transitional Government to prepare the Interim Cooperation Framework (ICF). The ICF identified priority interventions and associated financing needs to support Haiti's path to economic, social, and political recovery. As part of this initiative, donors committed US$1.1 billion until September 2006. Actual transfers have not reached the pledged amount, but the initiative has been extended to September 2007 with accompanying pledges of US$750 million (see paragraph 1.7) in order to accompany the new Government in its formulation of the Government Plan for 2008-2011.

1.13 The ICF included actions that supported the transition government in strengthening the legal framework by means of a new Organic Budget Law (OBL) and a new procurement decree, as well as a new Civil Service Law and a Central Administration Organization Law. The OBL has become the backbone of important steps in modernizing a budget process regarded as non-transparent and with weak accounting and auditing procedures. The procurement decree addresses the need to

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[1] World Bank: Haiti: Options and Opportunities for Inclusive Growth. Country Economic Memorandum. June 2006

implement bidding processes according to transparent and competitive standards. Moreover, weaknesses addressed in the civil service included understaffing, politicized hiring practices, lack of merit-based evaluation procedures and incentives, as well as steeply falling real wages in the public sector.

C. Economic Outlook

1.14 While economic conditions deteriorated significantly during the early 2000s, since the beginning of 2004, the Transition Government implemented macroeconomic stabilization policies that regained the support of the international community. These macro policies were framed in the abovementioned IMF EPCA programs and, macroeconomic performance has remained on track since. Financial stability has been restored, inflation has declined and the exchange rate has stabilized. Fiscal accounts show some recovery and the external current account deficit has narrowed. Maintaining macroeconomic stability should be the top priority for policy makers since it will be critical for economic recovery, combating poverty and ensuring sustained growth.

1.15 **Growth.** Haiti has initiated what is expected to be a cautious recovery. Growth has resumed after years of stagnation reaching 2.5% in FY2005/2006. This is a welcomed trend after decades of stagnation and given the contraction of recent years. However, the macroeconomic imbalances in the Haitian economy are enormous and the high dependence on foreign capital inflows is a chronic characteristic of the economy. Government accounts show persistent deficits, the current account balance is vulnerable, and the debt levels compared to exports reached a level of unsustainability that made the country qualify for HIPC debt relief.

Table 1.1: Selected Economic Indicators (% of GDP)
(Fiscal year ending September 30)

	2001	2002	2003	2004	2005	2006	2007
Growth in GDP	-1.0	-0.3	1.4	-3.5	1.8	2.5	4.0
Central Government balance (incl. grants)	-2.4	-3.0	-3.5	-2.4	-0.7	-1.4	-1.9
Current account balance (incl. grants)	-2.0	-1.0	-1.5	-1.3	1.3	-0.1	-1.0
External public debt	32.6	35.2	43.9	38.3	31.0	29.5	27.0
Inflation, CPI (end of period)	11.5	11.4	37.8	21.7	14.8	12	8.0
Exchange rate, Gourdes pr. US$ (end of period)	25.5	29.7	42.0	36.8	43.0	39.1	
Liquid gross reserves (in months of following year's imports)	2.2	1.5	1.2	1.4	1.4	1.8	2.0

*Projected

1.16 **Fiscal discipline.** The Government has managed to strengthen its fiscal position. This has been brought about by significant efforts to increase revenue, combined with a parallel reduction in capital expenditures. Domestically financed capital expenditures are down from an average of 2.5% of GDP in 2002-2004 to only 1% of GDP in FY2005/2006. Tax revenue has increased steeply in recent years, reaching 9.7% in 2006, which implies that as a percent of GDP, tax revenue is up

by one-third compared to the level observed at the beginning of 2000. Thus, the fiscal deficits were reduced to 0.7% and 1.4% of GDP in FY2004/2005 and FY2005/2006 respectively, compared to levels around 3% in the prior years (see Table 1.1)

1.17 **Expansive expenditure policy.** A boost in foreign support to budgetary expenditures has allowed for an expansive trend in overall expenditures, which since the start of this century has gone up by about 5% of GDP. In particular, a steep rise in grants from almost zero in FY2002/2003 to levels of almost 3.5% of GDP in FY2004/2005 and 2005/2006 has permitted a highly expansive expenditure policy, without sacrificing the Government's fiscal discipline. These foreign inflows allowed expenditures to increase by 1.2% of GDP both in FY2004/2005 and 2005/2006, more than offsetting the contractive effect on capital spending caused by the Government's reduction in domestically financed investments.

1.18 **Balance of payments.** The country's external position is vulnerable. The deficit in the balance in trade of goods and services lingers around 30% of GDP. The assembly industry, which in other respects constitutes an enclave with few positive externalities to the rest of the economy, is what prevents this deficit from being closer to 40%. Currently, the assembly industry accounts for 87% of total exports of goods, and is the sector that has demonstrated the most dynamic growth in recent years.

1.19 Thus, international aid and remittances are what support the current account. Remittances have reached what seems to be a rather stable level of about 21-22% of GDP. Grants finance a large portion of the remaining imbalance. Thus, the current account was only slightly negative in FY2005/2006 (see Table 1.1)

1.20 Indeed, with import payments three times higher than the value of its export receipts, Haiti's dependence on foreign capital inflows is rather glaring. While remittances might have taken a more permanent character and therefore should not be used to highlight vulnerability in external accounts, the fundamental role they have in balancing the current account emphasize the overwhelming imbalance between domestic production and demand.

1.21 Moreover, the current surplus in the capital and financial account is mainly constituted of loan disbursements. Recent fluctuations in donor support suggest that these inflows are less stable than, for example, direct investment, which currently accounts for only US$20 million (which, as an illustration, only amounts to 4.5% of what is received in grants).

1.22 **Monetary policy.** Turmoil in previous years caused inflation to soar, reaching a peak of 38% in 2003. Central Bank financing of government expenditures generated an excessive supply of liquid money. The erratic political environment that caused supply disruptions and an upward pressure on prices further enhanced this trend. In addition, soaring oil prices and a weak Gourde caused imported inflation to be high as well. The authorities have, as a result, taken a fierce monetary stance to fight this trend. With Central Bank financing brought to a minimum, the source for market liquidity growth is limited to the purchases of

foreign currency that are not being sterilized. Growth in broad money (M2) was therefore reduced to half of nominal GDP growth in FY2005/2006.

1.23 **Inflation.** Even though the persistent rise in oil prices continues to pose challenges to price stability, and the achievement of monetary control are easing the upward pressure on the inflation rate. Consequently, inflation as of end of FY2005/2006 was brought down to about 12%, and the Government has set out the ambitious goal of halving this rate by FY2008/2009.

1.24 **Exchange rate.** The above-mentioned substantial inward finance flows, in the form of aid and remittances, caused the Gourde to appreciate by as much as 11% from its peak in February 2003 to its level in October 2006. In addition, high domestic inflation has contributed to a real appreciation close to 50% over the same period.

1.25 **Net International Reserves.** Low levels of Net International Reserves (NIR) showcase the vulnerability of the economy. By end of FY2002/2003 NIR were down to about US$40 million and declined dramatically during the first half of FY2003/2004. By end of FY2005/2006 this level was up to US$126 million, almost double the levels seen in the previous year. Measured in months of the following year's imports, this equals about 0.7 months.

1.26 **Predictions for 2007.** Strongly supported by international aid, macroeconomic stability will be sought through a number of reforms in the area of revenue and expenditure management, financial sector strengthening, and debt management. Growth is expected to linger around 4% in coming years, allowing for GDP per capita to grow by 2.5%. The trade imbalance could be compensated by remittances and aid inflows. However, continued expansion of the import bill might bring about a current account deficit. The recently completed Interim Poverty Reduction Strategy (I-PRSP) emphasizes the reinforcement of the financial autonomy of the Central Bank, which suggests that the recent abating of monetary financing of fiscal expenses will proceed and that expansive effects will continue to be controlled. Strengthened revenue-generating capacity and continued aid inflow will allow for an expansive trend in fiscal policy, rising expenditures by 2.4% of GDP. Government spending will be guided by the objectives and prioritizations identified in the I-PRSP. Combined with improved allocation capability and a redirection of expenditures towards more efficient social spending, Haiti is expected to make its first strides in improving living conditions for its population.

1.27 So far in FY2006/2007, the economy remains broadly compatible with the PRGF' macroeconomic framework**.** Data on economic activity has not yet become available to confirm that real growth is picking up as assumed under the program. Inflation has declined at a slightly faster pace than anticipated, pushing real interest rates up by about 1 percentage point to a current level of around 6.5 percent, despite a reduction in the BRH policy rate[2].

1.28 **External support and fiscal priorities**: Sustainable public finances are thought to be one of the tools with which to spur growth in coming years. Recognition of the state's key role in inducing growth and reducing poverty has called for an increase

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[2] Aide-Memoire IMF Mission February 2007

and reprioritizing of public expenditures. Moreover, expansive and growth-inducing fiscal policies will have to make up for the contractive effects of tightened monetary policy. The new government has announced its commitment to focus spending on growth-inducing and poverty-reducing measures, already initiated by the preparation of the social program package "*programme d'apaisement social*". Among the immediate issues to be confronted are to improve the geographic distribution of social expenditures and provide occupational retraining for disarmament. While donor support is strong, the Government will have to build a coalition in the national assembly that will approve further budget reprioritizations.

1.29 In the past years, political instability has led donors to channel large shares of aid flow outside of the Government budget, through cooperation with local NGOs, etc. However, confidence in the new Government and a positive track record achieved through the donor community supported programs has increased donors' financial support for government expenditures. For FY2006/2007, while total pledges for loans and grants reached US$707.3 million[3], only US$102.9 million of which are for budget support.

1.30 In the budget, the boost in foreign transfers is reflected in a sharp increase in foreign-financed investment expenditures, which in 2007 is expected to increase by almost 70% from the previous year and almost three times the level two years earlier.

1.31 In particular, this increase is supported by a steep rise in budget grants, which rose to around 3.5% of GDP in FY 2005/2006. A further jump is expected for FY2007 where budget grants will account for 5.5% of GDP. Moreover, loan financing of investment or capital expenditures has increased sharply as well, from levels around 0.5% of GDP to 1.6%. The multilaterals[4] have shown an increased willingness to finance fiscal spending, increasing their share of budgetary financing from below 40% to almost half of the total transfers to the budget. However, also bilateral creditors have sharply increased budgetary financing with strong emphasis on capital expenditure projects.

1.32 Cumulative external financing requirement of Haiti are review on a regular basis as part of the PRGF arrangement with the IMF. Financing requirements for year 2007 are projected to be US$226.88 millions, they have been fully identified and financing requirement for year 2008 are projected to be US$136.13 of which US$13.40 has not been identified (see Table 1.3 below)

[3] A special case in point, but not included in the calculations done here, is the inclusion of Haiti into the PetroCaribe initiative recently approved by the authorities. The initiative consists in Venezuela offering 7000 barrels of oil a day. Whilst the price follows the market, favorable terms of the purchase will generate resources for the Government when the fuel is sold in the domestic market. 60% of the oil import bill will be paid immediately, while the remaining 40% will be paid over 25 years with a grace period of two years and an annual interest rate of 1%. The Government is considering assigning the funds generated by this arrangement to specific social and development-oriented investments.

[4] The IDB, the EU, World Bank, and the IMF

Table 1.3 - Haiti, Financing Needs FY2007/2008 (millions of US$)
(Year-end September 30)

	FY 2007 Preliminary	FY 2008 Projected
Total External Financing	**226.88**	**136.13**
Program PRGF	53.91	23.08
Paris Club – Debt Restructure	48.33	7.82
HIPC Debt Relief	21.73	18.02
Budget support	**102.91**	**87.22**
Loans	**15.00**	**15.00**
IDB	15.00	15
IDA	--	--
Taiwan	--	--
Others	--	--
Grants	**87.91**	**58.82**
IDB	12.50	12.50
IDA	10.00	13.00
European Union	33.11	14.30
Belgium	1.85	-
Canada	6.80	6.02
France	3.90	2.60
Spain	2.60	10.40
Taiwan	-	-
USA	10.00	
Venezuela	3.00	-
Others	4.15	-
Budget support no identified	-	13.40

Source: based on data from the IMF. This estimation is subject to change

1.33 **Debt and the HIPC initiative**: Haiti's external public debt stood at US$1.3 billion at fiscal year-end 2005, equivalent to US$932.9 million in 2005 NPV terms. Multilateral agencies are the main creditors with 82.2% of the debt's book value (US$1.098 billion). The IDB holds the largest share with US$533.9 million (40% of the total), followed by the IDA with US$507.1 million (37.9% of the total). Bilateral creditors account for 17.8% of the total debt, or US$238.5 million. Of that amount, US$192.9 million is owed to the Paris Club.

1.34 The NPV of external public debt after traditional debt relief would be US$928.3 million, or 176.7% of exports of goods and services, so total relief of US$140.3 million in NPV terms would be needed to bring Haiti's debt below the sustainability threshold of 150%. This entails a common reduction factor of 15.1% for all participating creditors.

1.35 Haiti was declared eligible in September 2006. Consideration of the HIPC decision point by the IMF and IDA (the International Development Association) Boards took place in November 2006. To qualify Haiti must continue to pursue macroeconomic stability, and agree on completion point triggers. The IDB's Board of Governors adopted Resolution AG-02/07 on 19 January 2007, (i) approving debt relief for Haiti in the context of the E-HIPC Initiative, (ii) directing and authorizing the Board of Executive Directors to take all necessary steps to implement such debt relief as provided for in the conclusions and recommendations of document AB-2507; and (iii) granting interim debt relief of US$10 million for each of 2007 and 2008.

1.36 The IMF is estimating that Haiti will reach the completion point by September 2008. In order to do so, triggers have to be met in the area of preparation and implementation of a Poverty Reduction Strategy; maintenance of macroeconomic stability as well as debt control; adoption of a number of measures in the area of public financial management and governance; implementation of tax policies and strengthening of administrative capacity; and successful introduction of a set of reforms in the social sector. The total debt reduction from the enhanced HIPC might reach 15% of NPV debt (or US$139 million in NPV terms).

1.37 Upon reaching the HIPC completion point, Haiti would further qualify for 100% relief of IDA debt under the Multilateral Debt Relief Initiative (MDRI) and the IDB under the IDB Relief 2007.

D. Donor Coordination for Budget Support in Haiti

1.38 This Grant has been prepared in a manner consistent with the IMF's PRGF Program and the Bank's strategy in the area of economic governance, which consisted of two previous PBLs -one completed, one in execution- approved in 2003 and 2005. These PBLs were designed taking into account the two EPCA programs with the International Monetary Fund (IMF).

1.39 Through the EPCA programs, the IMF aimed at facilitating Haiti's admission into a subsequent Poverty Reduction and Growth Facility (PRGF) arrangement and its eligibility for the enhanced HIPC debt relief initiative. The IMF agreed in November of 2006 on a medium term economic program which is supported under the PRGF in the amount of US$108,4 million[5] of which the first tranche equal to US$42.2 million was disbursed in November 2006, followed by six biannual disbursements of US$11.4 million until December 2009. The PRGF-supported programs focus on sustaining macroeconomic stability through fiscal discipline and prudent monetary policy.

E. The Sector: Economic Governance

1.40 Better economic governance and institutional development are necessary for economic recovery and improved living conditions. Substantial improvement in the management of public finances, better articulation and coordination of external financing, and greater administrative effectiveness will have a lasting impact on the level of human development in the country and will strengthen the State's legitimacy for public action.

1.41 The Transition Government, with the support of the Bank, made an important contribution to stabilize the economy and improve governance and transparency in public sector operations. Reliance on Central Bank financing of the budget was reduced to a minimum, government budgets were approved before the start of the fiscal year, annual auditing of government accounts resumed (although there is still a lag), and information on budget execution was published on the government's website. As well, a system for financial management (SYSDEP), that facilitates the monitoring of budget execution, was partially implemented. In the future the system needs to be extended in terms of coverage and functions. The creation and

[5] SDR 73.7 million, converted according to the IMF published exchange rate as of 10.19.2006 equal to US$1=SDR1.47088

strengthening of key institutions, such as the supreme audit office *Cour Supérieure des Comptes et du Contentieux Administratif* (CSCCA), an Anticorruption Unit (ULCC) within the "MEF, and a coordination unit for the modernization of the civil service within the Prime Minister's Office (PMO), are other important achievements in the sector.

1.42 The approval of the Organic Budget Law[6] created a legal framework for budget formulation, approval, execution and monitoring, modernizing several areas of public accounting and changing processes, which had been engrained for years. Some progress has been recorded recently in matters relating to the budget process, particularly the budget approval process, and the coverage and presentation of budget information. The Government approved the FY2004/2005 budget before the end of September 2004, the first time in seven years that Haiti was able to have a budget before the beginning of the fiscal year. As of FY2006/2007, the "*Programme d'Investissement Public*" (PIP) included a detailed list of programs and projects, as well as their corresponding financing source (internal, bilateral, or multilateral). The PIP provides important oversight over the actual allocation of loan disbursements and grants that finance capital expenditures. However, it should be noted that the PIP also includes grants for local Non-governmental Organizations (NGOs) etc. but only when the financing source is a non-private entity in the donor country.

1.43 Although these actions have translated into concrete results in the management of public resources, the country should continue to deepen its reform path in order to achieve greater efficiency and transparency. An analysis of the country's public expenditure management practices and systems still reveals several weaknesses which impede the efficient use of domestic resources and external financing: (i) weak basic budget formulation, execution and reporting; (ii) weak oversight, which translates into low transparency and accountability; and (iii) deficient human resource management. This is accompanied by a very low yield of the tax system, which has left the tax/GDP ratio at a level that is inadequate to support Haiti's development needs.

F. Challenges

1.44 Although the country's challenges in the medium and long term are many, in order to continue with the reform path that the Bank has been supporting in the past years, certain areas need to be further developed to enhance policy-making capacity in the public sector. In this regard, best practices indicate that the operational budget should not only determine the amount of inputs, but also quality and the real cost of outputs and services the public sector offers its citizens. Within this context, budgeting should be the mechanism for economic and social policy that identifies the short-term costs of implementing mid- and long-term policies. In the short term the budget is an administrative tool, but in the medium term, it should provide each agency with information about the nature and magnitude of the goods and services it provides and place them in the context of institutional goals that are linked to a

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[6] The Loi de Finances was approved on December 10, 2003 and published in Le Moniteur in August of 2004. The Law was slightly modified in 2005 and approved by Decree on February 16, 2005 and published in Le Moniteur on May 25, 2005.

national development plan. Based on the above, the following actions are considered to be a priority in the short term.

1.45 ***Public financial management:*** The inclusion of the investment budget in the annual budget law is essential. Although loans and grants from some donors were incorporated in the last two budget laws, this information was not comprehensive. Projects financed by donors within the framework of the ICF are not identified in the new budget classification, making it difficult to monitor implementation. Moreover, information on investment implementation is scattered. Over the short-term, responsibilities of the MPCE, MEF, spending ministries and the Strategic Coordination Unit of the PMO regarding project preparation, execution, and financial and physical monitoring should be clarified and coordination enhanced, and assistance provided to improve capacities. For this to be effective, it would require donors to provide more comprehensive and timely information on their investments. In order to attack these problems it is important to incorporate investment projects in terms of institution in charge of implementation, category of programs and type of funding, at first, as an annex to the Budget Law. Also important for monitoring the Poverty Redaction Strategy Paper (PRSP) will be the establishment of a tracking mechanism for poverty-related expenditures in order to protect expenditures in key line items in the social sectors that have an impact on poverty reduction.

1.46 Widespread use of extra-budgetary accounts characterizes Haiti's fiscal management. Several ministries operate what is known as "*comptes propres*" or "own accounts," which consist of ministry specific revenue and fees that are collected and spent without entering the central budget. This practice has allowed room for a rather arbitrary and non-transparent use of large fiscal flows. The Ministry of Finance is moving forward in implementing a mechanism for registering the amount and actual use of these funds but continues to face information problems.

1.47 In addition, there exist a number of specific funds among which the Management and Management and Development Funds of Territorial Collectivities (FGDCT) is the most important, but also the Road Maintenance Fund, the Special Accounts of the Treasury (CST), and the Emergency Fund are significant. These funds were created by law and are mostly financed by earmarked taxes that do not enter the budget. An inter-ministerial "*Commission de Reenforcement des Statistiques Publiques*" was established in early 2006. This Commission responds to the IMFs request to end the practice of channeling funds off budget. However, it should be noted that although not included in the government budget, ministerial "*comptes propres*" and the specific funds are reported in the BRH's table 10R, but are not registered in the State Financial Operations Table (TOFE)[7], creating a discrepancy between the two.

1.48 The TOFE should be based on accounting data in order to obtain maximum information so as ensure accuracy. Then, the TOFE should be compiled by using

[7] TOFE are a compilation of information on government revenue and expenditures from different sources on a monthly basis. It is prepared by the DEE.

monthly accounts, and avoid the use of non-accounting data as far as possible. The TOFE should comprise the extra budgetary and social security units included in the BRH's current Table 10R to improve oversight. Among other problems, this practice leads to a significant deflation of both tax revenue and expenditure data.

1.49 ***Transparency.*** Transparency International's (TI) Corruption Perception Index has consistently placed Haiti among the lowest ranking countries worldwide. While a study by TI's Haitian branch indicated that the private sector believes corruption is the leading constraint on economic growth and investment, it also suggested that it is widely tolerated. Government's limited control of financial data and the lack of any law requiring information to be made public meant that citizens had little or no knowledge of how public resources were used. Media coverage remains uneven and civil society groups are more focused on basic service delivery than specialized advocacy. The Government's control mechanisms remain weak, and plagued by their own internal problems. To improve this it is necessary to provide an institutional and legal framework for a comprehensive medium and long term actions in order to prevent corruption and ensure the integrity of public actions. In this sense, making the "Inspection General des Finances" (IGF), created by decree in the beginning of 2006, within the MEF operational is key. The IGF has the attribution to control, audit and inspect public sector, mixed or private entities that benefit from public funds (internal controls).

1.50 ***Human resources.*** Haiti has a relatively small corps of public employees, estimated to be around 46,000. The territorial and sector distribution of public servants does not correspond to actual needs. Besides, the civil service has experienced a severe brain drain, with well-prepared professionals departing for international agencies, NGOs, or the North American continent because of low wages. However, the problem may not only be attributed to the size, quality and distribution of the civil service but also to the failure to design and implement working procedures, and the deficiencies in oversight that would ensure that those responsible for core functions have the necessary resources to perform them well. The lack of emphasis on outputs, outcomes and the responsibility of institutions in producing them add to the reasons that encourage misuse of resources and employee absenteeism. Moreover, the inadequacy of human resources in the public sector is one of the greatest impediments to successful policy formulation and project implementation.

1.51 The deterioration in the quality and composition of public employment, particularly at the management and technical level, because of failure to provide clear incentives in compensation and performance (transparent and dynamic recruitment and promotion systems, etc.); and the weakening suffered by the public sector in its ability to perform the functions assigned to it, not only because it lacks qualified personnel but, because it lacks comprehensive and up-to-date figures on the number of civil servants employed by public institutions, their respective salaries, and budgeted positions requires immediate attention. These factors make it difficult for the Ministries to develop and implement a policy for hiring personnel, or estimate the impact of any reforms to the public service. In this context, there are a number of issues that need to be addressed in order to start the process of civil

service reform, in particular: (i) the strengthening of the legal framework on civil service; (ii) the creation of a Central Administration Human Resource Unit in charge of elaborating the norms and tools to facilitate human resource management; and (iii) the gradual application of merit-based selection and career management throughout the public sector.

1.52 In order to solve the problems named above, it is important in the short term to address the following issues: (i) Adoption of two regulations on civil service: "*Décret portant sur la Revision du Statut General de la Fonction Publique*" and "*Décret portant sur l'organisation de l'Administration Centrale de l'Etat*; and (ii) the operationalization of the Office of Management and Human Resources (OMHR) at the Office of the Prime Minister. The regulations on civil service and central administration and organization mentioned above comprise the necessary legal framework to support civil service reform.

1.53 ***Internal revenue***. One of the Government central point in its reform agenda concentrates on raising fiscal revenues. Higher tax collection are necessary to safeguard fiscal sustainability, to achieve sustainable strengthening of Haiti's state, to increase delivery of public services, and create room for growth-enhancing public investment. Tax revenue in Haiti is by international standards low, amounting to only 10% of GDP. A perforated tax base, a stagnant economy, and weak tax administration explain why current revenue streams do not back expenditure needs. The IMF, in its PRGF-supported program, has set the goal of increasing tax revenue by 1% of GDP by FY2009[9]. The measures included in existing programs are strengthening the existing tax administration with a main focus on enforcement, fighting tax evasion, improving collection procedures, and reorganizing tax agencies along functional lines. The DGI does not have a solid institutional framework, with a clear definition of roles, responsibilities, and controls and, in general, of procedures. In this context, it is clear the need to have more controls, in that regards it is important to strengthen the control and exchange of information of DGI's central office and its regional centers. In order to stream line its processes a general Code of Procedures ("code des procedures") is much needed. The opportunity should be taken to do away with the tax-by-tax approach to procedures in the legislation and consolidate all procedures in one single law (today, each tax Law includes its procedural regulations that overlap, and above all disrupt a streamlined management of the tax system).

1.54 ***Customs administration.*** The General Customs Directorate (AGD) has as its main functions to implement and enforce the legal and regulatory provisions on the movement of merchandise and other cargo, and transportation in and out of Haitian territory. Customs Collection represented 70% of Haitian revenue collected for 2004. The AGD is beset with serious challenges that impede its ability to fulfill its mission. Structural and control weaknesses have provided an ideal environment for fraud, smuggling and other illicit trafficking to thrive. Furthermore, Haiti has recently become a member of CARICOM, and as such it is faced with the task of aligning its customs regulations and structure with those of the Common Market.

[9] IMF, Briefing Paper for Initial Discussions on a PRGF-supported program, May 31, 2006.

Even though Haiti is a member of World Trade Organization (WTO) and CARICOM and thus committed to the implementation of several basic principles of both International Agreements, it has not yet honored its international obligations and lags behind in terms of enacting legislation setting up the "transaction value system" (WTO backbone) or the CARICOM Agreement in general. A draft Customs Code is ready, that introduces most of the needed changes (like the transaction value system, the establishment of clear duty/tax liability throughout the trade chain, a new penalty structure, and the introduction of record keeping requirements). To eventually implement the procedures within the Customs Code, the country needs to upgrade and expand its customs information system to obtain timely information from the major ports in the country, and to be able to streamline procedures that facilitate trade and reduce the possibility of illicit actions.

1.55 **The country strategy**: The new Government adopted the ICF as its short-term country strategy. This Strategy has four pillars: (i) strengthening political governance and promoting national dialogue; (ii) strengthening economic governance and promoting institutional development; (iii) promoting economic recovery; and (iv) improving access to basic social services. The second pillar, strengthening economic governance and promoting institutional development, sets out the country's reform program in this area. For several aspects of the strategy, the government has made substantial advances in pursuing reforms, with the support of the IDB and other donors.

1.56 The new Government has centered its priorities on building a modern state and creating a climate for private investment in order to ease the constraints for growth in Haiti. In this context the government considers that as a medium term strategy an improvement in the quality of public institutions and economic governance is critically needed to improve the business environment. This will be accompanied by lifting other restrictions to growth by improving the education system, develop the inadequate infrastructure, improvements in human capital, etc. all necessary conditions for restoring growth in Haiti.

1.57 **Government fiscal strategy**. The authorities' medium-term fiscal strategy is to boost revenues and enhances budgetary management, to allow for more poverty-reducing spending and investment, and institutional development of central and local governments. The aim is to reform comprehensively the procedures for budget preparation and execution, and establish a three-year framework for budget projections, consistent with medium-term poverty-reducing expenditures.

a. ***Revenues***. Direct and indirect tax revenues will be gradually increased to raise yields closer to levels in other low-income countries. The authorities' strategy will initially focus on establishing effective customs control through ports of entry other than Port-au-Prince, and a comprehensive reform plan for revenue administration will be prepared later.

b. ***Expenditure policy***. Government expenditure will be re-oriented from transfers and subsidies to public sector enterprises toward spending in key areas such as health education, and security. The public investment program will center on the supporting infrastructure and will be coordinated with external donor assistance.

c. ***PetroCaribe***. The resources from the agreement with Venezuela will be used transparently and exclusively to boost public investment and social projects

d. ***Customs***: The government strategic plan of the Customs includes: (i) updating legal environment and making it in conformity with the international standard; (ii) improving the effectiveness of responsibility, and (iii) establishment of qualified customs services. In this regard, they are in the process of approving a new Tax Code that defines legal, economic, and organizational fundamentals of customs and aims at protecting the sovereignty and economic security of the Republic of Haiti.

1.58 **The Bank strategy**: The IDB played in a key role in the development of the ICF, which in turn forms the framework for IDB support and donor coordination for Haiti. The Board of Directors approved the Bank Transition Strategy (TS) for the 2005-2006 periods (GN-2212-6), in March 2005. It represented the Bank's short-term response to the Government's request for external assistance under the Interim Cooperation Framework (ICF).

1.59 The overall objective of the TS was to consolidate implementation of the ongoing portfolio and support the recovery and transition process under the ICF. A related key objective of the TS was to prepare the ground to eventually move from a transition mode to a long-term development effort in the Bank's approach to Haiti, through preparation of a full country strategy. Consolidating the gains from reconstruction and addressing governance issues will lay the foundation for longer-term growth and poverty reduction. Poverty reduction is the main longer-term goal for Haiti. The TS supported the improvements in financial management, particularly measures and policies to increase tax revenues and budget process reform, which are crucial to help reverse the deterioration of the social and economic situation.

1.60 **The Bank's new strategy under preparation** will focus on four pillars: (i) governance; (ii) economic recovery; (iii) improving human development, and (iv) private sector development. This program fits within the governance pillar by supporting the continued improvement of the country's capacity to formulate, execute and register the use of resources, in particular in key sectors for poverty reduction, as well as promoting actions that contribute to improving the transparency of the public sector.

G. Previous Bank Support for Public Finance Reform

1.61 The Bank has had a leadership role in economic governance through several sequentially programmed operations. The following table summarizes the Bank's most recent Technical Cooperation and Loans under execution in the area of economic governance, and the main objectives pursued through these interventions. It is also specify the links to the two World Bank operations that have been prepared as parallel initiatives.

Table 1.4: Previous Bank and World Bank Support in the Area of Economic Governance

Project	Main Objectives	Links to Program
Projects with Complementary Actions		
Institutional Strengthening Initiatives **ATN/SF-8157-HA (Dec. 2002)**	Actions completed: strengthening of the Ministry of Economy and Finance's (MEF) Office of Economic Studies (DEE). Actions on-going to: (i) assist the Treasury for patrimonial accounting; (ii) assist the AGD with the improvement of its capacity to collect and analyze statistics; (iii) assist the Ministry of Planning and External Cooperation (MPCE) in improving its capacity to coordinate external assistance.	Improved analytical capacity at DEE and MPCE provides government with the means to prepare a comprehensive budget, include investment budgets, identify donor financed investments and structure a tracking mechanism for poverty reduction expenditures.
Support for Revenue Institutions **ATN/SF-8583-HA (Dec. 2003)**	This Technical Cooperation (TC) has completed actions for: (i) Definition of strategic plans for modernization and strengthening of customs and internal revenue. Actions are on going for: (i) assistance in preparing revised operational manuals; (ii) strengthening of control functions; (iii) training program in customs and tax collection. Actions need to begin for: (i) develop a plan for performance-based evaluations.	The work undertaken for the TC led the government to request a thorough diagnostic and plan for reform of these institutions. This diagnostic has been a key input for the revision of the tax and customs legal framework. This TC will support the elaboration of the New Tax Code (Code de Procedeurs Fiscale), and already financed the preparation of the new Customs Code. (Internal Revenue and Customs conditionalities)
Support for Anti-Corruption Unit **ATN/SF-8886-HA (Oct. 2004)**	This operation supported the creation of the Anti-Corruption Unit (ULCC) at the MEF, and the following activities are on-going: (i) the drafting of an up-to-date legal framework for anti-corruption, according to the international conventions signed by the country (ii) a medium and long-term strategy and action plans to prevent and combat corruption; (iii) technical assistance in establishing a financial disclosure system for public officials;(iv) the design of an Internet Bulletin Board for government procurement opportunities and awards in order to improve transparency in this area.	The work of the TC will support the design and approval of the medium and long-term national anticorruption strategy. (Transparency Conditionality)
Institutional Strengthening and Development Facility **1632/SF-HA (Jun 2005)**	This operation supports: (i) Institutional reforms to create a well-functioning public procurement office in key institutions of the Executive Branch; (ii) enhance the capacity for budget formulation, presentation, and analysis of expenditure and policy options, linking the budget to the expenditure and procurement plans; (iii) implement internal controls (Inspection General de Finances); and (iv) enhance the capacity of the AGD and DGI to increase revenue collection This Loan is beginning execution.	This program supports the operational capacity of the Inspection General des Finances (internal controls); a link between planning and budgeting, which needs the definition of investment programs in the budget; and actions needed to enhance DGI and AGD capacity to collect. (Public Financial Management, internal revenue Customs and Transparency Conditionalities)
EGTAG I and II (2005 and 2006) World Bank	EGTAG 1: Work on normative and legal framework for procurement and anticorruption; limited support to training institutions (on going). EGTAG 2: Develop human resource unit (completed), basic management tools, and capacity to implement merit career system; and monitoring of service delivery (on going)	This program will complement these actions by defining the anticorruption strategy for the government and designing the human resource management strategy to be implemented by the Office of Human Resource Management (OMHR).
Human Resource Management in the Public Sector HA-L1018	The Program will provide financing to create HR management tools to rationalize and organize the civil service, to prepare a broad civil service modernization and implementation of the new civil service law approved in 2005. The objective of the proposed project is to support the Government of Haiti's (GOH) efforts to: (i) develop and implement a sound human resources (HR) regulatory framework and HR management tools to	This Program would support the establishment of the legal and institutional framework for implementing human resource management tools, through the adoption of two regulations on civil service. And the design of the Human Resources Strategy for Central Government that includes, staffing, compensation, and turnover plans.

Project	Main Objectives	Links to Program
	rationalize and organize the civil service in the ministries of Planning and External Cooperation, Education, Health, Public Works, and Agriculture, as a means to prepare the groundwork for a broad civil service modernization, and (ii) improve service delivery and the capacity of such ministries for policy-making and project implementation.	
	Projects with sequential actions	
Public Finance Reform **1499/SF-HA (Nov. 2003)**	The Public Finance Reform Program achieved its objectives, including the approval of a new legal framework for public finance, the establishment of a new budget nomenclature, the decrease in the use of discretionary current accounts from 58% of total expenditures in FY2002/2003, to 4.18% of FY2004/2005, a percentage that has been maintained through 2006. (Completed)	The new program builds on the achievements of this loan, and continues the implementation of the Organic Budget Law, particularly on the budget formulation and execution, supporting the expansion of the budget classification to include economic function classifiers, and on the internal control structure.
Fiscal Reform and Governance **1644/SF-HA (June 2005)**	The Program supports the enactment of key Regulations (Arreté) for the implementation of the Organic Budget Law (OBL); the expansion of SYSDEP (completed); and the limitation of current account use for non-wage expenditures (achieved); establish the legal framework for internal controls creating the IGF (achieved); implementation of the ULCC's action plan, and the presentation of the legal framework for anti-corruption (on-going), as well as a new customs code (completed)) and revision of the most important tax laws.	This new program will continue the support actions started under the two PBLs approved in 2003 and 2005. It will establish the policies needed to achieve operational capacity for the General Finance Inspection (internal control), as well as ensure the capacity of the government to access revenue information from the DGI and AGD offices, and to begin the preparation of the new "Code de Procedure Fiscales". It will create the environment to eventually implement the new customs code, as it supports the beginning of the implementation of customs information system.
Economic Governance and Growth **EGRO I (2005) and EGROII World Bank**	EGRO I: established the legal framework for procurement; approve budgets annually according to the framework established in the Organic Budget Law; EGRO II: will support the approval of the Law for Disclosure of Public Officials, and design of a tracking mechanism for poverty reduction expenditures.	This Programs complement this PBG actions by supporting; the design of the mechanism for tracking poverty reducing expenditures and the approval of an anticorruption legal framework, and the mechanisms for civil society evaluation of economic governance programs. The ETAG II is also financing the Public sector census.

1.62 **Lessons learned**: One of the most important lessons learned from the Bank's work with Haiti is the importance of donor coordination, in order to prevent backward and forward duplication of actions. In this regard, the Bank has played a leading role in donor coordination in the Economic Governance Sector. Another critical lesson learned from the last three years is to design projects with the political, economic and social environment as the basis for determining conditions, to make sure that the actions planned are realistic and viable within the existing conditions.

II. THE PROGRAM

A. Program Objective

2.1 The general objective of the Program is to contribute to improving the efficiency, effectiveness and transparency of the management of public resources in Haiti, thereby providing a strong fiscal basis for sustained growth. This first Policy Based Grant will support policy reforms in six areas: (i) macroeconomic management,

(ii) public financial management, (iii) human resource management, (iv) transparency, (v) internal revenue, and (vi) customs.

B. Program Description

2.2 ***Macroeconomic management***. As a general condition for the disbursement of the single tranche, the GOH should maintain a sound macroeconomic framework in accordance with the objective of the PRGF IMF Program. The GOH will present a Policy Letter explaining its commitment with this condition. The Bank will prepare a macroeconomic assessment using as an input the IMF's reviews.

2.3 ***Public financial management.*** Over the last three years, the Government has adequately reflected in the budget the policy priorities defined in the Interim Cooperation Framework (ICF) and the I-PRSP prepared in 2006. However, the links between sectoral policies and priorities and the budget is still weak. This situation is largely due to the weak capacities of the budget preparation units, which are having great difficulty in translating their objectives and sectoral priorities, when they exist, into the budget. Moreover, the recurrent budget is prepared by the DGB of the MEF, and the investment budget by the MPCE. Even within some Ministries the preparation of the two budgets is done separately by the respective services in charge of the recurrent and investment budgets. Discussions between these two entities and the sectoral ministries occur during the same period but separately, and budget proposals are made on the basis of different budget classification schemes. Although the process does result in a single budget document, the budget conferences are conducted separately, which means that recurrent costs generated by new investments cannot be taken into account.

2.4 Although the 2006/07-budget formulation took place over a period of four months, instead of the 10 months stipulated in the text, because the President of the Republic took office in May 2006 and the Government was installed in June, the Annual Budget Act was approved prior to the beginning of the fiscal year. In this regard, this operation will continue supporting the existing annual budget timetable and the integration of the recurrent and investment budgets by recognizing: (i) the approval by parliament of the 2006-2007 budget before September 30th 2006, and (ii) the inclusion in the budget of annexes containing the investment budget that classifies investments according to institutions, programs and source of funding (external or domestic, donation or loan).

2.5 ***Transparency.*** The general objective of this area is to provide the institutional and legal framework needed to verify the integrity of public actions, supporting the operationalization of the "Inspection General des Finances" (IGF). The objective of the IGF is to ensure: (i) the conformity of expenditures with the existing laws and regulations; (ii) the accuracy of the financial and budgetary reports; and (iii) the effectiveness of expenditure operations. To accomplish this, the program supports continued financing for the IGF in the budget, and the naming of inspectors to fill positions within the office. It also supports the further reduction in the use of current accounts, by eliminating their use for the payment of salaries.

2.6 ***Human resources.*** The objective of this area is to support the strengthening of the Civil Service legal framework through the adoption of two civil service regulations and their publication in "*Le Moniteur*" in order to have better normative tools to manage the most critical human resource needs.

2.7 Over the short and medium term, the Government will continue to strengthen the civil service through limited increases in the size of the civil service. The vast majority of new civil servants will be hired in high priority areas to reduce the adverse effects of the brain-drain phenomena and uncompetitive compensation program on the quality of public services provided by the State. In this regard, the OMHR will regulate and monitor selection, appointment, promotion and transfer of all staff. A new compensation program, finance by the Bank through a project approved last year "Support for Public Sector Human Resource Management (HA-L1018), will be used to provide more attractive terms and conditions of employment to fill posts in the most needed sectors and areas that often lack competent civil service staff. In order to set forth the terms and conditions for the functioning of the *Conseil Supérieur de l'Administration et de la Fonction Publique*, the Project will support the preparation and approval of regulations defining the composition and functions of the Conseil. These functions will include the preparation and implementation of all actions related to the modernization of the civil service, especially in relation to the quality of service delivery.

2.8 ***Internal revenue.*** Tax revenue in Haiti accounts for just 10% of GDP; and the resulting resource shortage means insufficient and low-quality public expenditure, and chronic fiscal deficits financed through borrowing. Under these circumstances, tax reform is essential if the aim is to achieve faster growth and a more equitable society. There are several reasons for promoting tax reform: firstly, and most importantly, the State is too small and vulnerable to deliver the public goods needed to foster economic growth and raise the standard of living of the population. The low tax burden in recent years readily explains why the country is unable to improve its levels of education and health care, build the infrastructure needed for development, and provide the legal certainty and citizen safety demanded by private investors when making decisions on investments.

2.9 The Bank has been supporting the strengthening of the DGI through a technical cooperation Support for Revenue Institutions (ATN/SF-8583-HA) and an Institutional Sector Facility: Institutional Strengthening and Development Facility (1632/SF-HA). The Modernization of the tax administration needs to strike a balance between immediate resource needs and medium- and long-term structural reforms. In this context this operation will continue to strengthen the tax administration by supporting the connectivity of the DGI regional offices with the Central DGI office and the MEF. This is really needed to enable a more effective and efficient operation of the DGI.

2.10 ***Customs.*** The ultimate goal of this program is to continue assisting the GOH in its efforts to improve the efficiency of the Customs Offices in order to contribute to steadily improved tax revenues; and facilitate and expedite legitimate commerce and travel. The Bank has been supporting customs through a technical cooperation Support for Revenue Institutions (ATN/SF-8583-HA) and an Institutional Sector Facility: Institutional Strengthening and Development Facility (1632/SF-HA) by strengthening the customs administration by simplifying procedures, improving the audit capacity and the institutional abilities to prevent fraud, In order to continue the strengthening of the custom administration, this operation will support the

connectivity of the AGD's central office airport and Port au Prince Port in order to simplify the control capacity of the agency.

2.11 In the future the introduction of the information technology into the customs services in the central and regional customs agencies will contribute to the automation of customs procedures for registration and control, collection of customs duties, updating the export trading, transport and other documentation to the international standards, reduction of customs clearance time and maintaining the customs external trade statistics.

C. Triggers for the Second Policy Based Grant

2.12 A second policy-based grant will depend upon the achievement of specific triggers, and would aim to complete the reforms undertaken under the proposed operation, as part of an on-going reform in the sector. These triggers are:

a. Maintenance of a stable Macroeconomic Framework: commitment to keep the budget within the PRGF program targets, which implies no Central Bank financing and an overall deficit of 1.6 percent of GDP, excluding grants and externally-financed projects;

b. Based on the existing expenditure classification, adopt a mechanism for tracking expenditures allocated to poverty reduction;

c. Expand the TOFE coverage including in it the ministries and deconcentrated agencies' own resources and identify related expenditures;

d. Operationalization of the Direction General des Finances;

e. Initiation of the preparation of the National Anticorruption Strategy;

f. Prepare and approve regulations that determine the way the *Conseil Superieur de l'Administration et de la Fonction Publique* functions;

g. Initiate the preparation of the Human Resources Strategy for the Central Government;

h. Begining work to prepare the new "*Code des Procedures Fiscal*" the new tax procedures code.

i. Creation of a commission responsible for reviewing tax laws and regulations to be submitted to Parliament. This Commission will include participation of professionals of DGI and from the MEF.

D. Grant Facility

2.13 This is the first Policy-Based Grant of two designed under a Programmatic Approach, for a total of US$12.5 million from the resources of the Grant Facility. A Single tranche of US$12.5 million will be disbursed once the Operation is eligible for disbursement and the authorities provide the Bank with documentation, as agreed, that the conditions described in Annex I have been satisfied. It would be followed by a second operation in 2008, estimated initially at US$12.5 million, for which this document establishes the necessary triggers.

2.14 The proposed operation is in line with the Government strategy of supporting the continuation of a reform process in the sector, which is gradual, and the amount takes into account the country's budget support financing needs as established in the PRGF Program with the IMF. On this point, the PRGF foresees no Central Bank Financing for the deficit for the 2006/2007 fiscal years. This calculation is

based, in part, on the disbursement of the third tranche of operation (1644/SF-HA) of US$5 million, and on a US$10 million disbursement of the first tranche of the Program for Support to the Reform of the Financial Sector (HA-L1008), and the disbursement of this PBG.

2.15 As to the dimensioning as it pertains to the proposed reforms, this first program encompasses conditionalities linked to the most important policy reforms envisioned under the country's sector strategy. The Policy Based Grant is structured so as to allow reforms begun with program 1644/SF-HA to advance further, to ensure that government has ownership of key outputs, which will define the path to be taken for future reforms in the sector.

III. PROGRAM EXECUTION

A. The Beneficiary and Executing Agency

3.1 The beneficiary will be the Republic of Haiti, which has designated the Ministry of Economy and Finance (MEF) as executing agency for the program.

B. Project Execution and Administration

3.2 The MEF will be responsible for: (i) satisfying the program conditionalities; (ii) delivering reports and evidence of compliance with the grant terms; (iii) supporting the compliance process and the terms of this grant and others under execution and in the pipeline that would help make the reforms implemented under this program sustainable; and (iv) receive the grant proceeds. As stated by the general norms governing this Policy Based Grant, the beneficiary must deposit the grant proceeds in separate, special accounts and provide the Bank with evidence that such accounts have been opened prior to the first disbursement.

C. Procurement of Goods and Services

3.3 As a policy-based grant, no procurement considerations apply. The fast-disbursing funds from the policy-based grant will be used partly to support the beneficiary's balance of payments. The procedures for this type of operations to be followed in this instance, as established in document GN-2001-2, disbursements will be made against satisfactory implementation of agreed upon policy changes, including compliance with any specified tranche release conditions. Funds shall be disbursed, in a single tranche, once the beneficiary has presented evidence satisfactory to the Bank that all contractual obligations have been met.

3.4 **External audits.** The Bank may require disbursement audits or audited financial statements on how the grant proceeds are used. Such audits would be conducted by independent auditors selected by the Bank under Bank-approved terms of reference.

D. Execution Period and Disbursement Schedule

3.5 The operation disbursement will take place in a single tranche. The single tranche of US$12.5 million will be eligible for disbursement once the grant is approved, considered eligible and the authorities provide the Bank with documentation, as agreed, that the conditions described in Annex I have been satisfied. The Project

Team has verified during analysis that the conditionalities for the disbursement of the single tranche have already been fulfilled.

3.6 **Separate Account.** Proceeds of the grant will be deposited by the Bank in a separate account of the beneficiary, agreed upon with the Bank, as established in the existing policy (GN-2001-2).

E. Monitoring and Evaluation

3.7 The project team in ICF/FMM will be responsible for monitoring this program within the Bank, with the support of the Bank's Country Office in Haiti. The beneficiary and the Bank have agreed to monitor program execution through follow-up meetings, the dates of which will be mutually agreed. Upon completion of the first operation, the project team will prepare a simplified version of the project completion report (PCR), which will be used as input for determining policy conditions for the second PBG, including any adjustments to the trigger mechanisms proposed in the program's Policy Matrix (Annex I). This simplified PCR will include a measure of program indicators in order to determine progress against them, and to make any necessary adjustments to the program to meet its medium-term targets.

3.8 The Results Matrix (Annex II) describes the expected outcomes and impact indicators for the program, with their respective baselines, where these are available. The set of indicators will be assessed in a final evaluation to be conducted under terms of reference agreed between the beneficiary and the Bank, which will serve as the basis for the project completion report (PCR).

3.9 The Executing Agency is responsible for collecting all necessary data for monitoring and evaluation. The costs associated with the collection and processing of this data is being borne by the authorities, as part of the investments being undertaken with external financing in the sector. It is expected that this Program and the operations related to the Economic Governance sector outlined in this document, will provide the necessary resources to maintain pertinent information to follow up the outcomes of this Program and the impact on an ex-post basis. The larger portion of indicators are those which the government is required to follow because of its commitments in investment Programs, or through the PRGF with the IMF.

3.10 For the monitoring and evaluation of this Program, the project team and the GOH will include an analysis of the outcomes as they relate to the execution of the Fiscal Reform and Governance Program (1644/SF-HA). The evaluation must take into account how the policy actions undertaken under the 2005 approved program impacted the policy decisions and outcomes associated with this Program. Furthermore, since the impact of this Program is directly linked to the outcomes of the ISDF loan (1632/SF-HA), and the ETAG I and II World Bank's technical assistance the mid-term and final evaluations of these projects (if available) will be part of the monitoring and evaluation inputs.

IV. VIABILITY AND RISKS

A. Institutional Viability

4.1 The Ministry of Economy and Finance (MEF) is the executing agency for this Program. The MEF has shown its capacity to undertake reforms, even in the most adverse circumstances. The first and second Public Finance Reform Loans approved for Haiti in 2003 and 2005, have advanced the framework for financial management in the country, and with reforms that not long before its approval were considered unlikely. Furthermore, the MEF will be responsible for the reforms supported by the EGRO II of the World Bank, and are executing the PRGF Program, which the proposed Program is based upon. This ensures the necessary level of coordination and coherence among all the Economic Governance Programs financed by the Bank and the World Bank in the framework of the PRGF. All these Programs have other public sector entities involved in implementation, under the coordination of the MEF.

4.2 To further insure institutional viability of the reforms, this Program is supported by the Institutional Strengthening Development Facility (ISDF) 1632/SF-HA, under execution, which addresses actions needed in the area of budget, and revenue collection and customs, and an investment loan "Support for Public Sector Human Resource Management" (HA-L1018). Furthermore, the Program is further based upon the coordinated investments in the sector undertaken by the World Bank (EGTAG I and II grants) and USAID technical assistance.

B. Socioeconomic Viability

4.3 The improvement in management and expenditure brought about by this program will in themselves help enhance decision-making regarding the allocation of resources to meet the country's social needs. Moreover, this Program aims to facilitate the flow for donor resources to priority and poverty reducing investments in Haiti. Furthermore, the program aims to build donor confidence in the capacity of resource management institutions in Haiti, to facilitate the flow of external resources.

C. Financial Viability

4.4 The election of a coalition-oriented Government and the renewed commitment by the international donor community to support the pro-poor growth path set out by the authorities are fueling rising optimism about the Government's ability to face its current challenges. This program will contribute to create the fiscal space needed in this process by contributing to increase revenue; streamline its Public Finance Management; improve control and transparency; and allow for a more efficient use of existing as well as pledged resource increases.

4.5 The program falls into a well-coordinated and coherent strengthening of public finance management. The program has been designed and will be executed in close coordination with complementary donor programs in order to maximize the important synergies that these programs present.[8] Fiscal space will widen

[8] The World Bank's EGTAG, the IMF's PRGF, as well as the Bank's executing PBL on Public Sector Reform (1499/SF-HA). In addition, the program has been prepared in parallel with an investment loan, focusing specifically on human resource management in the public sector (HA-L1018).

substantially as increased revenue-generating capacity and high donor confidence will allow for increased spending as well as substantial redirection of current allocation. Between 2006 and 2009, the Government's expenditure capacity will be up by 3% of GDP. In addition to the important donor support described here, the Government's own revenue-generating capacity will increase by 1% of GDP. As growth in GDP will be high, this actually equals a nominal growth of more than 55%. The IMF recently announced what they characterized as conservative estimates about real annual growth reaching 4% in coming years.

4.6 One of the key achievements under the donor community supported programs was the elimination of Central Bank financing of budget deficits, for the first time since 1999. This was brought about by a significant improvement in the government revenue effort and spending discipline. The authorities' commitment to continue with fiscal discipline anchored by zero central bank financing of budget deficits requires the strong support of the donor community. Therefore, this PBG, being a budget support program, is essential to avoid Central Bank financing by helping to close the financing gap while providing adequate resources for investment and poverty reduction.

4.7 In addition, one of the requirements for achieving the completion point under the HIPC initiative is to continue to avoid Central Bank financing of fiscal deficit. Upon reaching the completion point, Haiti will also become eligible for IDA and IMF debt relief under the Multilateral Debt Relief Initiative (MDRI), and IDB under the "IDB Relief 2007".

D. Environmental Impact

4.8 The project team considers that owing to the nature of this operation, no direct social or environmental impacts are foreseen. The Committee on Environmental and Social Impact (CESI) meeting on September 29, 2006 approved the Program without comments.

E. Benefit and Beneficiaries

4.9 The introduction of improved budgeting, the exercise of better controls on the use of public resources, the reduction of the loss, misuse and waste of public resources, and the improvement in the transparency along with the introduction of increased public accountability and human resource management will represent a substantial change in the modus operandi of Haiti's Government and public institutions. This in turn implies lower transactions costs and, higher rates of investment and an increased likelihood of a return to growth. Finally, in this climate, the Government of Haiti will thus be better able to meet its poverty reduction and growth targets.

4.10 Moreover, the program will strengthen the Government's capacity to make the most efficient use of expanding revenue. It is expected that the increased fiscal space will allow the Government to undertake investments with significant growth-inducing potential. Guided by the I-PRSP and the PRSP currently in preparation, which has as priority areas: security, infrastructure and energy, education and health, among others. Prioritized investments in these areas will lift central constraints to growth; thus, it is clear that expected benefits of the reforms supported by this program would be substantial.

F. Risks

4.11 The main risk is related to the political stability that might inhibit the efforts to improve economic governance. Another risk has to do with the need to achieve consensus for the proposed reform. Overcoming these weaknesses will require an active and sustained commitment to build and work with the new Parliament, and a transparent process of consultation that helps to ensure performance, accountability, and implementation of the reforms. This is a priority in terms of building new legitimacy of the Haitian state with its citizens. Another risk has to do with the macroeconomic framework, if the donors committed resources to finance the financing gap does not materialize in time, it could risk the continued on-track status of the IMF program.

HAITI
STRENGTHENING PUBLIC SECTOR MANAGEMENT
(HA-L1017)
CONDITIONALITY MATRIX

Problem	Objective of the program	Actions Taken	Conditionalities PBL I	Triggers for second Policy based Operation	Key expected outcomes and Benchmarks of the Program
	Maintain macroeconomic stability		Sound macroeconomic framework maintained in accordance with the objectives of this Program.	Sound macroeconomic framework maintained.	Enhance business environment
Public Financial Management: There are major weaknesses in conceptual and systems aspects of the public financial management system.	Strengthen the role of the budget as an instrument for efficient and transparent management of public expenditures. Improve public information on budgetary expenditure allocation and disbursements.	Support the MEF in developing their capacities in budget execution by improving registry procedures, budget classification and the chart of accounts, as well as information systems (SYSDEP) IDB, WB.	The 2006-2007 budgets approved by Parliament before September 30 and published in the Monitor. (*Means of Verification*: Loi des Finances 2006-2007 – Le Moniteur) The law for the budget includes an annex with the investment budget classified according to institutions, program and source of funding (external or domestic, donation or loan). (*Means of Verification*: Loi des Finances 2006-2007 – Le Moniteur)	Based on the existing expenditure classification, adopt a mechanism for tracking expenditure allocated to poverty reduction. Expand the TOFE coverage including in it the ministries and deconcentrated agencies own resources and related expenditure	Optimization of the use of domestic and external resources specially those that have an impact in poverty reduction. Better allocation of public funds for social programs aimed at benefiting the poor. At least x% of resources are allocated to social programs
Transparency: Limited experience in inclusive, transparent or responsive governance in Haiti.	Enhance transparency and financial accountability by applying the legal control provisions as specified in the organic Budget Law to create an environment conducive to an efficient control of public expenditures	Development of internal and external control systems; CSCCA strengthening IDB, WB.	Resources are allocated to the Inspection General des Finances for payment of salaries and operational expenses (*Means of Verification*: Loi des Finances 2006-2007 – Le Moniteur) Legal dispositions preclude the use of resources of compte courrants for the payment of salaries with exception of autonomous agencies that function partial or totally through its compte courrants (*Mean of verification:* Article 25 of the Loi des Finances 2006-2007 – Le Moniteur)	Operationalization of the Direction General des Finances Initiation of the preparation of the National Anticorruption Strategy	Improve transparency by ensuring that al least 4 report of expenditures are audited by the Inspection General des Finances. Reduced corruption and waste means greater returns on public and private investments
Human Resources: Inadequate quality and quantity of civil servants especially	Strengthening GoH capacity to manage human resources in compliance with the	Support to create a human resource agency in the Executive and	The Government has prepared, approved and is into effect a new regulatory framework for reorganizing the Executive Power	Regulations have been prepared and approved in order to determine the way the Conseil Superieur de	More efficient allocation of human resources and improved capacity of those holding technical positions.

Problem	Objective of the program	Actions Taken	Conditionalities PBL I	Triggers for second Policy based Operation	Key expected outcomes and Benchmarks of the Program
technical personnel.	new normative framework.	provide training for Public officials WB and AECI	and for the revision of the General Rules of the Public Function (*Means of Verification:* Décret portant sur la Révision du Statut Général de la Fonction Publique – Le Moniteur Décret portant sur l'organisation de l'Administration Centrale de l'Etat. Le Moniteur)	l'Administration et de la Fonction Publique functions. Initiate the preparation of the Human Resources Strategy for Central Government	All proposals for new recruitment and promotions are within the new legal framework and within budget allocations in the spending Ministries based on a new HR Strategy.
Internal Revenue: Cumbersome tax legislation structure and organizational deficiencies prevent the DGI from achieving the government's revenue objectives	Continue harmonizing and simplifying the tax legal framework consolidating e the tax administration and procedures This would allow a common procedural treatment for most Tax Administration functions, thus contributing to help DGI make the move to a modern organization, separated by functions rather than by taxes.	Strengthening DGI capacity, new tax code (IDB) reorganization, training and equipment. IDB, France, IMF, USAID.	Connectivity with at least three of the main offices of the Direction Générale des Impôt fully operational to permit online information exchange with MEF. (*Means of Verification*: Letter of the Minister of Finance informing that satellite connections have been made and attaching report of USAID regarding installation of equipment and energy)	Consultants to elaborate the new tax procedural code have been hired and have begun working. Creation of a commission responsible for reviewing tax laws/matters that will be the subject of new drafts to be submitted to parliament, with the participation of professional of DGI and technicians and professionals from the MEF and DGI,	DGI will become a modern organization. Increased revenue collection by 1% of GDP by 2009
Customs: The lack of information has exacerbated structural and control weaknesses that can facilitate fraud, smuggling and other illicit activities.	Support the establishment of information systems and connections that are needed for the *Administration Générale de Douanes* to become an institution that operates according to basic international standards.	Strengthening AGD capacity, reorganization, training and equipment. IDB, France, IMF, USAID.	Connectivity with at least three of the main regional offices of the *Administration Générale de Douanes* fully operational to permit online information exchange with MEF: (Possibly three of the following four Cap-Haitian, Gonaives, St. Marc and Miragoane). (*Means of Verification*: Letter of the Minister of Finance informing that satellite connections have been made and attaching report of USAID regarding installation of equipment and energy)	Initiate implementation of SIDUNEA in at least two selected Customs Offices	The Administration Générale de Douanes will become an institution that operates according to basic international standards. Reduce by 30% the time for merchandise to be released from customs.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-__/07

Haiti. Non Reimbursable Financing ____/-HA to the Republic of Haiti
Strengthening Public Resource Management

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, as administrator of the IDB Grant Facility, hereinafter referred to as the "Account", to enter into such contract or contracts as may be necessary with the Republic of Haiti, as Beneficiary, for the purpose of granting it a non reimbursable financing to cooperate in the execution of a program to strengthening public resource management. Such non reimbursable financing will be for an amount of up to US$12,500,000 or its equivalent in other currencies, except that of Haiti, that form part of the Account, and will be subject to the Terms and Conditions and the Special Contractual Clauses of the Project Summary of the Project Report.

(Adopted on ___________ __ 200_)

LEG/OPR/REG2/IDBDOCS#834969
HA-L1017